

Water Privatization

League of Women Voters of Metropolitan Tulsa

November 2011 Unit Meeting Topic

Water privatization is a short-hand for private sector ownership or management in the provision of water services and sanitation, although sometimes it refers to privatization and sale of water resources themselves (water trading).

Because water services are seen as such a key public service, water privatization is often controversial.

Globally, about 70 million people or about 2% of the urban population is served by privately owned utilities, essentially in England and Wales, Chile and parts of the US. Another estimated 200 million people or 6% is served by utilities that are privately managed, but publicly owned, in about 40 countries such as in parts of France, China, Saudi-Arabia, Spain, the Philippines and Indonesia. In addition, an unknown number of people are served by private small-scale water providers in developing countries.

Proponents of private sector participation argue that it has led to improvements in the efficiency and service quality of utilities. They also say that it has increased investment and has contributed to expand access. Critics deny these improvements, saying that private sector participation led to rate increases and has turned a public good into a private good. Statistical studies comparing public and private utilities show little difference in performance between them.

The motives for water privatization vary from one case to the other, and they often determine the choice of the mode of privatization: Management and lease contracts are used to increase efficiency and improve service quality, while asset sales and concessions primarily aim to reduce the fiscal burden or to expand access. Ideological motives and external influences also play a role. Often several of the above motives are combined.

Fiscal motives

In some cases, where access is already universal and service quality is good, fiscal motives dominate.

Broadly speaking, there are two forms of private sector participation in water supply and sanitation.

- *Full privatization*, assets are permanently sold to a private investor. Full privatization of water supply and sanitation is an exception today, being limited to England, Chile and some cities in the United States.
- *Public-private partnership*, ownership of assets remains public and only certain functions are delegated to a private company for a specific period.

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Public-private partnerships (PPPs) are the most common form of private sector participation in water supply and sanitation today.

The three most common forms of PPPs, in the order of increasing responsibilities for the private partner, are:

- a management contract, under which the private operator is only responsible for running the system, in exchange for a fee that is to some extent performance-related. Investment is financed and carried out by the public sector. The duration is typically 4–7 years.
- a lease contract, under which assets are leased to the private operator who receives a share of revenues. It thus typically bears a higher commercial risk than under a management contract. Investment is fully or mostly financed and carried out by the public sector. The duration is typically 10–15 years.
- a mixed-ownership company in which a private investor takes a minority share in a water company with full management responsibility vested in the private partner.
- a concession, under which the private operator is responsible for running the entire system. Investment is mostly or fully financed and carried out by the private operator. The duration is typically 20–30 years.

Concessions are the most common form of PPPs in water supply and sanitation. They are followed by leases, Management contracts are used in Saudi Arabia, Algeria and Armenia, among others. Mixed-ownership companies are most common in Spain, Colombia and Mexico.

A concession for the construction of a new plant is called a Build-Operate-Transfer (BOT) contract. Under a BOT contract the private operator signs an agreement with a utility that purchases treated water or wastewater treatment services

Private companies are typically selected through competitive bidding and need to have demonstrated previous experience. Selection is either done through a combination of price and quality, or solely based on price. In the case of a management contract, the price is the management fee (fixed fee plus performance-based fee); in the case of a lease it is the lease fee per unit of water sold; in a concession it is the water tariff; and in an asset sale it is the price paid for the company.

Forms of regulation

Being monopolies, all water utilities - public or private - need to be regulated for service quality, environmental compliance and other aspects. The awareness for the need to regulate typically increases substantially when profit-oriented private operators become involved: Monitoring the performance of both the private and the public partner, applying sanctions in case of non-compliance and dispute resolution become particularly important. The regulatory tasks depend on the form of private sector participation: Under a management contract the monitoring of the achievement of performance

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standards, on which the remuneration of the private company depends, is typically carried out by an independent consulting firm. Under a concession contract or in the case of an asset sale, tariff regulation through a regulatory agency or the government is a key regulatory function. Water concessions are frequently renegotiated, often resulting in better terms for the private company.

Impact of privatization

The evidence concerning the impact of water privatization is mixed. Often proponents and opponents of water privatization emphasize those examples, studies, methods and indicators that support their respective point of view. As with any empirical study, results are influenced by the methods used. The results also depend on the choice of the indicator used to measure impact: One common indicator is the increase in access to water supply and sewerage. Other indicators are changes in investments, water-borne diseases or indicators for service quality (e.g. continuity of supply or drinking water quality) and efficiency (e.g. water losses or labor productivity).

A study of household water expenditures in cities under private and public management in the U.S., however, concludes that "whether water systems are owned by private firms or governments may, on average, simply not matter much."

Privatization Pros:

- Water will reach more people in a more efficient manner and service quality will be improved
- For smaller cities contracting out services is more cost-effective than organizing their own departments, such as for police and fire protection.
- Cities save money which is needed for pension obligation deficits, to pay for needed city improvements including police and fire stations and create annual savings.

Privatization Cons:

- As a basic human need, water service should be a responsibility of governments. Transfer of control to a private entity that seeks to maximize profits reduces public accountability and can adversely affect the quality and equity of service.
- Water privatization can negatively impact low-income and underserved communities by unfair rate increases and poor service to these communities.
- Water privatization may lead to lower quality service and often result in higher rates. In cases where communities have tried to reclaim their water systems from private entities, poor water quality, unresponsiveness to customer complaints, and rate hikes have been the most frequent complaints.

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- Private companies don't have a stake in the community in which they operate. This can have negative effects on small communities when it results in firing city employees and hiring new staff or significantly cutting benefits to long-time employees.
- Many privatization agreements fail to include adequate public participation. In addition, many of these contracts do not include enough provisions for contract monitoring and accountability.
- Many privatization efforts ignore the impact on local ecosystems and downstream water users and may have long-term negative effects on the environment.
- Private companies, which stand to make more money for the sale of more water, may neglect the potential for water use efficiency and conservation improvements.
- Cities don't own their own destiny. They must go to the private company in order to get, for example, water mains added.
- The danger in relying on private companies for such essential needs as water, is that the private company has a stranglehold on its customers. You must have water, unlike cable television, where you can go to satellite or do without.

Sources:

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http://en.wikipedia.org/wiki/Water_privatization

<http://www.c-win.org/news/pros-cons-water-privatization.html>

Questions:

- 1. What is the strongest argument in a favor of privatization of water services?**
- 2. What is the strongest argument in opposition to privatization of water services?**
- 3. What performance and control requirements are important in privatization contracts?**
- 4. Should water be treated as an economic good and managed accordingly?**