

# MASTERARBEIT

Titel der Masterarbeit

„Privatization: An appropriate Form of Water  
Management?  
The Effects of Water Sector Privatization on the Basis  
of Four Examples from Selected EU Countries“

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## **Eidesstattliche Erklärung**

Ich erkläre hiermit eidesstattlich, dass ich die vorliegende Arbeit selbstständig und ohne Benutzung anderer als der angegebenen Hilfsmittel angefertigt habe. Die aus fremden Quellen direkt oder indirekt übernommenen Gedanken sind als solche kenntlich gemacht. Die Arbeit wurde bisher in gleicher oder ähnlicher Form keiner anderen Prüfungsbehörde vorgelegt und auch noch nicht veröffentlicht.

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## List of Abbreviations

ADES ... Association Démocratie Ecologie Solidarité

BOT ... Build-Operate-Transfer

BWB ... Berliner Wasserbetriebe

BWH ... Berlinwasser Holding S.C.

CDU ... Christian Democratic Union

COGESE ... Compagnie de Gestion des Eaux du Sud-Est

CSC ... Customer Service Committee

DTI ... Department of Trade and Industry

DWI ... Drinking Water Inspectorate

EA ... Environmental Agency

EEC ... European Economic Community

ERT ... European Roundtable of Industrialists

ESF ... European Service Forum

ESN ... European Service Network

EU ... European Union

EVN-AG ... Energie-Versorgung Niederösterreich Aktiengesellschaft

GATS ... General Agreement on Trade in Services

LOTIS ... Liberalisation of Trade in Services

NGO ... Non-Governmental Organization

NME ... Norrköping Environment & Energy Company



## List of Abbreviations

OFWAT ... Water Services Regulation Authority

ÖTV ... Die Gewerkschaft öffentliche Dienste, Transport und Verkehr

PPP ... Public-Private Partnership

REG ... Régie Des Eaux de Grenoble

RWA ... Regional Water Authority

RWE ... Rheinisch-Westfälisches Elektrizitätswerk

SAUR ... Société d'Aménagement Urbain et Rural

SEG ... Société des Eaux de Grenoble

SEK ... Swedish krona

SGEA ... Société Grenobloise de l'Eau et de l'Assainissement

SPD ... Social Democratic Party

Swalec ... South Wales Electricity

TNC ... Transnational Corporation

U.S. ... United States of America

WBFG ... Wasserbautenförderungsgesetz

WPD ... Western Power Distribution Ltd

WRG ... Wasserrechtsgesetz

WTO ... World Trade Organization

WWA ... Wastewater Plant Act

## 1. Introduction

There has been and still is a quite heated debate whether privatization is an appropriate form to serve the public sector – especially water supply which is recognized as a commodity good, essential for life. There might not be an answer that is straight forward to this question as pro-privatization or pro-public service advocates argument. It should not be forgotten that within our world, political, economic, environmental as well as social situations vary – which leads to the conclusion that privatization might not be inappropriate in all countries as well as regulation might not be helpful everywhere. In countries, where there is corrupt government leading to government failure, regulation of water supply leads to poor water service. Privatization would be more appropriate in this case, as regulation can be expected to be inefficient where institutions are corrupt. Nevertheless there exist circumstances, where privatization leads to a vicious circle – especially in poor countries – which make poor people even poorer. As investing in poor countries implies higher risk, a higher cost of capital is included which is passed on to the consumers in form of increased tariffs.<sup>1</sup> To sum up, there does not exist a “one-size-fits-all solution”<sup>2</sup>.

In this thesis, it will be examined if privatization is an appropriate form for water management. Moreover, the effects of water sector privatization on the basis of four countries of the European Union will be scrutinized. In Chapter 2, which deals with theory, it is first attempted to give an overview about liberalization and privatization, furthermore definitions will be given. Thereafter, factors influencing the effects of privatization will be presented and subsequently, privatization will be critically reviewed. The motives of the European Union for a liberalization and consequently privatization of water provision services will be investigated and its collaboration with the World Trade Organization (WTO) as well as its influence on the GATS (General Agreement on Trade in Services) will be presented. By taking countries of the European Union in Chapter 3 – namely England and Wales,

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<sup>1</sup> N. Prasad, 2006, Privatization Results: Private Sector Participation in Water Services After 15 Years, p. 680, 686, *Development Policy Review*

<sup>2</sup> N. Prasad, 2006, Privatization Results: Private Sector Participation in Water Services After 15 Years, p. 685, *Development Policy Review*

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France, Germany, Sweden as well as Austria – as example, successes and defeats as well as the impacts of privatization will be weighed. Finally, there will be given a conclusion – Chapter 4 – about the effects of privatization on the water sector.

## 2. Theory

In this section, the already existing literature will be analysed and critically discussed. First, definitions concerning regulation, liberalization and privatization as well as water characteristics will be provided. Furthermore, the reason for choosing privatization or regulation will be examined as well as how privatization of water supply affects society. Moreover, it will be investigated if privatization is an adequate form of water management and successes as well as defeats of privatization will be highlighted. The collaboration of the European Union with the World Trade Organization as well as its influence on the GATS will be pointed out. Finally, the dealing with water sector management within the European Union will be addressed.

### 2.1. Regulation, Liberalization and Privatization

Regulation means that the state itself takes responsibility for the provision of certain goods or services. Normally, this is the case for goods or services where there exist natural monopolies. A natural monopoly means that neither two nor more operators could produce a good or service more cost efficiently than one could do<sup>3</sup>.

If the state intervenes it is mostly by setting minimum standards for quality or providing certain rules for market transactions.<sup>4</sup>

Provision of water services by the state as well implies some challenges as for example the problem of lobbying.<sup>5</sup> Especially in states where the institutions and bureaucracy are corrupt, regulation leads to inefficient service provision with lots of people not connected to service and neglected infrastructure.<sup>6</sup>

Liberalization and privatization have to be distinguished before going further into the topic of privatization. Liberalization in general means to create or extend

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<sup>3</sup> Borrmann, Finsinger (1999), Markt und Regulierung, p. 8, 122, Verlag Vahlen

<sup>4</sup> Borrmann, Finsinger (1999), Markt und Regulierung, p. 8, Verlag Vahlen

<sup>5</sup> J. Rees (1998), Regulation and Private Participation in the Water and Sanitation Sector, p. 5, Tac Background Papers No. 1, Global Water Partnership

<sup>6</sup> N. Prasad, 2006, Privatization Results: Private Sector Participation in Water Services After 15 Years, p. 686, *Development Policy Review*

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market conditions in formerly publicly regulated industries. The aim is to create competition in order to increase efficiency and minimize costs. Liberalization often leads to privatization which means a shift of publicly operated tasks to the private sector. Having the focus on the water sector, liberalization means here to abolish regional monopolies. Consequently, the current monopolists are no longer able to decide about the form of water provision in their territory. Privatization as far as the water sector is concerned means that the tasks of water provision are overtaken by a private company.<sup>7</sup>

### 2.1.1. Forms of competition

Basically, there are two forms of competition – “*competition within the market*”<sup>8</sup> and “*competition for the market*”<sup>9</sup>. In the water sector mostly “*competition for the market*” takes place – several private companies take part in an auction and bid in order to get a temporary monopoly. There is no “*competition within the market*” then, as they bid for getting a monopoly status. Furthermore, high (sunk) costs are implied in order to build the infrastructure like for example tubes and plants – it would not be cost-efficient if two or more companies would build such an infrastructure, especially because the water sector is a natural monopoly.<sup>10</sup> Natural monopolies imply that direct competition would lead to market failure. If the infrastructure is already built by one operator – the incumbent – he is able to continuously increase his cost advantages through an increase in the capacity of service provision compared to a potential new entrant – a new competitor – so that the newcomer will be kicked out of the market or may not even be able to enter it. Consequently, the water sector can be called “non-contestable market”. This implies that it is economically not sensible to build more than one line network as

