

Wackerbauer, Johann

Article

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PRIVATISATION AND REGULATION OF WATER SUPPLY

The water industry is a “public health” industry and has been the provider of a “social good” over many decades. The widespread availability of clean and affordable water supply and sanitation services is necessary and improves the economic position of the individual and of society’s well-being. While other network industries as telecommunications, public transport or the electricity sector have been subject to extensive liberalisation and privatisation efforts in most European countries, the water supply remains the only infrastructure industry which is still predominantly publicly organized. Globally, around 95 percent of the population connected to the water supply is served by a public sector operator – for Europe, the corresponding figure is around 80 percent. Discussion on private sector participation in the water supply refers to various forms of maintenance and operation contracts on the one hand and total privatisation on the other hand. Within Europe, there are different models of private sector participation which follow different types of regulation. In any case regulation is indispensable, because like other network industries, the water supply remains a natural monopoly even if it is operated by private companies. A liberalisation of the market for water supply can take place in different ways. The concrete basic features depend on what regulations the market for drinking water is or should be subject to, and in what way and to what extent the private sector should be involved into the organisation of water supply.

In the supply of drinking water, the pipe network represents a natural monopoly but not the production of drinking water. As drinking water is provided in different qualities, this is not a homogenous commodity such as, for example, electricity. With the electricity supply the operation of the network by a monopoly can be separated from supply by competing companies. The transport of drinking water from competing providers is essentially more problematic, as this would involve a thorough mixing of various qualities. Operation of the network and production of drinking water can be separated from one another only with difficulty. The high fixed-cost component in the supply of water makes the laying of parallel networks by competing bidders unprofitable –

the classical case of a natural monopoly. This is characterised by subadditivity (i.e. a monopolist can supply the relevant market more cost-effectively than two or more companies) as well as through the irreversibility of investments (so-called “sunk costs”). With the presence of “sunk costs” free entry into and departure from the market are not possible. The relevant market is then not a contestable market in the sense of the theory of “contestable markets”. With water supply, competition takes place only for the market but not in the market, whether it be some kind of yardstick-competition between private providers simulated by the regulatory authorities or by franchise bidding for the right to temporary operation of the water supply network.

In less developed countries, especially those undergoing rapid urbanisation, a major challenge is to develop the basic infrastructure to provide water services. The developing countries’ opportunities for financing the provision of basic water services internally through water charges and government support is limited. This makes it necessary to obtain support from more developed countries in the form of foreign direct investment, capacity building and technology transfer. This means that private sector participation is a prerequisite for building up the infrastructure for water supply in developing countries, which can choose between different models for privatisation and regulation of water supply. In the EU-15, the only country where the provision of operational services in the water supply has been totally passed to the private sector is the United Kingdom, and more specifically this is only true for England and Wales. In Scotland and Northern Ireland, independent, publicly-owned companies provide the water services. Another singular case is France, where there is a mix of a few private operating companies and a large number of municipalities that have divided the regional supply areas among themselves. In other countries like Germany, Greece, Italy, the Netherlands, Portugal and Spain either the municipalities or (majority) publicly-owned companies control the water supply. In the remaining EU-15 countries, the water supply is organised by municipality companies only.

Johann Wackerbauer