

## **Case study: System of households' water use subsidies in Chile.**

### **1. Description**

In Chile the privatization of public water companies during the 70's and 80's resulted in increased tariffs. As a consequence, national debate arose on the access to water services by the poorest. Before the privatization, it was recognized the necessity of a gradual increase in the tariff in order not to generate circumstances which could eventually complicate its implementation. With the aim of ensuring that all the population could have access to this basic service, the government and institutions related to sanitation designed a mechanism within the regulatory structure to protect the most vulnerable or poor households. Consequently, Chile adopted a subsidy system to the consumption of drinking water.

The aim of the subsidy system was to channel the resources to those who actually needed them. With this purpose, some necessary conditions and legal requirements were imposed to access these subsidies.

This situation was also possible given the level of development of the country. A significant proportion of its inhabitants had sufficient incomes to pay for the basic services without needing any support or additional help. This made it possible for Chile to adopt a subsidy system focused on the most vulnerable social groups.

In 1989 the Law No. 18,778 was issued, which established a subsidy to the payment of drinking water supply and sanitation services. This law intended to complement the law on tariffs for these services, which would come into force in 1990. The latter implemented a self-financing tariff regime that aimed to incorporate operation, management and investment costs of running water supply and sanitation services. Such costs are determined periodically based on efficient operation of the services; however they remain inaccessible to poor families. Additionally, when adding the costs of waste water treatment into calculations, it became evident that the poor would encounter great difficulties in having access to water services. This situation was addressed in the subsidy law aiming to protect low-income families.

The system chosen was a direct subsidy, targeted to users. It granted access to basic consumption of drinking water and sewage service for each household.

### **2. Actions taken**

The Subsidy Law No.18.778 established a direct subsidy for drinking water consumption and sewage services to low-income family groups and residential customers.

The law set a percentage to be subsidized on fixed and variable charges, not less than 25% nor more than 75% of consumption. This subsidy had to be equivalent for beneficiaries of the same geographical region with a similar socioeconomic status. In addition, it established that the subsidy could not exceed a total consumption of 20 m<sup>3</sup> per month.

This law also set the terms on how a direct subsidy for the consumption of drinking water and sewerage services is granted to residential users of low-income. This subsidy system is managed by the corresponding municipalities, which in turn are responsible for the registration process and selection of beneficiaries. The municipalities also facilitate water companies with a list of selected users to ensure that the bill clearly and separately reflects the amount to be paid to the water company by users and the amount to be paid by the municipalities.

The subsidy is compatible with any other subsidy the beneficiary may have received or be entitled for, in accordance with the attributions set by each municipality. Therefore, the selection system has been established to adapt on specific socio economic situation at municipal level. It constitutes a method of socio economic characterization enabling state social action to be targeted on the poor. It is achieved by the so-called CAS form (Socioeconomic Characterization Survey), now FPS (Social Protection Form). This form enables differentiation among the poorest households by assigning scores. It is designed for an equitable distribution of the various subsidies granted by the Government's social protection network.

The FPS form is a tool of the Ministry of Planning (MIDEPLAN), dedicated to rank families for social assistance. It can identify social priorities and select beneficiaries for the different social programs, mainly state subsidies.

MIDEPLAN annually recommends to the Ministry of Finance the number of grants by region and the cubic meters of consumption to be subsidized. It also makes proposals on the necessary budget to finance subsidies.

The subsidy is granted to the beneficiary for three years maximum, being possible to reapply as long as the compliance with legal requirements is proved by the municipality.

The procedures for determining the amounts of subsidies and socioeconomic levels are stipulated in the corresponding regulation, which also determines the type and amount of the subsidy to be applied in cases where the consumption measurement is not available. The first regulation was established by Decree No. 786 of the Ministry of Finance in 1989.

The initial low application of the law as well as other factors led to amendments of the subsidy law.

The first amendment was made by Law No. 18,899 in December 1989. It required mayors (government representatives in regions) to hold 90% of the total subsidies allocated in the previous year budget.