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<sup>7</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 5, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>8</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p.8, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>9</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p.8, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>10</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 6, Österreichischer Städtebund und Bundesarbeiterkammer

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neither consumers nor private companies would get any gain out of this.<sup>11</sup> According to P. Becker (2007) a third form of competition within the water sector would be “*competition around specific services*”<sup>12</sup> which is competition for separate parts of the whole production chain like for instance maintenance of the infrastructure. This form of competition is possible and does not consequently lead to market failure.<sup>13</sup>

### 2.1.2. Factors influencing the effects of privatization

Privatization is not automatically increasing efficiency if state-owned service provision proved to be inefficient. According to Rees (1998) there are some factors which have an impact on the results and effects of privatization.<sup>14</sup>

First, it has to be considered in which form privatization takes place. There are several forms from which to choose.<sup>15</sup> Privatization could take place in the form of divestiture – full or partial divestiture. Full divestiture stands for the cession of all the assets that used to be state-owned to the private sector. The private sector has then full responsibility – namely it has to do the whole capital investment, operations and maintenance as well as revenue raising. Partial divestiture means that the state transfers only part of the responsibility to the private sector. A concession would be a long-term contract committed to the private sector where the assets remain publicly owned. Another form of long-term contract would be a lease where the assets remain as well publicly owned with the difference that important capital investments are a responsibility of the government too, not of the private company. Then there is the so called BOT-model. The abbreviation stands for “Build-Operate-Transfer”. Here a contract is created for the purpose that the private company builds some specific parts of the infrastructure. The private

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<sup>11</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 12, 13, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>12</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p.8, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>13</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p.8, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>14</sup> J. Rees (1998), Regulation and Private Participation in the Water and Sanitation Sector, p. 6, Tac Background Papers No. 1, Global Water Partnership

<sup>15</sup> J. Rees (1998), Regulation and Private Participation in the Water and Sanitation Sector, p. 6, Tac Background Papers No. 1, Global Water Partnership

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company has to do the capital investment and is the owner of the asset until the transfer to the public sector takes place. There is also the possibility of creating short-term contracts as for example the management contract where the private company's only responsibilities are maintenance and doing the operations. Last but not least there is the service contract which is issued for conducting just a specific service in return for a fee.<sup>16</sup> The term Public-Private Partnership, abbreviated PPP, subsumes some of these forms of privatization, namely leasing, the BOT-model and concessions. It defines "*any contractual agreement that involves co-operation between public and private sectors in all or some aspects of the delivery of public services or provision of infrastructure*"<sup>17</sup>. This involves the transfer of a certain amount of risk from the public to the private sector.<sup>18</sup>

Second, the structure of the industry has to be examined. As already mentioned, most of the segments in the water industry are monopolistic. One way to introduce competition is to make an auction so that the private companies have to make a bid and the one with the "best" bid wins.<sup>19</sup> The auctioneer has to decide how to design the bid. If they want to ensure high quality in order to protect the consumer interests, they need to set minimum quality standards or give a higher emphasis on quality in the weighting function.<sup>20</sup>

Third, the role of the regulatory body has to be considered. The regulatory body has to interact with a lot of other stakeholders as for example political parties, labour unions, financial institutions or consumer organisations – that is to say the actual part it is taking is the result of a bargaining process.<sup>21</sup>

It has to be emphasized that private companies are very careful when it comes to regulation. They want to minimize regulatory interference. However, regulation is

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<sup>16</sup> J. Rees (1998), Regulation and Private Participation in the Water and Sanitation Sector, p. 15, Tac Background Papers No. 1, Global Water Partnership

<sup>17</sup> J. Bastin (2003), Public-Private Partnerships: A Review of International and Austrian Experience, p. 2, Studiengesellschaft für Wirtschaft und Recht, Wirtschaftsuniversität Wien

<sup>18</sup> J. Bastin (2003), Public-Private Partnerships: A Review of International and Austrian Experience, p. 1, 2, Studiengesellschaft für Wirtschaft und Recht, Wirtschaftsuniversität Wien

<sup>19</sup> J. Rees (1998), Regulation and Private Participation in the Water and Sanitation Sector, p. 21, Tac Background Papers No. 1, Global Water Partnership

<sup>20</sup> Borrmann, Finsinger (1999), Markt und Regulierung, p. 319, 320, Verlag Vahlen

<sup>21</sup> J. Rees (1998), Regulation and Private Participation in the Water and Sanitation Sector, p. 27, Tac Background Papers No. 1, Global Water Partnership

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needed in order to protect consumer and public interests. Accurately described and fixed contract terms are desirable for the regulatory body as well as for the private firms that bid in the auction. Private companies may prefer specific contract terms as they can make better predictions about the return on investment and what maximum willingness to pay for the bid. Consequently, the regulatory body might attract a greater number of bidders as specific contract terms relate to lower risk for the private companies. When it comes to long-term contracts the regulatory body has to be very careful about setting contract terms – monitoring of the actions of the private companies should not be restricted too much.<sup>22</sup>

There is the issue of duality with water as a resource – it can either be seen as a natural or as a commercial good, as a “source of life” or as a “source of profit”. The first perception indicates that water is a human right and essential for every living creature and plant. The second perception implies that water has a great potential of generating profits as it is a scarce resource without any substitutes.<sup>23</sup>

The European Union for example defines water as a “*service of general economic interest*”<sup>24</sup> and consequently gives water the character of a commodity good. It further differentiates water into “water as natural resource” and “water provision”.<sup>25</sup>

### **2.1.3. Privatization: An adequate form of water management?**

There are some characteristics of the water sector making it disadvantageous to get private sector involvement. One of the most important characteristics is that the water sector infrastructure represents a natural monopoly.<sup>26</sup> As already explained, a natural monopoly means that one operator can always provide a good or service at cheaper cost than two or more operators could do – implying economies of scale and scope.<sup>27</sup> That is to say that competition would be more

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<sup>22</sup> J. Rees (1998), Regulation and Private Participation in the Water and Sanitation Sector, p. 29, 30, Tac Background Papers No. 1, Global Water Partnership

<sup>23</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 10, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>24</sup> European Commission, accessed on 15<sup>th</sup> December 2014

<sup>25</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 11, 12, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>26</sup> J. Rees (1998), Regulation and Private Participation in the Water and Sanitation Sector, p. 8, Tac Background Papers No. 1, Global Water Partnership

<sup>27</sup> Borrmann, Finsinger (1999), Markt und Regulierung, p. 122, Verlag Vahlen



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costly than one operator producing on its own. However, competition between private firms leads to lower prices and reduces market power. As the water sector is a natural monopoly, the best option would be only one operator, though. Monopolists who do not experience any disciplining effect of potential competition do not have any incentives to lower prices or increase quality.<sup>28</sup> To make matters worse, water does not have any substitutes. Especially for parts of the population that have a low price elasticity of demand, high market power of private firms which normally leads to increased water tariffs is socially unattractive.<sup>29</sup>

Moreover, it has to be emphasized that urban development depends on water infrastructure. If private companies are operating, it has to be made sure that capital investments are not avoided – which is often the case as private companies intend to minimize their expenditures – in order to stimulate further development and innovation.<sup>30</sup>

Yet another matter is the high sunk cost in the water sector – i.e. that the plants and tubes cannot be used for other purposes and the costs for them cannot be recovered – which implies high risk and therefore higher cost of capital. According to Rees (1998) there exist five sorts of risk. First, construction risks which imply the issue of new technologies emerging when the infrastructure has already been built. Second, commercial risks like increasing competition. Third, financial risks like interest rates or if the private company operates on an international level there is the risk of varying exchange rates but there is as well a regulatory risk – changing laws and so forth – and a political risk, for example if a company operates in countries where there are dictatorships and political instability, expropriations are a daily issue. Governments try to reduce risk exposure for private companies – which help them to reduce the financial burden by making investments – by giving them exclusive rights. This increases the danger of

