

## Basic Sanitation Policy in Brazil: ideas, institutions and challenges in the Twenty-first Century

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**Abstract** *This paper describes the challenges currently facing Brazil's basic sanitation sector. The sector's characteristic profitability and dynamism have brought State-run Water & Sewage (W&S) services into the spotlight of the structural reform agenda on the argument that governments do not have the resources necessary to universalize coverage. There is a pattern of W&S services' operating with a surplus, which helps explain the intense dispute in recent years in favour of legal changes to the market position of CESBs and local providers to favour an expanding role for private agents. Converging with the structural reform agenda, Law 14,026, sanctioned on 15 July 2020, made far-reaching changes to the legal framework for sanitation and provided for the State's complete withdrawal from the sector. The new regulatory framework prohibited programme contracts, required tender processes for sanitation service contracts, encouraged regionalization without CESBs, set out national guidelines for States and municipalities to access federal funding and introduced a national regulation regime under the National Waters and Basic Sanitation Agency. The model of cooperation that operates in the SUS could serve as a reference for constructing a social pact in the sector.*

**Key words** *Basic Sanitation, Water & Sewage Services, State-level Sanitation Enterprises, Privatization, Regionalization*

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## Introduction

This paper describes the challenges currently facing Brazil's basic sanitation sector. The government policy addressed here contemplates: i) drinking water supply, which consists in providing and maintaining the infrastructure and installations necessary to the public supply of drinking water, from collection to residential connections and related metering; and ii) sanitary sewerage, that is, providing and maintaining the infrastructure and installations necessary for the collection, transport, treatment and final disposal of sewage<sup>1</sup>.

Spiller and Savedoof<sup>2</sup> describe Latin America as markedly backward in water and sanitation (W&S) provision capability. They attribute this to opportunistic behaviour by governments, which has led to operationally inefficient public and private basic sanitation enterprises, poor quality service provision, tariff pricing at below production cost, plus the use of these organisations for corrupt purposes<sup>2</sup>.

In Brazil, research into institutional arrangements in the W&S sector has highlighted aspects of the national dynamics that may relativise the above conclusions. Firstly, the Brazilian literature draws attention to a path-dependency effect on progress in the W&S sector. The notion of path dependency relates to the influence of past decisions on public policy: when a policy embarks on a trajectory of change, it may be obstructed by the existing institutional setup<sup>3</sup>. This theoretical approach highlights the dominance of State-level Sanitation Enterprises (*Companhias Estaduais de Saneamento Básico*, CESBs) set up as part of the National Basic Sanitation Plan (*Plano Nacional de Saneamento Básico*, Planasa) in the 1970s and controlled by the state governments<sup>4</sup>. The Planasa suppressed any municipal title by centralising W&S services in enterprises under the control of the state Executives<sup>5</sup>.

A second approach to the institutional setup in the sector reveals that, in Brazil, provision of basic sanitation has developed in association with the promise of financial gain. Over the past three decades, leaders throughout the federation have opted to expand state and municipal tax bases by commercialising basic sanitation services<sup>6</sup>. The pursuit of new sources of revenue explains governments' investment decisions and their preference for providing services to urban areas<sup>7</sup>. As a result of this mercantile bent, it is argued that only an active investment policy by the federal government can surmount the serious deficit in access to basic sanitation services<sup>8</sup>.

A third line of explanation associates the deficit in coverage with the sector's being operated by institutions of State and argues for the expansion of private investment. The state and municipal enterprises' lack of financial capacity, resulting from unrealistic tariffs and operational inefficiency, is regarded here as limiting investment in W&S in Brazil<sup>9</sup>.

The Brazilian literature correctly identifies the resilience of the institutional arrangement inherited from the Planasa. Non-conventional economic theory deploys the concept of asset specificity to explain the resilience of infrastructure investments, which cannot be reallocated to other uses or replaced by competition mechanisms<sup>10</sup>.

The fact is that the model put in place by the Planasa was never problematised, not even during the process of concertation resulting in the 1988 Federal Constitution, which left the CESBs in a comfortable position and postponed any decision as to who held title or what participation there should be by private agents<sup>11</sup>. Turolla<sup>12</sup> pointed out that the 1988 Constitution attributed competences for operating sanitation at the three levels of government, but that moves since then to alter the legal framework for sanitation have been sparing: nineteen years after the 1988 Constitution, Law 11,445, of 2007, laid down national guidelines for sanitation, thus framing the debate over title<sup>12</sup>. The new jurisprudence increased the transaction costs of the CESBs' continuing regional hegemony by specifying the municipalities as the holders of title to basic sanitation services and enabling them to delegate service organisation, regulation, inspection and provision to third parties<sup>13</sup>.

