

PROGRAM OF SUPPORT FOR THE MODERNIZATION AND REHABILITATION  
OF THE WATER SUPPLY AND SANITATION SECTOR

(VE-0056)

EXECUTIVE SUMMARY

**BORROWER AND GUARANTOR:** Republic of Venezuela

**EXECUTING AGENCY:** HIDROVEN and HIDROLARA

**AMOUNT AND SOURCE:**

IDB:	US\$30 million
Local counterpart funding:	US\$30 million
Total:	US\$60 million

**FINANCIAL TERMS AND CONDITIONS:**

Amortization period:	20 years
Disbursement period:	3 years
Interest rate:	variable
Inspection and supervision:	1%
Credit fee:	0.75%
Currency:	U.S. dollars under the Single Currency Facility

**OBJECTIVES:** The objective of the proposed operation is the development of institutional guidelines and strategies to boost the sector's operational and financial efficiency; to encourage service providers to take responsibility for the functions, assets, and services (including the improvement of water quality) entrusted to them and to respond appropriately to users and authorities; and to support private sector participation in the operation of the systems.

**SCOPE:** The Bank's strategy for the sector is to make spending more efficient and promote and consolidate its financial sustainability. The problems faced are structural in nature and solving them will require a transitional period of some five years. In an initial stage, therefore, the object of this program is limited to establishing the institutional framework necessary for the sector to evolve gradually and consistently towards the desired levels of efficiency under HIDROVEN's technical secretariat and to promoting the consolidation of the operator ? HIDROLARA. In addition, under the technical assistance component of the proposed operation, the restructuring of other operators, which will be able to participate in a second rehabilitation program,

will be started.

**DESCRIPTION:**

Engineering and administration (US\$5.5 million)

This category will cover: personnel costs, equipment, and overhead for the program executing unit at HIDROVEN and HIDROLARA's coexecuting unit; and the cost of hiring a consulting firm to inspect the rehabilitation works under the individual meter program.

Sector component (US\$14.9 million)

This subcomponent will finance equipment and hiring of consultants to provide the technical training needed, to implement the new regulatory framework for the sector, and to carry out the following **technical assistance** activities:

1. A study to review the sector profile proposed in the study on the institutional and legal framework of the water supply and sanitation sector.
2. Design and implementation of policies and administrative procedures for systems still under the responsibility of the regional water companies.
3. Development of a management information system and preparation of a basic sector information inventory needed for planning and regulatory tasks.
4. Drafting of sector guidelines and standards.
5. Development and implementation of general policies such as water resource regulation, rural water supply systems, and conditions for private-sector participation.
6. Payment of HIDROVEN staff benefits so that the new regulatory agency is able to begin work with no liabilities (estimated at US\$300,000).

Hiring of an integrated management services company (IMSC) for HIDROLARA (US\$3.8 million)

This component involves hiring an international specialized private-sector firm ("management company") to handle the technical and operational aspects of HIDROLARA's service delivery. The IMSC will be in charge of all decisions in the administrative, technical, business, and financial

areas and will be responsible for fulfillment of operational and financial management indicators set forth in the performance contract.

This component will include the fixed costs associated with managerial and institutional strengthening functions undertaken by the private management company during the first three years. The second part of the cost involves a variable payment incentive to the company based on progress in attaining operating and financial indicators. The variable payment would be financed with internally-generated resources from HIDROLARA (HL) operations and is not part of the program costs.

Minor rehabilitation and improvement works on existing infrastructure in HL's existing water supply and sewerage systems (US\$21.4 million)

This component is comprised of: (i) works for the rehabilitation and improvement of HL's urban water supply systems; (ii) works for the rehabilitation, replacement, and repair of the existing sanitary sewer system in the city of Barquisimeto; (iii) unmetered water program; and (iv) construction of minor rehabilitation and improvement works for water supply and sewer systems in small urban and rural communities in the state, costing up to US\$100,000 equivalent each.

Studies, equipment, and technical assistance for HL (US\$3.1 million)

This component covers consulting services contracts for the following activities: (i) master plans for water supply, sewerage, and drainage for Barquisimeto; (ii) studies to optimize the use of electricity at water supply facilities administered by HL; (iii) improvement of operations at HL treatment plants; (iv) review of HL's accounting process to reconcile differences between business and accounting systems; (v) establishment of the internal audit office of the IMSC; (vi) continuation of the user census initiated by HL; (vii) study to identify a way of managing the state's rural water systems, currently being administered by the MSAS; (viii) regularization of HL's assets; (ix) observation and study visit for HL, municipal, and state authorities to familiarize them with integrated management activities in a similar company; and (x) equipment for HL.

**ENVIRONMENTAL CLASSIFICATION:** The Environment Committee, at its meeting of October 17, 1995, classified this as a Category III operation. The environmental summary was approved on October 22, 1996.