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<sup>28</sup> J. Rees (1998), Regulation and Private Participation in the Water and Sanitation Sector, p. 10, Tac Background Papers No. 1, Global Water Partnership

<sup>29</sup> J. Rees (1998), Regulation and Private Participation in the Water and Sanitation Sector, p. 10, Tac Background Papers No. 1, Global Water Partnership

<sup>30</sup> <sup>30</sup> J. Rees (1998), Regulation and Private Participation in the Water and Sanitation Sector, p. 11, Tac Background Papers No. 1, Global Water Partnership

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opportunistic behaviour, though, as with increased market power and less control, private companies are likely not to meet the formerly agreed requirements.<sup>31</sup>

As already highlighted, the water sector infrastructure represents a natural monopoly, so by privatizing the sector, efficiency might not increase as forecasted. Whether there is an increase in efficiency depends on several factors, namely in which form privatization takes place, the industry structure and the regulatory regime. Consequently, privatization does not entail a totally unregulated private company. Public regulation is crucial in every step of the privatization process in order to protect public interests.<sup>32</sup> The following figure will give a better overview of the characteristics, the water sector owns.

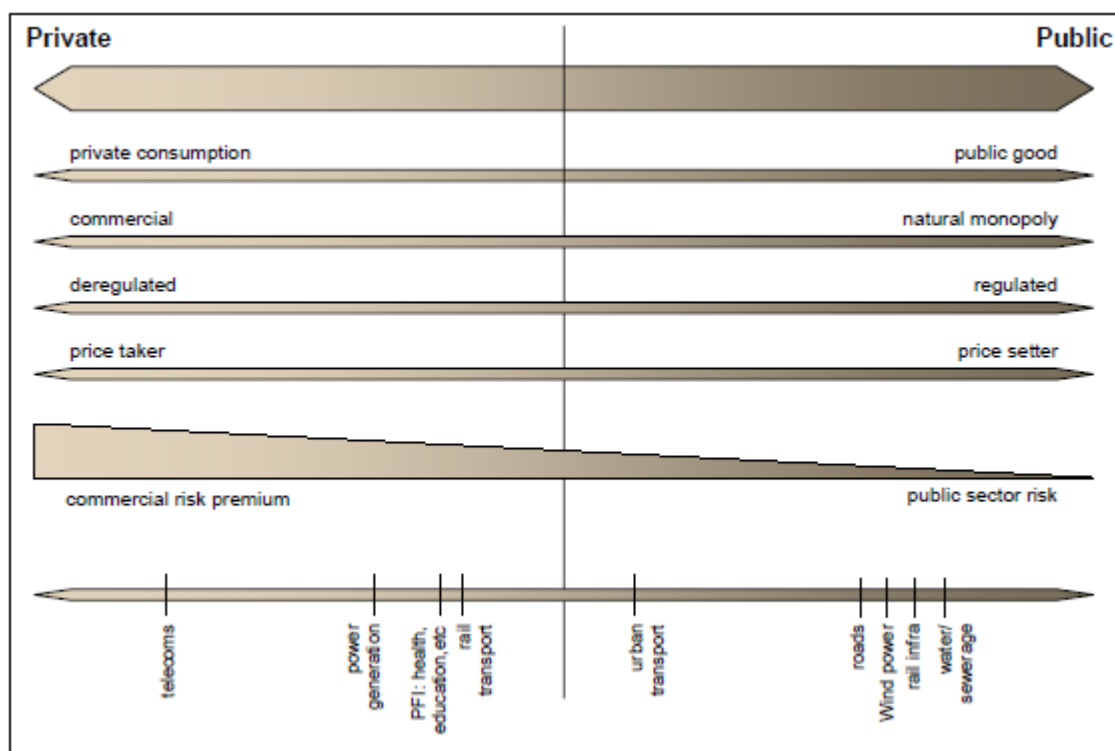


Figure 1: Characteristics of public and private sector<sup>33</sup>

<sup>31</sup> J. Rees (1998), Regulation and Private Participation in the Water and Sanitation Sector, p. 12, 13, Tac Background Papers No. 1, Global Water Partnership

<sup>32</sup> J. Rees (1998), Regulation and Private Participation in the Water and Sanitation Sector, p. 30, 31, Tac Background Papers No. 1, Global Water Partnership

<sup>33</sup> Source: J. Bastin (2003), Public-Private Partnerships: A Review of International and Austrian Experience, p. 2, Studiengesellschaft für Wirtschaft und Recht, Wirtschaftsuniversität Wien

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### 2.1.4. Privatization: Critically Reviewed

Pro-privatization advocates argue that for-profit organizations do operate more efficiently as they intend to minimize their costs. Furthermore, necessary investments can be made which the government might not be able to afford.<sup>34</sup> Experience shows that in most of the cases, this did not happen. The word *for-profit* already tells that these organizations were not built to maximize or even increase social welfare but increase profit. Profit can on the one hand be increased by reducing cost, on the other hand by increasing price. Reducing costs can often be reached by reducing quality. If it is not defined in the contract that the private for-profit organization has to improve and extend infrastructure – which is rather costly, high sunk costs in this sector should not be overlooked – it can be assumed that an improvement or extension will not happen, which can be observed in various cases. Especially in poor countries, where most of the poorest people do not have access to water supply or sanitation services, privatization which was hoped to extend service to those not having access, did not bring the desired remedy. The other issue is the rise of water tariffs – as when increasing prices, profits can be raised – which leads to even more difficulties concerning access for the poor. Often their sole possibility is then to consume unsafe drinking water, making them ill and unable to generate an income, increasing poverty even more – a vicious circle.<sup>35</sup>

Other arguments of pro-privatization advocates might be that the private sector has more incentives to focus on innovating, as when there is competition every company seeks to have its comparative advantage. Another issue is that public regulation necessarily involves a political bias in its decision as the government's aim is to be re-elected in the next term. So, higher taxes or fees that would possibly be necessary in order to maintain the required infrastructure might not be enforced out of fear to lose votes. Nevertheless, these arguments of pro-privatization advocates need to be critically reviewed especially regarding the water sector, even more as Rees (1998) provides five substantial arguments –see

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<sup>34</sup> N. Prasad, 2006, Privatization Results: Private Sector Participation in Water Services After 15 Years, p. 669, 670, *Development Policy Review*

<sup>35</sup> N. Prasad, 2006, Privatization Results: Private Sector Participation in Water Services After 15 Years, p., 672, *Development Policy Review*

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above – why regulation is indispensable in the water sector and why an unregulated water sector often leads to market failure.<sup>36</sup>

Even if contracts define precisely what measures the private company that takes over water supply has to implement, there is nowadays the so called “*sign and renegotiate*” trend which – in other words – means that originally promised actions are in the end often not taken and the contract is modified in favour of the private company afterwards.<sup>37</sup>

As already mentioned, private for-profit organizations intend to maximize their profit, they do not care about equal treatment of the rich and poor – even if social welfare increases by means of privatization, due to increased investment and so forth, this does not entail that the gain would be distributed equally among society. Interests of the private and public sector are in most of the cases different ones. The poor are often “overlooked”.<sup>38</sup> The rise in water tariffs, which often comes along with privatization of water supply, increases inequality – the poor part of the population has to dedicate a relatively larger part of their income to pay the water bill which means that an increase in water tariffs affects them much more than richer people. Water does not have any substitutes, so the demand is inelastic and people do not have any other choice than to buy it. So if prices rise, people cannot switch to a similar product. The real issue here is that every human being needs more or less the same amount of water for hygiene, drinking, cooking and so on, no matter how much income he or she has. This means one cannot really economize on water because it is a necessity – this might mean real distress for a lot of people who are not able to afford tariff increases.<sup>39</sup>

