Decentralization of Water and Sanitation Services

Document Overview

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opportunities for all
This public expenditure review (PER) in the water supply and sanitation sector (WSS) in Honduras aims to shed light on the sector’s current financing structure at the national and sub-national public expenditure levels of government. It also examines the effects of the water sector’s decentralization upon its financing and service provision under varying governance and political economy conditions. It concludes by presenting the main findings and policy recommendations for decision makers that informed the World Bank’s *Honduras Public Expenditure Review 2008-2012*.

This work is based upon the analysis of available information from widely distributed sources, including government budget documents, allocations and actual expenditures from sector ministries and key sector institutions. Its content provides contextual information on the sector’s institutions; policies, and challenges; analyzes the financing flows; and focuses on the performance of urban service providers under the decentralization. It also unfolds the results of an econometric analysis of the regulator’s data for 92 urban service providers that cover 85 percent of the total urban population and field data captured from 11 case studies.

### I. DECENTRALIZATION IN CONTEXT

#### Sector Overview

*In Honduras, coverage levels are increasing but remain unequal, and service quality continues to be limited.* The existing infrastructures allow using only 5 percent of water resources available in nature, and the provision of safe and sustainable drinking water and sanitation services to all the inhabitants remains a challenge. In 2011, 89 percent of the population had access to an improved source of water, and 81 percent of the population had access to an improved sanitation facilities, compared with 81 percent and 65 percent respectively in 2000. As such, Honduras has achieved the Millennium Development Goal (MDG) targets for sanitation. However, this apparent success masks significant disparities between urban and rural areas, and among poverty quintiles in Honduras. The fact that more than one million people do not obtain drinking water from improved sources, and 2.2 million Hondurans do not use improved sanitation facilities, most of them in rural areas, is particularly stark.

Honduras still lags behind most other Latin American...
countries with an average coverage in 2010 of 94 percent for water and 80 percent for sanitation. Even for the population with coverage, service quality is limited, and the financial sustainability of service providers remains challenging regardless of the decentralization levels.

**Sector Institutions and Policies**

The decentralization of the sector is incomplete, with governance being both a central issue in itself and a concern for the sector’s financing. There are a number of policies and strategies governing Honduras’ water sector. Aiming beyond the targets set by the MDG, the Government of Honduras (GoH) set ambitious national targets\(^4\) in the Poverty Reduction Strategy Paper (PRSP), and mandated for a coherent legal framework and stronger institutions to achieve these targets. Consequently, in 2003, the Drinking Water and Sanitation Sector Framework Law was passed to mandate the decentralization of all water and sanitation services. Since then a Strategic Plan for the Modernization of the Water Supply and Sanitation Sector (PEMAPS) was adopted in 2005; subsequently, in 2011 a Water Supply and Sanitation National Policy was prepared by the Drinking Water Supply and Sanitation National Council (CONASA). The current administration adopted the *Vision of the Country 2010-2038* and *Nation Plan 2010-2022*, setting new sector targets\(^5\) and policy measures. Among the policy measures was the

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4 The PRSP targets largely surpass the MDG targets, aiming to provide access to water and sanitation to 95 percent of the population by 2015.

5 VP/PN coverage targets: 93 percent of rural households with drinking water, and 60 percent household with sanitary sewerage by 2022. Surprisingly, the first Government Plan 2010-2014 under the Nation Plan, passed later in 2010 has adopted the PRSP targets of ensuring access to water and sanitation to 95 percent of the population by 2014, which seem to be unattainable, as the sector is off-track to meet the targets, even by 2015.
transference of the 17 water systems still being operated by the Servicio Autonomo Nacional de Acueductos y Alcantarillados (SANAA), among them Tegucigalpa’s water system. While the responsibility for service provision is attributed to the municipalities, there are a wide range of service provision models in practice that differ from city to city. Currently, only 60 percent of the population is being supplied by a decentralized autonomous service provider in conformity with the Framework Law. The remaining 40 percent of the population is still being supplied directly by the municipalities or by SANAA.

**Sector Financing Arrangements**

The water and sanitation sector in Honduras is financed through a combination of three funding sources. These sources adhere to the Organization for Economic Co-operation and Development’s (OECD’s) Framework for Water Supply and Sanitation Sector Financing. The first source of financing comes from tariffs collected by service providers based on volume, socio-economic conditions, or a combination of both.

The second source of financing comes from taxes that help supplement operating costs and some investment costs not covered by tariffs. Taxes generally flow in the form of budget assignation from national or municipal administrations to service providers or sector institutions; as well as indirectly through fiscal transfers from the national government to the municipalities. Further sector financing, mostly for investments, is provided by external transfers in the form of grants or credits from external donors to national or local institutions and service providers.