Nonetheless, Law 11,445/2007 favoured states' interests by including programme contracts as an option when renewing concession contracts between municipalities and CESBs<sup>14</sup>. Decree 7,217/2010, which regulated Law 11,445/2007, ratified both the regionalised provision of basic sanitation services and programme contracts, but failed to address the dispute over title<sup>15</sup>.

In the context of the new 2007 Basic Sanitation Law, the Growth Acceleration Programme (*Programa de Aceleração do Crescimento*, PAC) fostered major progress towards universal access, side-lining the federative conflict and relegating the role of private agents<sup>16</sup>. Note that, with the institutional incentives of the second half of the 2000s and the investments of the PAC, local services quickly began to be set up, bringing municipal governments to the centre of sanitation policy<sup>17</sup>.

Subnational governments sought to generate new revenues by investing in W&S, achieving financial return and service provision by means of semi-autonomous or directly administered public entities<sup>18</sup>. The W&S sector in Brazil became structurally profitable. For example, total operating revenue in 2020 (72.4 billion reais) exceeded total disbursements (65.4 billion reais), with services being provided by regional (state), local (municipal) and micro-regional enterprises<sup>18</sup>. There is a pattern of W&S services' operating with a surplus, which helps explain the intense dispute in recent years in favour of legal changes to the market position of CESBs and local providers to favour an expanding role for private agents.

The sector's characteristic profitability and dynamism have brought State-run W&S services into the spotlight of the structural reform agenda on the argument that governments do not have the resources necessary to universalise coverage. The W&S service reform agenda advocates granting water supply and waste water treatment concessions to private companies. In the process, it is common to hear the precarious state of the basic sanitation sector described as a national calamity, except where services are operated by private enterprise<sup>19</sup>.

Advocates of a greater role for private agents argue for public-private partnerships; federal regulation; consortia among smaller municipalities; and, most importantly, an end to programme contracts<sup>9,20</sup>.

### **The new legal framework for sanitation in Brazil**

Converging with this structural reform agenda, Law 14,026, sanctioned on 15 July 2020, made far-reaching changes to the legal framework for sanitation and provided for the State's complete withdrawal from the sector. The new regulatory framework prohibited programme contracts, required tender processes for sanitation service contracts, encouraged regionalisation without CESBs, set out national guidelines for states and municipalities to access federal funding and introduced a national regulation regime under the National Waters Agency (*Agência Nacional de Águas*, ANA), which was renamed the National Waters and Basic Sanitation Agency (*Agência Nacional de Águas e Saneamento Básico*)<sup>1</sup>.

The new framework bars programme contracts, stipulating that basic sanitation services be delegated by tendering. Programme contracts

had made it easier to renew contracts between CESBs and municipalities. In that way, municipal governments could sign cooperation agreements, while CESBs maintained sanitation services provided to municipalities without the need for tendering. Under the new framework, this is no longer possible. CESBs must dispute tendering processes with private or public enterprises if they wish to retain services in the municipalities<sup>21,22</sup>.

Public basic sanitation service provision contracts must set universalisation targets ensuring that 99% (ninety-nine percent) of the population is served with drinking water and 90% (ninety percent), with sewage collection and treatment, by 31 December 2033, as well as quantitative goals for uninterrupted provision, loss reduction and improved treatment processes. Law 14,026/2020 also sets 31 March 2022 as the deadline for inclusion of universalisation targets in existing contracts<sup>1</sup>.

Federal Executive Decree 10,710 of 2021 also stipulates the methodology that drinking water and/or sewerage service operators should use to demonstrate their economic and financial capacity to meet the universalisation targets of the new legal framework for sanitation<sup>23</sup>. The need for a rapid response to the demands of Decree 10,710 left great uncertainty as to the future of the CEBS and the possibility that state W&S enterprises would be replaced by private agents in the more profitable municipalities<sup>24</sup>.

As it happened, however, the CESBs were successful in renewing contracts and signing contract amendments in profitable municipalities (most state capitals), extending their positions in the leading markets. On the other hand, the new framework failed in formatting new concession contracts for private investors to participate in small towns made unprofitable by the regionalisation strategy<sup>25</sup>.

In this scenario of conflict, what is striking is that little importance was given to any federative endeavour to agree on implementation of the new sanitation regime. Agreement reached by way of negotiations, coalitions and Ministry of Health inducements was crucial, for instance, in the successful construction of the Unified Health Service (*Sistema Único de Saúde*, SUS). Note that, at the outset of Brazil's re-democratisation, federal government-controlled health sector funding was partly transferred to be executed directly by states and municipalities, in exchange for their acceptance of a standard agenda of priority policies and programmes. Health sector financing

was organised around an ingenious system of conditional transfers set up in the 1990s<sup>26</sup>.