The Wall Street Journal even wrote in 2003: “*The World Bank itself must pay far greater attention to the fiery politics of privatization and especially to the effect of*

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<sup>36</sup> A. Holmqvist (2004), Restructuring of public water utilities: A case study from Norrköping in Sweden, p. 13-15, Royal Institute of Technology, Department of Land and Water Resources Engineering, Sweden

<sup>37</sup> N. Prasad, 2006, Privatization Results: Private Sector Participation in Water Services After 15 Years, p., 682, *Development Policy Review*

<sup>38</sup> N. Prasad, 2006, Privatization Results: Private Sector Participation in Water Services After 15 Years, p., 674, *Development Policy Review*

<sup>39</sup> N. Prasad, 2006, Privatization Results: Private Sector Participation in Water Services After 15 Years, p., 675, *Development Policy Review*

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*rising prices on the poor and disaffected*<sup>40</sup>. (cited from: E. Schenner (2006), p. 24)<sup>41</sup>

Another issue is that due to higher risk and higher cost of capital when engaging in poor areas, private companies often do “cherry picking”. This means that they intentionally choose those areas which assure the highest profits – which are urban areas where access already exists and most of the population can already afford the service.<sup>42</sup>

One of the aims of privatization – to provide more people with water – does not necessarily prove to be successful. As you can see in the grouped bar chart below, during the first 10 years of privatization, there is no significant relationship between privatization and higher access rates.<sup>43</sup>

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<sup>40</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 24, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>41</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 24, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>42</sup> N. Prasad, 2006, Privatization Results: Private Sector Participation in Water Services After 15 Years, p., 688, *Development Policy Review*

<sup>43</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 24, Österreichischer Städtebund und Bundesarbeiterkammer

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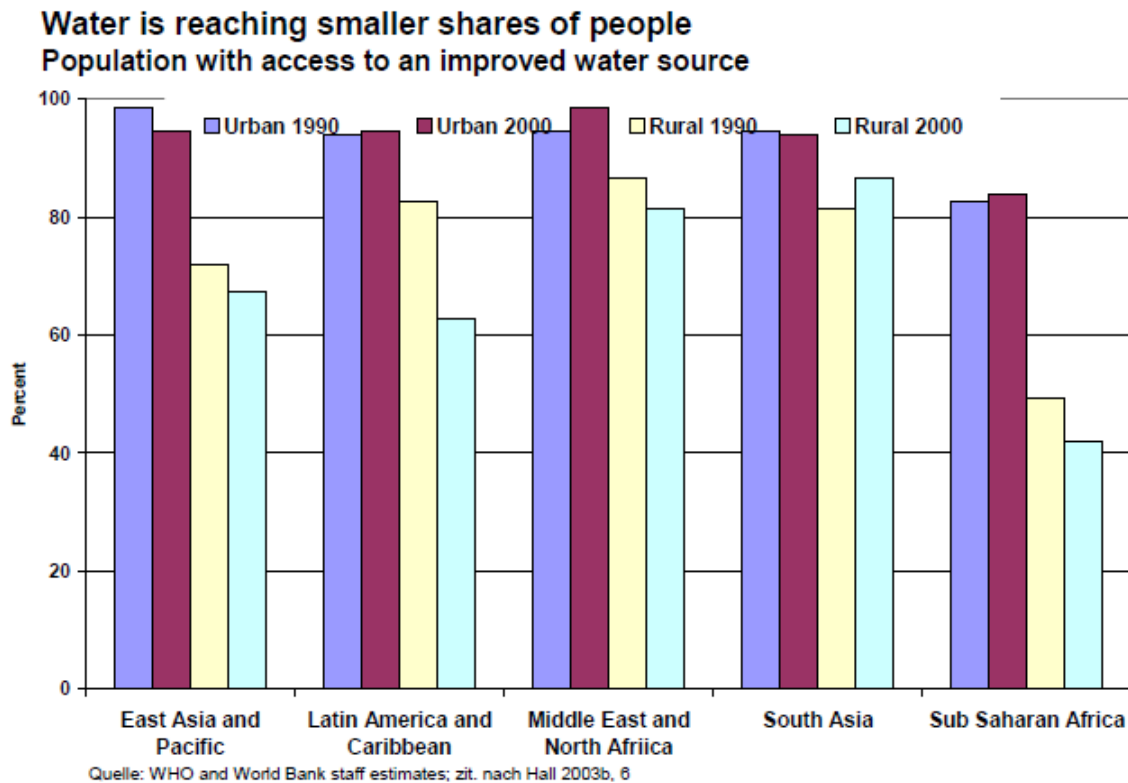


Figure 2: Change in accessibility after 10 years of privatization<sup>44</sup>

The profit-maximizing culture of private companies and the aim of the public sector to create basic water provision for the whole population is somehow contradictory – the public sector aims to increase social welfare and the private sector intends to increase its own welfare. The environmental issue that water is a scarce resource is not addressed by the private sector. It may even be worsened as an increase in consumption increases profit as well. Hall et al. (2003) have shown that privatization indeed led to price increases and a two-class system was created – private companies prefer to provide water services to people who can afford the service in order to maximize their profit. Water quality is of course a big issue as well. From the profit-maximizing behaviour of private companies it can be derived that they will do minimum investments in tube networks and will try to reduce their

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<sup>44</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 24, Österreichischer Städtebund und Bundesarbeiterkammer

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costs wherever possible. It gets even worse, if private companies are not monitored by the public sector due to lack of know-how or resources.<sup>45</sup>

There is an interesting expression, namely “*reality gap*”, stated by Prasad (2006). It describes the situation occurring in developing countries very well. Often privatization advocates do not realize the actual political, institutional, economic, social and environmental circumstances in those countries. They ignore or overlook the fact that those countries still need to develop political, institutional, economic and social stability.<sup>46</sup> It is simply not very likely to succeed by taking a certain strategy and adopt it in a totally different setting – the strategy also has to be adapted.

Prasad (2006) states “[...], *access to water is a human right and it is the government’s obligation to provide such a vital resource to everyone. This implies that the state has the capacity as well as the duty to deliver water services to everyone.*”<sup>47</sup> Unfortunately, this is not the case in every country or area of the world. There exist corrupt governments as the case may be dictatorships, greedy to put everything possible into their pocket. They do not focus on the maximization of social welfare but that of their own. When this is the case, privatization might lead to an improvement of water and sanitation service provision compared to regulation.

### **2.2. The European Union and the World Trade Organisation**

The European trade policy has crucial significance as far as the European Union’s status as diplomatic power is concerned as well as how it is perceived from the outside. One of the goals of the European Union is the abolishment of trade barriers within the member states. Liberalization of water provision services falls

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<sup>45</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 25, 26, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>46</sup> N. Prasad, 2006, Privatization Results: Private Sector Participation in Water Services After 15 Years, p., 684, *Development Policy Review*

<sup>47</sup> N. Prasad, 2006, Privatization Results: Private Sector Participation in Water Services After 15 Years, p., 670, *Development Policy Review*

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under the exclusive competence of the European Union, not the individual member states.<sup>48</sup>

Another important institution which collaborates with the European Union is the World Trade Organisation (WTO). Their goal is to liberalize international trade. It is believed that liberalization of trade will provide welfare. For the means of the water sector, it has to be focused on the GATS (General Agreement on Trade in Services).