**POVERTY TARGETING:** Under the terms of the Eighth Replenishment mandate on poverty alleviation and the Bank's criteria for implementing that mandate, this program does not qualify as a poverty-targeted investment.

**CONTRACTING OF CIVIL WORKS, GOODS, AND RELATED SERVICES:** The threshold amounts above which international competitive bidding will be required for procurement under this program are US\$3 million for works and US\$350,000 for goods and related services.

**BENEFITS:** The following goals are expected to be achieved through execution of the program:

- a. For the sector: (i) creation of an autonomous regulatory agency for the sector and implementation of the new legal and institutional framework for the sector; and (ii) completion of the process of decentralizing operations into at least four new companies that would participate in a future rehabilitation stage.
- b. For HIDROLARA, by the end of the program the following targets will have been reached: (i) establishment of efficient systems for reviewing and setting rates and for billing and collection system; (ii) incorporation of 81,000 unregistered hook-ups into the business system; (iii) improvement of service conditions for 331,000 users; (iv) installation of individual meters for 54% of residential users, 86% of business users, and 100% of industrial users; (v) reduction in percentage of unmetered water to 41.3%; (vi) operating margin of 61.2%; (vii) 100% coverage of operating costs, including depreciation of program investments; (viii) 33.5% coverage of depreciation of assets transferred to HL; (ix) billing of 84% of users compared to current level of 55%; (x) accounts receivable equivalent to no more than three months of billing; and (xi) if investments additional to the program's are not made, a debt coverage ratio of 4:1 and an investment coverage ratio of 3.3:1.

**RISKS:** The main risks that could negatively affect the operation are:

- a. Lack of interest on the part of international

firms regarding the integrated management services contract and high bids due to perceived risk. To make participation more attractive to such firms and decrease the perception of risk, the program will use Bank resources to finance the fixed component of the payment to the firm for the first three years of the contract.

- b. Counterpart resources are not transferred on a timely basis. This risk is minimized by the support that has been received from the regional and municipal governments in the process of setting up the company; by reducing the country's financial restriction associated with recovery of fiscal accounts through the World Bank loan and allocation of counterpart resources in 1997 from the treasury's ordinary resources.
- c. Lack of consensus on the sector profile to aim for among the various institutions involved in service delivery. To reduce this risk under the program, technical assistance will be included and a series of special workshops will be held to provide an opportunity to discuss the details of the proposals submitted and the consequences on the future development of the sector.
- d. Absence of political support at the highest levels for adoption of the legislation needed to implement the regulatory framework. To ensure that sector reform will have the support required for the necessary changes, the National Commission for Water and Sanitation Sector Development will be set up with representatives from the various institutions involved in the sector. This commission's functions will include considering and approving the various sector restructuring proposals and fostering political support for approval of the new regulatory legislation.
- e. Insufficient interest on the part of the regional and local governments in the service decentralization and transfer process. To mitigate this risk, HIDROVEN has established a Decentralization Committee in charge, among other things, of informing local governments about the decentralization process. In addition, to participate in the program, local authorities shall undertake to set up an autonomous enterprise that will be in charge of delivering the service and grant working capital for the necessary studies to be conducted.

**THE BANK'S  
COUNTRY AND  
SECTOR STRATEGY:**

The Bank's strategy in Venezuela is aimed, *inter alia*, at supporting modernization of the State, particularly the decentralization process and improving efficiency and equity in social service delivery. In this regard, the proposed operation would seek to consolidate structural regulatory reforms, in particular through efficient institutional and regional decentralization of the service and increased participation by users and private firms.

**SPECIAL  
CONTRACTUAL  
CONDITIONS:**

Prior to the first disbursement for the components involving the IMSC and minor rehabilitation works for HL, the borrower will submit to the Bank:

- a. Evidence that HL's rate base has been reviewed and that its application makes it possible to be consistent with the financial indicators expressed in the performance contract (paragraph 5.15);
- b. Evidence that the performance contract has been ratified by the municipal councils (paragraph 3.20);
- c. The agreement signed by the nation and HL for the transfer of the loan proceeds and establishment of the trust (paragraph 3.30).

Other special conditions that will be included in the contract are:

- a. Presentation of the integrated management services contract signed by a private operator will be a condition precedent to the commitment of resources for the second group of rehabilitation works (paragraph 3.16);
- b. The commitment of resources for the third group of rehabilitation works will be subject to the fulfillment of efficiency indicators (paragraph 3.16); and
- c. Investments in addition to those in the program during its execution period are not to exceed certain limits (paragraph 5.14).

(Other contractual conditions are described in the following paragraphs: 3.31, annual supervision meetings; 3.32, reports; 3.39, recognition of expenditures; 3.44, maintenance; 3.46, auditing; and 3.45,

environmental conditions).