The second amendment was made in 1991 (Law No. 19,059). It extended to those users who registered only drinking water service (no sewer service) and the percentage to subsidize ranged between 40% and 75% of consumption. It also established MIDEPLAN's responsibility for annually proposing to the Ministry of Finance the number and type of subsidies to be granted per region as well as the necessary budget to finance them.

The following change was made in 1994 (Law No. 19338) and aimed to expand the range of financial assistance by raising the maximum percentage to be subsidized to 85%. The law also enabled the population served by rural drinking-water systems to gain access to this subsidy. In addition, this law established the subsidy to the investment in rural drinking-water systems, destined to cover the difference between their cost and the amount that users were able to pay. The Regulation was amended once more by Decree No. 195 of February 19, 1998.

As mentioned before, SAP law was initially not fully operational due to administrative difficulties for its grant. Furthermore, the subsidy did not adjust to the different tariff levels in the different regions of the country. Amendments to this law were intended to speed up the registration process by enabling water companies to temporarily identify potential beneficiaries.

The partnership between private and public companies with the municipalities has performed well. Private water companies have expressed their willingness to cooperate and encourage the subsidy system by promoting it among citizens. The incentive for companies is to rescue the owing customers as, in this way, they ensure receiving the subsidy of 15 m<sup>3</sup>/month corresponding to those homes.

The Superintendence of Sanitation Services is the regulator entity of water companies. It is responsible for the improvement and administration of the subsidy system. It determines the total amount of subsidies needed by the region and/or tariffs groups. This was carried out considering the levels of family income, according to the FPS, of MIDEPLAN, ensuring that the payment for 15 m<sup>3</sup> of consumption did not represent more than 5% of the family income. This is in line with the recommendation of the Pan American Health Organization.

The subsidy for drinking water consumption and sewerage services is granted and administered entirely by the respective municipalities. It is available to residential customers of public drinking water and sewage services. Through this benefit, the State funds a proportion of a maximum consumption of 15 m<sup>3</sup> of drinking water and sewerage service, which is indicated in the bill that the beneficiary receives. The beneficiary pays the difference between minimum and real consumption. Moreover, according to law 19,949, which established a system of social protection called "*Chile Solidario*" for families in a situation of extreme poverty, there is an additional amount of subsidies to the consumption of drinking water and sewage, which cover 100% of the first 15 m<sup>3</sup> of the consumption.

A subsidy of the first 15 m<sup>3</sup> of water consumption is given in a percentage which can vary between 25% and 85% depending on local tariff levels and the socioeconomic level of the beneficiaries. The subsidy is applied to the fixed and variable charges for drinking water and sewerage (including wastewater sewage treatment where appropriate). It is valid until January 31 of the following year, having the possibility of renewing it automatically each year for a maximum of three years. After this time, the applicant may reapply, declaring at the Municipality that the reasons which enabled the grant of the subsidy have remained unchanged.

Applicants must contact the Social Department of the Municipality and complete the data form to apply for this benefit. The requirements to be met are:

1. Prove residence in the corresponding municipality, and make permanent use of this property.
2. Be surveyed in the FPS system, with valid form.
3. Prove that the family group is currently under an economic situation which makes it impossible for it to pay the cost of the services, what is verified through the FPS score.
4. Be up to date regarding the payment of drinking water and sewerage services. In case of being behind with payment, beneficiaries may request the company to sign an agreement for debt settlement.
5. Submit a written application to the municipality.

The subsidy is not approved on the following grounds:

- Expiration of the three years of validity of the subsidy.
- Failure to inform the municipality, at least 30 days in advance, on the change of address within the area of its competence.
- Having changed the address outside the area of competence of the municipality where the application has been submitted
- Failure to pay the non-subsidized part of bill.
- Failure to provide the background information to review the applicant's socioeconomic condition.
- Voluntary resignation of the beneficiary.

Applications may be submitted at any time of the year. Numbers of grants depend on the available quota for each municipality. The number of subsidies granted in the 1990-2006 period is shown in figure 1 below.

In case of rejection, it is possible to reapply as long as the requirements for the approval of the subsidy are fulfilled.