The four most important principles of the GATS are the following:<sup>49</sup>

- **Non-discrimination:** *“With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country<sup>50</sup>.”* (GATS, Art. II, § 1)<sup>51</sup>
- **National treatment:** *“In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers.<sup>52</sup>”* (GATS, Art. XVII, § 1)<sup>53</sup>
- **Market access:** *“With respect to market access through the modes of supply identified in Article I, each Member shall accord services and service suppliers of any other Member treatment no less favourable than that*

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<sup>48</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 27, 28, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>49</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 34, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>50</sup> World Trade Organization, accessed on 25th October 2014

<sup>51</sup> World Trade Organization, accessed on 25th October 2014

<sup>52</sup> World Trade Organization, accessed on 25th October 2014

<sup>53</sup> World Trade Organization, accessed on 25th October 2014



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*provided for under the terms, limitations and conditions agreed and specified in its Schedule.*<sup>54</sup> (GATS, Art. XVI, § 1)<sup>55</sup>

- **Domestic regulation:** *“In sectors where specific commitments are undertaken, each Member shall ensure that all measures of general application affecting trade in services are administered in a reasonable, objective and impartial manner.”*<sup>56</sup> (GATS, Art. VI, § 1)<sup>57</sup>

The GATS are mainly criticised because of the fact that primary industrial nations and more specifically private companies will benefit most from the Agreement. By including water provision in the responsibility of the WTO, GATS enhances the commodification of water which is a natural resource.<sup>58</sup>

The European Union made a proposal to the WTO that the GATS-classification about environmental services should be revised and simultaneously made a reclassification offer. Because of this reclassification proposal, liberalization of water provision services according to the GATS would be made possible which once more points out the significant interest the European Union has concerning the liberalization of water provision services.<sup>59</sup>

The process of whether a proposal of the European Union would be implemented or not can be divided into three stages – namely the pre-negotiation stage, the main negotiation stage and the post-treatment stage.<sup>60</sup>

### 2.2.1. The pre-negotiation stage

The pre-negotiation stage – which took place in the year 2000 – implied the matter why the European Union had an interest in the implementation of a certain proposal, the main players involved – i.e. that had an interest in liberalization – as

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<sup>54</sup> World Trade Organization, accessed on 25th October 2014

<sup>55</sup> World Trade Organization, accessed on 25th October 2014

<sup>56</sup> World Trade Organization, accessed on 25th October 2014

<sup>57</sup> World Trade Organization, accessed on 25th October 2014

<sup>58</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 35, 36, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>59</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 42, 43, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>60</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 39, Österreichischer Städtebund und Bundesarbeiterkammer

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well as the possible consequences of an implementation – that is to say what consequences does liberalization have on municipalities.<sup>61</sup>

As the European Union is one of the leaders as far as international trade in services is concerned, it is a priority for the European Union to enhance the liberalization of international service markets. One of their top priorities is the environmental sector which implies the liberalization of water provision services. It is emphasized that this sector has such an importance because of the positive impact liberalization would have on the trade and development policy as well as its “win-win” dimension – developing or under-developed countries could benefit from liberalization by getting the necessary know-how which would lead to improvements in public health. The most important motive for liberalizing the environmental sector and consequently water provision services, though, is that the environmental sector is a “key sector” in the European Union, creating a comparative advantage. The three private companies which have the worldwide biggest market share are the two French companies Suez Ondeo and Veolia Water as well as the German company RWE.<sup>62</sup>

The main players influencing the decision-making process in the pre-negotiation stage can be further divided into formal and informal actors. The formal players are composed of the European Commission which is obviously a great advocate of liberalization and the European Council which is more conservative. Leon Brittan, a former European Commissioner for Trade and external affairs, puts it the following way: “*While the Commission strives to promote the cause of liberalisation, it can only go as far as member states allow it.*”<sup>63</sup> (cited from E. Schenner (2006), p. 44). Although, the European Council disposes of the greatest decision-making power, the European Commission has the bargaining power and control in the stage of agenda-setting. One of the factors why the European Commission has such a liberal bias is the adaptation to the neoliberal

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<sup>61</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 39, 43, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>62</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 40, 41, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>63</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 44, Österreichischer Städtebund und Bundesarbeiterkammer

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ideology. Another factor is the fact that most of the leaders are supporters of the “free market”. Last but not least, it shall be emphasized that the influence of transnational economic interests represents an important factor that leads to a liberal bias of the European Commission. The willingness of the member states to liberalize certain sectors depends on their competitive ability in those sectors and on the lobbying efforts on the national level. Especially, France, Germany and Britain were from the beginning in favour of a liberalization of the water sector as they are in possession of those companies dominating the private water market – only the two French companies Suez Ondeo and Veolia Water having a market share of 70 % worldwide. It has to be highlighted that the pre-negotiation stage was very non-transparent.<sup>64</sup>

The informal players are composed of transnational corporations (TNCs) which are pro-privatization advocates and non-governmental organizations (NGOs) which take a critical position on the enhancement of privatization. Of course, the international companies providing water services have special interest of a worldwide opening up of the water market in order to increase their scope of action as well as their significance. They had several possibilities of how to influence the process concerning the GATS Round. They were able to lobby directly by addressing the formal players as the European Commission or their national governments or they could get members in lobbying associations as for instance the “European Roundtable of Industrialists”, short ERT or the “European Service Forum”, abbreviated ESF. One of the former commissioners, Leon Britton, even assured them: *“I look forward to hearing about your objectives and priorities for the new GATS Round. You are the driving force of consultation system which we have established; my door is open for any matters of concern. And I expect that whenever the overall ESN comes to some conclusion, these will represent the views of the industry, although I will also be ready to listen to problems of individual companies.”*<sup>65</sup> <sup>66</sup>(cited from E. Schenner (2006), p. 46) This highlights to

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<sup>64</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 44, 45, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>65</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 46, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>66</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 45, 46, Österreichischer Städtebund und Bundesarbeiterkammer

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what extent the European Commission was willing to enhance and promote the liberalization of services. The NGOs though, form the critical part concerning liberalization and consequently privatization. They were afraid that the natural resource water would be commercialized and that through privatization there would be a decrease in quality of water provision services. Nevertheless, NGOs received less attention and their actions remained rather unseen for quite a while. Nowadays, as they started to strategically associate, they provoked public attention and their influence rose.<sup>67</sup>

The last issue addressed during the pre-negotiation stage was about the consequences of liberalization on municipalities. First, the market access obligation, according to GATS, Art. XVI, severely restricts the scope of action of municipalities. For instance, it would be forbidden to keep up public sector monopolies. That is to say that municipalities would be obligated to make water service provision accessible to all possible providers and would therefore not be able to decide themselves, if they prefer to undertake water provision on their own or to outsource it. The LOTIS Committee put it as follows: “*Under the GATS opening service markets to foreign providers is self evidently inconsistent with retaining public sector monopolies.*”<sup>68</sup>(LOTIS Committee, cited from E. Schenner (2006), p. 47) Moreover, it would be forbidden to favour domestic companies because of national treatment, regulated in GATS, Art. XVII. Non-discrimination, regulated in GATS, Art. II, leads to an automatic opening up of the water sector to all other countries. Some parties worry that this will lead to a broadening of liberalization of water provision. Due to domestic regulation – regulated in GATS, Art. VI – national governments are compelled to abolish any trade barriers. Requirements on quality should not restrict trade more than necessary. This raises the fear that quality standards for water provision will be seen as trade barrier.<sup>69</sup>

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<sup>67</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 45, 46, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>68</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 47, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>69</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 47-49, Österreichischer Städtebund und Bundesarbeiterkammer

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### 2.2.2. The main negotiation stage