**Sector Targets and Investment Needs**

Investment needs in Honduras’ water and sanitation sector are greater than the investments planned. The distribution of necessary investments varies depending on the sector’s targets and the desired service provisioning levels. As mentioned, there are various targets co-existing for the water supply and sanitation sector (MDG, PRSP, Plan de Nacion [PN]/Vision de Pais [VP]), underscoring the need for the GoH to define a unique set of targets. For this Public Expenditure Review, two main scenarios are considered, both of which come directly from the MAPAS exercise: a) The MDG targets aiming for Honduras to attain 88 percent water coverage and 75 percent sanitation coverage by 2015. This target has been achieved, but sustaining the coverage levels and ensuring that the quality of the services provided

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**Figure 3. Financial Structure of the Water & Sanitation Sector**
meet sector standards would require an annual investment of 6,200M HNL, including new capital, replacement cost of capital stock, and rehabilitation, and b) the Nation Plan adopting PRSP targets for the sector in terms of access to water and sanitation for 95 percent of the population by 2022. To achieve this target an overall annual investment of 7,572M HNL would be required.

II. DECENTRALIZATION AND FINANCIAL FLOWS

Sector Funding

Funding at the national level comes largely from donors and is complemented by some national funds. On average, between 2002 and 2011, funding from the national level, including off-budget donors, in-budget donors and national government, represented 550M HNL per year; from which donor funding was around 70 percent. The largest funders are, in decreasing order: Spain, who provided very significant support in the first half of the decade; IADB, who increased lending in the second half; followed by Japan, USAID and the Central American Bank for Economic Integration (CABEI).

Municipal level funding, including fiscal transfers from national government, represents an important source of funding for the sector, and has increased significantly between 2005 and 2010. This funding comes mostly from general transfers from the national government and the municipalities’ own resources, mostly real estate taxes. This significant increase, 291 percent (in actual 2010 HN Lempiras), can likely be explained by the fact that fiscal transfers have increased overall. Some tariffs might also have been adjusted and increased, resulting in higher municipal income and possibly in greater awareness that WSS service provision is a municipal responsibility. In the same time span, approximately 150,000 urban dwellers have started receiving services from municipal utilities instead of SANAA.

The analysis also shows a significant income increase due to tariffs, reaching about 70 percent (in actual 2010, HN Lempiras) between 2002 and 2011. Presumably, part of this increment can be derived from both an increase in the number of users, which increased by 36 percent over the same period, and a combination of improved billing and collection practices.

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6 The information available is limited and there is no consolidated and harmonized source of information, except for the years 2005 and 2010 when a significant effort was conducted by the Secretariat of Interior and Population, SEIP, leading to an extensive database of municipal finances, mined for this report.

7 In municipalities without an autonomous service provider, WSS services are often paid directly to the municipal cashier and are not further distinguished in municipal accounting. Thus, in this paragraph, some of the municipal-level funding might actually really be from tariffs, although because larger systems are autonomous, the effect is not likely to be very significant.
There is a large variance in tariff levels in the cases studied, and in some places tariffs might be reaching affordability limit for the lowest income quintile, assumed to be 3 percent of household income. An in-depth analysis of existing cross-subsidy schemes would be relevant to assess their distributional impact.

**Sector Spending**

**Investment Levels and Structure**

National investment levels in the sector are below international standards, and are trending down.

According to the Human Development Report (HDR 2006), countries such as Honduras must invest at least 1 percent of their GDP in WSS. Between 2002 and 2011, the average was only 0.13 percent. Investment levels by the national Government and donors in the WSS sector have generally been decreasing over the last 10 years both in absolute numbers and as a share of overall national budget.

The largest share of total investment is currently allotted to urban water. On average, from 2002 to 2011, 69 percent of total WSS sector investments were used for water projects with 46 percent allotted to urban areas. Sanitation, which is significantly lagging behind water in terms of coverage, received only 31 percent of the sector’s investment; of which 23 percent was invested in urban areas and the remaining 12 percent in rural areas.

The current levels of investment are insufficient to reach the Government’s own targets Depending on which set of targets is adopted, MDGs or the government’s VP/PN set of targets, the annual investment needed varies between 4,900M HNL and 6,000M HNL. This compares to an actual current investment level of ~488M HNL, excluding municipal investments of ~218M HNL in 2010; or generally speaking, only about 10 percent of the total investment needs. In other words, there is a high risk of not sustaining the level(s) of coverage achieved because of population growth and the lack of funding for infrastructure replacement and rehabilitation.