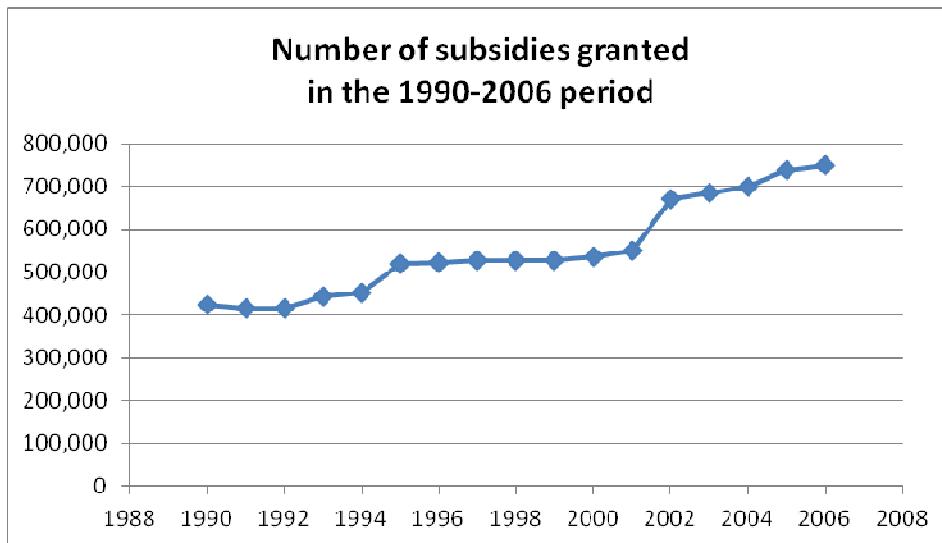


Figure 1: Number of subsidies granted in the 1990-2006 period.

### 3. Results achieved

The subsidy system has evolved from a low initial use to the current high levels of implementation, enabling the access of poorest people to sanitation services. In addition, sanitation plans including the construction of new wastewater treatment plants all over Chile are being implemented, with the coverage already reaching 86% in 2010.

Originally the subsidy sought to support 20% of the poorest families in each administrative region in Chile, as indicated in the results of the CASEN Survey. Since 1987, this Survey has been the main instrument of socio economic assessment of social policy in the country. This instrument has considered the prevailing tariffs from water companies as well as the income of households to determine the different percentages of subsidy to be applied. It ensured that Chilean families did not spend more than 5% of their average monthly income for water supply and sanitation services, as previously mentioned.

The implementation of subsidy system required some amendments to the subsidy law and its corresponding regulation. From these amendments on, there was a constant growth of both quota available and related budgets proposed by Ministry of Planning and allocated by the Ministry of Finance.

Since 2002, the quota and budget increased based on the results of the CASEN 2000 Survey. A maximum limit to subsidize 15 m<sup>3</sup>/month was set for the whole country except the metropolitan region.

In addition, the law 19,949 from 2004 set up a social protection system for families in extreme poverty called "*Chile Solidario*". It gives access to additional subsidies covering 100 % of the first 15 m<sup>3</sup>/month of drinking water consumption. This triggered an increase in the percentage of beneficiaries. The State budget allocation represents about 6% of the income of the water sanitation companies.

In 2010 the water services subsidies, including the ones provided by the *Chile Solidario* system, accounted for 702,058 beneficiaries reaching an amount of USD 75,000,000.

The introduction of the subsidy and the results achieved so far allowed an increase of water tariffs. This also resulted in cost recovery of water services without compromising social objectives and the distribution of such a basic and fundamental service.

According to MIDEPLAN analysis, the average consumption of a household composed of 4.8 inhabitants is currently 13 m<sup>3</sup>/month although the maximum volume subsidized might reach 15 m<sup>3</sup>/month. Those administrative regions where tariff rates are higher (Regions I, II and VIII) have also been favored with a higher percentage of subsidies to be allocated.