The main negotiation stage – which was initiated in 2002 and terminated in 2003 – was about the actual negotiations, results and possible consequences of liberalization for municipalities.<sup>70</sup> The negotiations were very non-transparent, though – the public was excluded and only speculations could be made. Only much later, the third-party claims of the European Union leaked through. The European Union demanded 72 countries to open up their water sector within the GATS and to offer free market access according to the GATS, Art. XVI and national treatment according to GATS, Art. XVII.<sup>71</sup> The European Commission claimed that the national scope of action of each third country would not be restricted through the GATS. This is an obvious contradiction to the clear demand of the European Union to receive free market access and national treatment according to the GATS. It further has to be considered that most of the 72 countries, demanded to open up their water service sector, are emerging and developing countries which often have a defensive position during negotiations and less know-how, so that they are not aware of the possible harm their concession could entail.<sup>72</sup> Moreover, it should not be ignored that the European Commission and the private sector worked together quite closely. There have been information exchanges and meetings between commissioners and representatives of private companies of the water sector. As a matter of fact, the European Commission had the intention to represent the water companies' interests within the GATS as emails from representatives of the European Commission to private water companies witness: *“One of the main objectives of the EU in the new round of [GATS] negotiations is to achieve real and meaningful market access for European service providers for their exports of environmental services. Therefore, we very much appreciate your input in order to focus or negotiating efforts in the area of environmental services.”*<sup>73</sup> (cited from

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<sup>70</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 39, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>71</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 50, 51, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>72</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 54, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>73</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 56, Österreichischer Städtebund und Bundesarbeiterkammer

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E. Schenner (2006), p. 56) This email incontrovertibly depicts the actual interests of the European Commission which do not seem to be environmental or development concerns but rather the promotion of private sector companies of the European Union.<sup>74</sup> Controversially, the European Union does not open its water market to third countries. Possible reasons might be the strong resistance of NGOs informing the population of the drawbacks a liberalization of the water sector would involve or that third countries do not have such a great interest in the liberalization of the European water market as the most powerful water industry is the European one. Another reason might as well be lobbying efforts of the European private water companies eager to protect their territory. To sum up, European private water companies do have a huge interest in the opening up of third countries' water markets, but at the same time are not willing to open up their market. The former commissioner, Pascal Lamy, advocating the liberalization of third countries' water markets, highlighted in turn that for important public sector services as water, the market will not be opened to third countries in order to protect the European value system and ensure an efficient provision to the population. This dismissive attitude to the liberalization of the European water market implicates, though, that liberalization could have negative effects on populations. The European Union's argument within the GATS Round that an opening up of the water market would have positive effects on the emerging and developing countries does hence not sound credible.<sup>75</sup>

The current EU trade agreements indicate that national treatment and market access are not implemented by the European Union, at least as far as publicly-funded services as water provision are concerned. This implies that European governments have the right to prioritize European companies and even to prohibit investments of third country companies in these services. Yet, if European governments allow third country companies to invest or provide services, they are allowed to reverse their decision at all times.<sup>76</sup>

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<sup>74</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 56, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>75</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 57, 58, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>76</sup> European Commission, accessed on 7<sup>th</sup> October 2014

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### 2.2.3. The post-treatment stage

The post-treatment stage took place between 2003 and 2006. Negotiations slowed down in September 2003, when a ministerial conference took place in Cancún – actually held in order to accelerate negotiations. Only in summer 2004 there was a reopening of the negotiations through the so called “July Package”. The European Union changed some of their demands concerning the environmental sector by attenuating them. It even withdrew some of their demands concerning the less developed countries. Moreover, the European Union started to differentiate between water provision for the industrial sector and traditional public water provision. Detractors fear that due to the lack of returns in the industrial sector, the consumers of the public sector will have to pay higher tariffs in order to cross-subsidize<sup>77</sup> the industrial sector – especially affecting the poor part of the population.<sup>78</sup>

One of the possible factors, why the European Union attenuated and even withdrew some of their demands, were the meagre offers of third countries – none of those countries offered an opening up of their water provision systems. Other possible factors were the manifold protests of NGOs, trade unions and European parliamentarians against the demand of liberalization of water provision and last but not least, the retreat of important private water companies from unstable emerging and developing countries – as they are profit-oriented they search for opportunities where higher returns on investment could be achieved. This development implied that a liberalization of the European water provision systems was not very probable.<sup>79</sup>

To sum up, it can be said that the European Union was the main driving force demanding liberalization of water provision services on the WTO-level. It should be highlighted that the European Union enhances the liberalization and consequently the opening up of water provision services of third countries but in

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<sup>77</sup> Borrmann, Finsinger (1999), Markt und Regulierung, p. 138, Verlag Vahlen

<sup>78</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 59, 60, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>79</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 60, 61, Österreichischer Städtebund und Bundesarbeiterkammer

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contrast, the European Union is not willing to open the European water market to third countries. The argument of the European Union, that a liberalization of the water market – of third countries – would entail economic growth, employment as well as know-how for the European population and improved water provision for people in developing countries, sounds not very credible. It sounds even more contradictory when considering the fact that the European Union does not want to open up its water market because of negative effects that liberalization could have on such important public services. It is more likely that the lobbying of European water companies was successful, so that the European Union is willing to adjust its interests with those of the private water companies.<sup>80</sup>

### 2.3. Within the European Union

Within the European Union water provision is seen as “*public services in common interest*”<sup>81</sup>. The accessibility of this service should be ensured for all people, irrespective of their income or their social position. The aim is to ensure the satisfaction of basic needs. Moreover, water provision has a special meaning because it is connected with public health.<sup>82</sup>

Municipalization often took place due to the inefficient behaviour or the simple inability of private companies to make water provision accessible for the whole population. Hence, countries want to ensure the provision of services through public authorities in order to guarantee security and protect the basic rights of the people. Water provision as a public service constitutes a part of the European value system.<sup>83</sup>

An important EU directive, that should be highlighted concerning water provision, aiming to harmonize the water sector within the European Union, for instance water quality standards, is the EU Water Framework Directive (2000/60/EG). This

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<sup>80</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 61, 62, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>81</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 4, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>82</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 63, 64, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>83</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 63, 64, Österreichischer Städtebund und Bundesarbeiterkammer



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directive was developed in order to standardize European water management. The main goals of this directive are the protection of the environment and the scarce resource water as well as the challenging of droughts and flooding. There are some steps, member states are obligated to take, regarding the EU Water Framework Directive, most importantly the compliance with certain quality standards and the implementation of river basin management.<sup>84</sup>

The objective of the EU Drinking Water Directive (Council Directive 98/83/EC) is according to Article 1 “[...] *to protect human health from adverse effects of any contamination of water intended for human consumption by ensuring that it is wholesome and clean.*”<sup>85</sup> It contains quality standards and threshold values for microbiological and chemical parameters.<sup>86</sup>

Due to liberalization efforts of the European Commission, interests of the European Union and the member states started to clash, as some of the member states wanted to protect their public services from the private sector and thus, liberalization. The eventual agreement was kept hold of in the EEC-Treaty from 1957, which states that the European Community is generally neutral regarding the ownership structure within the EU member states. One exception, though, are public services which are of “*general economic interest*”<sup>87</sup>. Those are liable to the European competition law. It was not clear, though, which of the public services were of general economic interest. In the White Paper of the European Commission a definition was intended to be given and it implied that “*the term services of general economic interest refers to all services of economic nature and*

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<sup>84</sup> A. Holmqvist (2004), Restructuring of public water utilities: A case study from Norrköping in Sweden, p. 32, Royal Institute of Technology, Department of Land and Water Resources Engineering, Sweden

<sup>85</sup> Council Directive 98/83/EC on the quality of water intended for human consumption, (1998), Official Journal of the European Communities

<sup>86</sup> Council Directive 98/83/EC on the quality of water intended for human consumption, (1998), Official Journal of the European Communities

<sup>87</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 5, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

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*covers in particular big network services [...]*<sup>88</sup> (cited from P. Becker (2007), p. 6).<sup>89</sup>

The attitude of the European Commission was quite contradictory, though, as they stated in their Water Framework Directive from the year 2000 that water supply was a public service and a “*non-typical trading good*”<sup>90</sup>. Contrariwise, they claimed that water supply was part of the services of a general economic interest.<sup>91</sup>

The European Commission advocates for liberalization because it holds that more intense competition would lead to price decreases for consumers, higher quality of water supply and transparency. The European Parliament slowed down the liberalization attempts of the European Commission, as it was clearly opposed to a liberalization of the water sector. Also the fact that “*competition within the market*” – as already mentioned – is not adequate for the water sector, detains the European Commission from realizing their request.<sup>92</sup>

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<sup>88</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 6, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>89</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 4-6, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>90</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p.9, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>91</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p.9, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>92</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p.10, 11, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

### 3. Examples of privatization within the European Union

## 3. Examples of privatization within the European Union

In this chapter, the main focus is put on the way, different countries of the European Union handle their water provision system – if it is either privately owned or maintained by the municipalities themselves. Furthermore, the various effects of privatization or regulation will be examined.