## Conclusions

Introduction of the new regulatory framework for sanitation is not complete. The agenda for the State's withdrawal from the sector has been leveraged by the situation of fiscal dependence of states, such as Rio de Janeiro, Rio Grande do Sul and Goiás, that went into fiscal recuperation (*Regime de Recuperação Fiscal*, RRF) in 2017. RRF involves total or partial divestment of equity holdings in public enterprises or mixed economy companies, or the concession of services and assets, or the liquidation or extinction of these enterprises, in order to meet liabilities with the proceeds<sup>27</sup>. Adhesion to RRF made it possible for the Rio de Janeiro State Water and Sewage Company (*Companhia Estadual de Águas e Esgotos do Rio de Janeiro*, CEDAE) to be auctioned in late April 2021 and showcased as the jewel in the crown of a series of possible W&S service concessions<sup>28</sup>.

The CESBs' efforts to maintain their dominant positions in profitable cities and the scant inclination among private companies to invest in small municipalities meant that the 31 December 2033 targets set by the sanitation framework – serving 99% of the population with drinking water and 90% with sewage collection and treatment – had become even more challenging. Universalisation of water provision in the North region will be extremely demanding (the region was only 68.9% covered in 2020) and provision of sewage collection and treatment may perhaps be unattainable (13.1% of the region's population had sewage collection and treatment services in 2020)<sup>18</sup>.

Abrucio and Samuels pointed out that the growing power of state governors was one of the key factors in Brazil's re-democratisation. Governors refused to yield the sparse decision-making space they had gained during the transition to democracy and not even the federal government was able to impose its will in areas of public policy where the states held title<sup>29</sup>. The CESBs' institutional resilience is a case in point.

Nonetheless, note that Brazil is a federation with aspirations to symmetry, where the 5,600 municipalities and 26 states have the same institutional responsibilities, except for the judiciary function, which is exclusive to the states and the Union<sup>30</sup>. In this federative arrangement, the three levels of government continue to dispute title to

the W&S sector because of overlapping, competing competences.

During the re-democratisation process, consensus on title to sanitation services was hindered by the heated dispute between advocates of state- and municipal-level government. Widespread use of political veto prevented the construction of new federative cooperation mechanisms, which preserved the power of state governments and relegated the debate over universalising coverage.

Legal initiatives to change this setup, by specifying the municipality as holding title to basic sanitation services (as, for example, in Law 11,445/2007), only increased the transaction costs of the CESBs' continuing regional hegemony. At the same time, the legislative environment of the first two decades of the twenty-first century – the Lula and Dilma governments – also strongly favoured the states' hegemony by introducing the "programme contract" as the rule under which several holders of title to municipal service provision could enter into contracts with a single regional service provider.

The Lula and Dilma administrations saw extraordinary expansion in W&S service provision by entities dependent on municipal and state governments striving to expand government revenues. Brito<sup>14</sup> observed, in that process, the sanitation sector's submission to the logic of the market, with the federal government playing an exclusively normative role.

It has to be acknowledged, however, that the capacity to generate financial returns differentiates Brazil's services from the inefficiency, poor quality provision and tariffs at below production cost observed by Spiller and Savedoof<sup>2</sup> in the W&S sector in Latin America. It can thus be said that Brazil's W&S sector has become structurally profitable, even when operating with relatively low tariffs on the consumption of medium- and high-income families.

On the argument that public entities lack the investment capacity necessary to universalise coverage, the pattern of profitability and the potential for raising tariffs have made W&S services a focus of the denationalisation agenda. In that regard, Law 14,026 of 2020 represented an extraordinary institutional victory for the coalition advocating concessions of water supply and sewage treatment services to private enterprise. The new sector framework imposed federal regulation, placed conditions on accessing federal funding and put an end to programme contracts, leading to exponential increases in the transaction costs of the CESBs' continued existence and

of the services operated by municipalities with greater fiscal capacity.

The present scenario renews the challenge to the legacy of the 1990s signalled by Turolla<sup>12</sup>: the federal government policy initiatives by the Lula and Dilma administrations fostered increases in service coverage, without however producing structural alterations that might permit any major expansion towards universalisation.

The national regulatory framework introduced in 2020 by the Bolsonaro government and ratified by the Supreme Court did not formulate a national sanitation policy that would provide for cooperation among municipalities and state governments. The model of cooperation that op-

erates in the SUS<sup>29</sup> could serve as a reference for constructing a social pact in the sector.

Without pursuing such a cooperation agenda, the challenge of universalising sanitation services will remain unmet. In that regard, the proposal by Turolla<sup>12</sup> of federative agreement in the sanitation sector could guide creation of a public fund for universalisation by concession area. Private agents show no inclination to invest in small rural municipalities, while leading state enterprises currently make a priority of maintaining substantial market positions. In that context, public funding should favour areas and regions which will not meet the universalisation targets set for 2033.

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Article submitted 20/12/2022

Approved 27/01/2022

Final version submitted 29/01/2022

Chief editors: Maria Cecília de Souza Minayo, Romeu Gomes, Antônio Augusto Moura da Silva