By 1995 the percentage of subsidized urban customers reached 17.6% of the population. This covered 5% of the turnover of the water utilities. Funding came from the national budget. By 2004 the percentage of subsidized residential customers reached 22%, representing 19% of cost recovery of water utilities. The amount of state investment for the subsidy system in 2004 reached USD 50 millions.

According to the CASEN survey of 2003, the subsidy system has been mainly distributed among the first five income deciles. The CASEN survey reported that the poor in Chile represent 18.8% of the population (2,9 mil. people). In 2003, approximately 680.000 households benefited from the subsidy system.

The subsidy system is focused on supporting the poor. Nevertheless, an opinion survey recently conducted by the MIDEPLAN showed that it is also covered a portion of consumers in the regions of northern Chile which do not belong to this category. This situation should be corrected in order to subsidize the remaining vulnerable customers in the country.

Municipalities were not well prepared to implement the subsidy system in terms of human resources. Moreover, in some cases the subsidy was used to support certain authorities or was managed for getting political support.

The partnership between public and private sector has worked relatively well. In general, private companies have been willing to support this system although they were not assigned to have direct control over the subsidies. They have also opted to facilitate agreements for the payment of debts by owing customers so that these can apply for the subsidies and the companies can regain the income from this sector of the population. Many water companies have launched field campaigns in which they approach the population to explain how to sign agreements for the payment of debts.

The water companies practically replaced the lack of state authorities to educate the poor in the social support system. In some cases, the private companies supplemented the task of municipalities. Another aspect to highlight is that the bureaucratic barriers which are sometimes established by some municipalities have hindered citizens from continuing the process of obtaining the subsidy. In addition, the system is still poorly known among the population, which mainly gets to know about it when going to the municipalities or when informed by friends or relatives. This situation remarks the important informative task yet to be carried out.

#### **4. Lessons learnt and importance for IWRM**

This case study shows many aspects that must be taken into account by a government when aiming to privatize water services in order to establish a subsidy system to provide adequate water services to the most vulnerable sectors:

- Prior to undertaking privatization and/or public-private partnerships, effective, clear and adequately implemented institutional and regulatory reforms need to be considered
- The direct subsidy scheme should be considered and must have an enabling but not supportive approach. It should therefore cover only part of the cost of drinking water and sanitation of the household, what contributes to keeping the payment habit of the population.
- The poorest households are willing to pay for a safe and reliable service however, sufficient education and promotion is a must. It is important to communicate the availability and mechanism of subsidies.

- A high percentage of households in Chile have a metering device, which enables the existence of a subsidy based on the real consumption of each beneficiary, instead of being a pre-established amount, as in other countries. The subsidy should cover only the difference between actual consumption and the ability to pay. It should not be allocated directly to the consumer but rather be transferred from the state to the water companies.

The privatization of the sanitation services has been possible due to:

- the existence of an infrastructure system and consolidated regulations in the country
- stable political conditions in the country, and
- a well-structured and reliable regulatory system

The implementation of the current sanitation system was consequence of a political decision to look for financing sources outside the government.

It is fundamental to have a counterpart of the granting entity that is a strong regulator as well as necessary administrative and legal tools to protect the customers' interests.

## **5. Contacts and references**

The information presented above was developed based on the law of subsidies (N°18.778) and the Supreme Decree N°195 (year 1998) of the Ministry of Finance.

The number of available subsidies in 2007 was obtained from the Decree N°1509 (year 2006) of the Ministry of Finance.

Information was provided also by the System of Social Protection of MIDEPLAN on historical records of the subsidy system of this Ministry.

Valdés Hernández, Fernando Patricio, independent consultant on water-related issues, attorney specialized in legal matters on water resources, researcher of the operation of the water market in Chile; co-author of the book "Privatization of the Chilean Sanitary Sector, Analysis of an incomplete process", year 2000, CESOC Editions, with over twenty one years of professional experience and expertise in the Chilean Water Codes (1981, 1951 and 1968) and in the legislation on water resources.

Emails: [valdesh.fernando@gmail.com](mailto:valdesh.fernando@gmail.com) [fernando.valdes@movistar.cl](mailto:fernando.valdes@movistar.cl)