The Single European Market projects in the 1980s led to a change of the economic policy towards neoliberalism – concerning public monopolies as well. During the 1990s, most of the member states did not have a lot of ambitions to liberalize their water provision systems. It became clear, though, that some member states followed the trend of private participation and during the 2000s, the European Union itself started to show a tendency towards the liberalization of water provision systems.<sup>93</sup>

Moreover, the European integration obliged member states to meet the deficit criteria of several treaties, as for example the Maastricht Treaty. Member states were required to reduce their public spending as well as their budget deficits. Hence, most member states agreed that partly or fully privatizing some of the public services would contribute to their reduction of budget deficits as the private sector would – from now on – have to make the necessary investments in those services. Clifton et al. (2006) state: *“Finally, privatization was not a EU policy but, paradoxically, an unintended consequence of the process of EU integration, since, though privatization is distinct from liberalization and deregulation, in practice many EU governments used privatization as a tool to facilitate and accelerate liberalization in the face of European legislation.”*<sup>94</sup> (cited from Becker, P. (2007), p. 3)<sup>95</sup>

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<sup>93</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 64, 65, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>94</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 3, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>95</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 2,3, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

### 3. Examples of privatization within the European Union

Within the European Union, it can be differentiated between different models of water policy.<sup>96</sup> Although, state owned companies still dominate the water sector within the European Union, it can be differentiated between four forms of privatization within the European Union:

- **“Full privatization<sup>97</sup>”**: This form is implemented in England and Wales and means that the whole process of water supply is undertaken by a private company.
- **“Fixed-term or functional privatization<sup>98</sup>”**: This type of privatization implies that water supply is delegated to a private company through concession for a certain period of time. France has implemented this type of privatization.<sup>99</sup>
- **“Mixed form of privatization<sup>100</sup>”**: It is a mix of functional and formal privatization where a private company participates in a municipal enterprise as it is implemented in Berlin, Germany.<sup>101</sup>
- **“Organizational or formal privatization<sup>102</sup>”**: This type of privatization can be found for instance in Austria and Sweden. It connotes that the state

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<sup>96</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 65, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>97</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p.11, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>98</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p.11, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>99</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p.11, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>100</sup> J. Wackerbauer, (2008), Public or Private Water Management: Experience from different European Countries, p. 6, IOP Conf. Series: Earth and Environmental Science 4

<sup>101</sup> J. Wackerbauer, (2008), Public or Private Water Management: Experience from different European Countries, p. 6, IOP Conf. Series: Earth and Environmental Science 4

<sup>102</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p.11, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

### 3. Examples of privatization within the European Union

keeps its responsibility of supplying water services. However, the water supplier is transformed into a company operating under private law.<sup>103</sup>

As the water markets differ substantially within the European member states, the water supply systems of five member states of the European Union will be explained in more detail.<sup>104</sup>

First, the water market of England and Wales will be scrutinized. It is especially interesting as it is the only European nation's water market which is fully privatized and this since 1989.<sup>105</sup>

Second, France's water market, where part of the water supply was first privatized during the 19<sup>th</sup> century through concessions, will be considered. Nowadays, the French water market is dominated by the three main private French water companies – namely Veolia Water, Suez Odeo and SAUR. It has to be emphasized that in contrast to England and Wales, the French water market is not fully but partially privatized<sup>106</sup>.

Third, the German water market – which is the largest within Europe – will be examined in more detail. It has to be emphasized that over 90 % of the water supply is operated by local authorities or municipalities.<sup>107</sup>

Fourth, it will be investigated how Sweden managed its water market. In the 1990s, partial privatization took place and during the 2000s even complete

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<sup>103</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p.11, 12, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>104</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 12, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>105</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 12, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>106</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 13, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>107</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 14, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

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takeovers by private water providers occurred.<sup>108</sup> The example of Norrköping will be explained in more detail.

Fifth, the Austrian water market will be presented. Interestingly, a public debate taking place during the year 2001 in Vienna even caused the prohibition of privatizing drinking water supply in Vienna. This prohibition was even included into the Viennese municipal constitution.<sup>109</sup>

#### **3.1. England and Wales**

As already mentioned, the water market in England and Wales was fully privatized in 1989 under the liberal administration of Margaret Thatcher. The complete responsibility was transferred from ten state-owned water companies – there already existed some privately-owned water companies as well<sup>110</sup> – to ten private water companies.<sup>111</sup>

##### **3.1.1. Authorities and Laws**

The national government built authorities to supervise the actions of the private companies, for instance the Office of Water Services, short OFWAT which is in charge of setting price limits.<sup>112</sup> The OFWAT used price caps and yardsticks in order to solve the problem of information asymmetry – private water providers clearly have an information advantage about their cost and demand functions they could possibly manipulate in order to get, for instance, more generous price caps.<sup>113</sup>

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<sup>108</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 16, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>109</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 16, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>110</sup> C. van den Berg (1997), Water Privatization and Regulation in England and Wales, The World Bank Group, Note No. 115

<sup>111</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 12, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>112</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 12, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>113</sup> C. van den Berg (1997), Water Privatization and Regulation in England and Wales, The World Bank Group, Note No. 115

### 3. Examples of privatization within the European Union

Price Caps represent a maximum price, companies are allowed to set, which is adapted every five years to social, political and economic circumstances. Through yardstick regulation the regulatory authority seeks to eliminate endogenous elements and to evaluate the companies' efficiencies by making the price, a company is allowed to set, subject to the costs of other comparable companies.<sup>114</sup> It has to be emphasized, though, that Price Cap regulation does involve potential weaknesses. If the price cap is set too generously, on the one hand, private water providers will possibly not operate efficiently. Hence, they will not minimize their costs. On the other hand, if the price cap is set too low, that involves the risk of underinvestment by the profit-oriented private water providers. Price Caps, as well, include the risk that cross-subsidization takes place, i.e. price discrimination by setting prices higher for some customer groups in order to be able to set lower prices for other groups of customers. This is possible because the regulatory authority imposed private water companies a price cap for the whole tariff basket and not for individual goods or services and consequently, the private water companies can choose where they set higher or lower tariffs as long as they stay beneath the price cap for the whole tariff basket.<sup>115</sup>

In addition to the OFWAT, there is the Drinking Water Inspectorate – DWI – responsible for controlling drinking water quality and the Environmental Agency, abbreviated EA, monitoring the compliance with environmental standards.<sup>116</sup> An important aim – intended to be achieved by introducing these independent authorities – was to protect the regulatory process and decision-making from political influences.<sup>117</sup> This goal was not quite achieved as politics continued to interfere in regulatory issues. The OFWAT had to reduce price caps twice during the first five-year period due to pressure from the political side. This leads to the assumption that the regulatory authority was not as stable and independent as

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<sup>114</sup> Borrmann, Finsinger (1999), Markt und Regulierung, p. 415, Verlag Vahlen

<sup>115</sup> C. van den Berg (1997), Water Privatization and Regulation in England and Wales, The World Bank Group, Note No. 115

<sup>116</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 12, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>117</sup> C. van den Berg (1997), Water Privatization and Regulation in England and Wales, The World Bank Group, Note No. 115