**Operation and Maintenance**

The information that is currently available indicates a drastic increase in salary costs, and to a lesser extent, a rise in SANAA’s operations and maintenance (O&M) costs. The trend is particularly troubling because the rise appears to coincide with the passage of the Framework Law decentralizing services and downscaling SANAA. Nonetheless, salaries and

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8 As per UNDP and WHO recommendations. Other organizations propose other values (OECD 2.6 percent, EPA 4 percent).
9 The term ‘urban water’ refers to water in urban areas.
Figure 7. Average bill and affordability for 2010 for a sample of service providers

Figure 8. Distribution of investments (national and providers) per Sub-sector (2002-2011)

Figure 9. Comparison of actual and estimated annual investment needs to achieve targets
benefits expenditures have significantly suffered a 95 percent increase that not only poses financial sustainability challenges for the utility, but also proportionally increases the severance costs during further decentralizations. As a result, salaries represented an average of 55 percent of total costs during the analysis period, much higher than the usual 30-40 percent.

III. DECENTRALIZATION AND PERFORMANCE

The analysis of the performance of urban water and sanitation service provision in the context of the ongoing decentralization process is based on the premise that a number of external, political and policy factors influence a utility’s performance.

Utility performance was assessed based on data available from the Regulator and on efficiency, tariffs, service quality and investment levels.

In addition, as a proxy to assess the overall performance of the utilities, a simple performance index (SPI) was developed using the following five parameters: i) employees per 1,000 connections, ii) level of metering, iii) level of continuity, iv) level of disinfection of water, and v) tariff effectiveness (average tariff over average cost). For each parameter,

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10 Data for 92 urban service providers covering 85 percent of total urban population, for which the regulatory agency has collected service provision indicators for the year 2010.

11 These indicators do not cover completely a utility’s performance; rather, they were selected based on the limited information available from the regulator’s database.
A score was assigned from 1 (worst) to 3 (best) based on international good practices.

The statistical analysis of overall performance (SPI) shows that most of the service providers are still steps behind from reaching a sustainable and efficient service. The analysis clearly suggests that municipal companies and water boards perform better than SANAA and municipalities.

The score summation yielded an overall score (ranging from 5 (worst) to 15 (best) used to classify the service providers into low, medium and good performance utilities.

**Size and poverty levels**

The analysis did not show statistically significant linkages between: i) the size of the serviced area, or ii) the poverty category of the municipality, and iii) utility efficiency or investment levels.

**Decentralization paths**

Forcing SANAA to decentralize service provision to unwilling municipalities has been a recipe for failure; conversely, following a demand-driven decentralization path, where
Local political economy factors

This type of factors often play an important role in determining success or failure. For example, the first 20 years of coherent and consistent policies and political will, that imposed broad-based water meter installation and raised water use awareness among citizens, played an important role in the success of Aguas de Puerto Cortes, which also benefitted from Honduras’ National Port Authority’s* steady income, which buys 35 percent of the distributed water at L30 per cubic meter.

Management models

The operational efficiency of service providers differs considerably among different management models: the more autonomous the service providers are, the more efficiently they operate. The analysis of investments at a municipal level suggests that the decentralization of services has been effective at mobilizing stronger municipal resources. For instance, municipalities with a decentralized management model, such as water boards and municipal companies, allocate more resources to water and sanitation infrastructure than those where SANAA is still providing water services.

* Honduras National Harbour Company.
**MAIN CONCLUSIONS**

- Sector information available to policy makers is insufficient to inform about the on-going decentralization process.
- Public Expenditure levels are insufficient to achieve the Government’s own objectives; they are decreasing and their composition does not fully match actual needs.
- Public Investment efficiency is difficult to assess, and the significant growth of operational expenses, particularly, salaries of SANAA staff, places the service provision sustainability at risk.
- Sector financing composition is changing due to decentralization; and currently decentralized funds by far represent the largest source of financing.
- Regulatory data reviews show that governance model and decentralization path strongly influence performance of urban service providers.

**RECOMMENDATIONS FOR DECISION-MAKERS**

- Improve the information basis on service quality and financing, and the data collection mechanism to systematically monitor and evaluate service providers’ performance.
- Increase national and municipal investment levels and improve their quality and alignment with government targets.
- Continue to support services decentralization to municipalities strategically, promoting programs that offer technical and financial support to municipalities to set-up or strengthen autonomous municipal utilities and to improve water and sanitation service quality and coverage.
- Adapt the public expenditure financing to a decentralized sector by adopting financing policies that promote efficient service providers, encourage cost recovery primarily through tariffs, define a subsidy scheme that allows affordable services for poorer citizens, and establish basic principles for investment financing to reach service providers.
- Ensure that institutional strengthening is taking place among the national institutions so they can execute their leadership, regulator, and technical assistant roles effectively; and ultimately be able to support the creation and strengthening of autonomous municipal utilities.

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