### 3. Examples of privatization within the European Union

desired.<sup>118</sup> Regarding consumer representation in the water sector, the Customer Service Committees, abbreviated CSCs, were established. However, this body did not have any considerable bargaining power and proved to be mostly a complaint department and not a monitoring system executed by consumers.<sup>119</sup>

#### **3.1.2. Allocation of responsibilities**

Until 1974, municipalities were mainly responsible for water and wastewater services. Until then, only 25 % of England's and Wales' residents received drinking water supply from private companies. The Water Act of 1973 greatly amended England's and Wales' water service sector. Through the implementation of the Water Act, ten Regional Water Authorities, abbreviated RWAs, were built which were responsible for operations and the assets regarding water services. It was planned that the local governments would be responsible for the RWAs by maintaining the majority on their boards. When the Water Act of 1983 came into force, the responsibility was transferred to the private sector, though, as it allowed the RWA's to take full control. Even though, the Water Act of 1983 established Consumer Consultative Committees, the private sector omitted them and the public was even excluded from RWA meetings.<sup>120</sup>

Regarding the privatization debate, there was consensus that the sector should not be torn apart – meaning that either the whole water sector should be privatized or it should be kept as it is. Even though there was opposition against privatization, it mostly did not concern the process of privatization itself, but rather the transfer of regulatory power to the private sector.<sup>121</sup>

In 1987, the re-election of the Conservative Party – which was in favour of privatizing the water sector – promoted the realization of water services privatization. In 1988, the privatization process was already coordinated by the

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<sup>118</sup> C. van den Berg (1997), Water Privatization and Regulation in England and Wales, The World Bank Group, Note No. 115

<sup>119</sup> R. de la Motte, (2005), WaterTime case studies – Cardiff, UK and Leeds, UK, p. 20, WaterTime, London

<sup>120</sup> R. de la Motte, (2005), WaterTime case studies – Cardiff, UK and Leeds, UK, p. 11, 12, WaterTime, London

<sup>121</sup> R. de la Motte, (2005), WaterTime case studies – Cardiff, UK and Leeds, UK, p. 13, 14, WaterTime, London



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government, which was eager to undertake privatization, among other things because of substantial investment needs within the water sector, it could not meet. All of the RWAs were finally floated in 1989, when full privatization was implemented.<sup>122</sup>

Even though privatization advocates' arguments were that under privatization water supply would be more efficient, more investments would be made, prices would fall and quality would increase, prices even rose by 46 % between 1989 and 1999.<sup>123</sup> As we can see in the figure below, price increases since the privatization of the water sector were quite substantial.

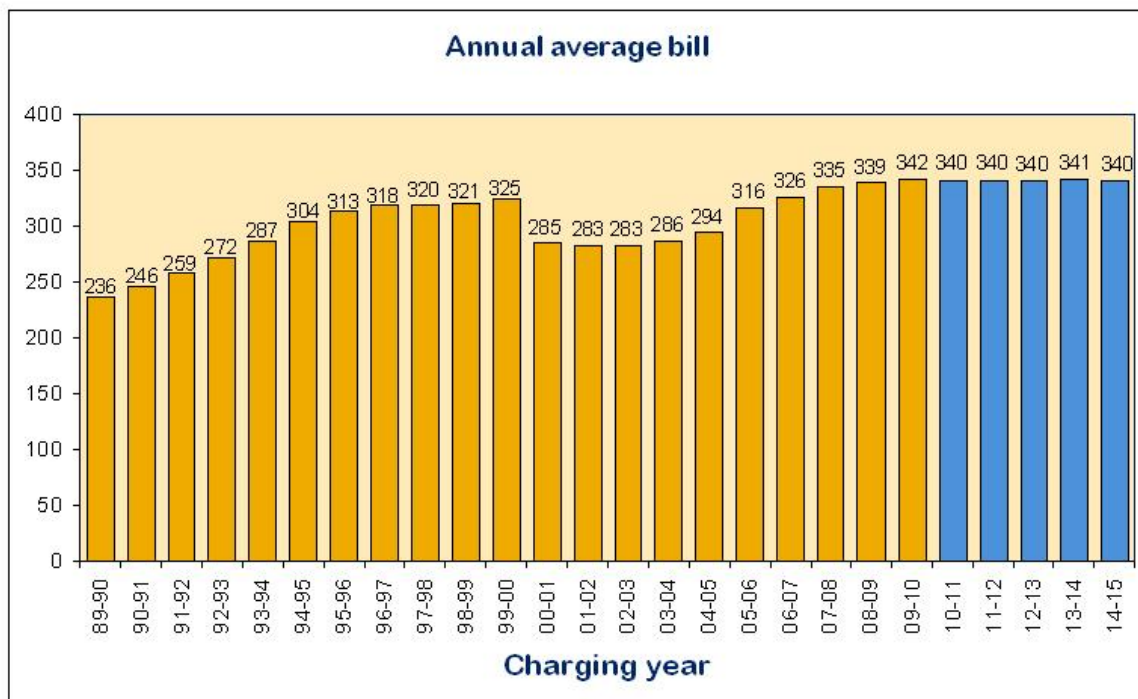


Figure 3: Changes in average household bills since privatization<sup>124</sup>

Even the operating costs increased despite the fact that work force was reduced. One of the main reasons might have been that the OFWAT set the price cap too

<sup>122</sup> R. de la Motte, (2005), WaterTime case studies – Cardiff, UK and Leeds, UK, p. 14, 15, WaterTime, London

<sup>123</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 12, 13, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>124</sup> OFWAT, accessed on 20<sup>th</sup> November 2014

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generously during the first regulatory cycle which didn't induce the private water providers sufficiently to minimize their operating costs and consequently to operate efficiently.<sup>125</sup> The OFWAT had to intervene and had to compel private companies to decrease their prices – by on average 13,7 % - by setting a tighter price cap.<sup>126</sup>

Although, high investments had been made during the first years of privatization, investments were not adequately high, as leakages rose significantly, for instance. One of the reasons was the pressure to pay “appropriate” dividends to the shareholders.<sup>127</sup> Soon, the profits were not invested in infrastructure anymore, but distributed to shareholders in form of excessive dividends and even to finance speculative diversification overseas. The distributed dividends were 11 % higher than the average distribution on the stock exchange.<sup>128</sup> Surprisingly, the managers' salaries of private water companies rose significantly but work force was reduced by about 21,5 %.<sup>129</sup>

Moreover, water quality proved to be low compared with other European member states.<sup>130</sup> It has to be feared that with profit-oriented private water suppliers, water quality will be at risk. As they intend to maximize their profits, they consequently want to minimize their costs and investing in infrastructure to improve water quality represents such costs. This leads to the conclusion that minimizing costs implies the minimization of quality which may entail negative health impacts. Even disconnections of households – which were not able to afford paying the water bill

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<sup>125</sup> C. van den Berg (1997), Water Privatization and Regulation in England and Wales, The World Bank Group, Note No. 115

<sup>126</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 12, 13, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>127</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 12, 13, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>128</sup> R. de la Motte, (2005), WaterTime case studies – Cardiff, UK and Leeds, UK, p. 18, WaterTime, London

<sup>129</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 12, 13, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>130</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 12, 13, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

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– took place, isolating people from safe drinking water, implicating negative effects on health as well.<sup>131</sup>

#### **3.1.3. An example of privatization: Cardiff**

Welsh water provided water and wastewater treatment services from 1989 on. Initially, they had severe problems to meet the European Union's standards on water quality, for instance. As the creation of multi-utilities was heavily promoted during the late 1980s, Welsh Water bought a stake of 9,95 % of South Wales Electricity, abbreviated Swalec, which it later increased to 14,9 %. This acquisition proved to be very unfavourable for Welsh Water which consequently sold its stake of Swalec in 1992. Welsh Water did not get discouraged, though, and continued diversification into other sectors. When the "golden share", owned by the government, was finally terminated, Welsh Water absorbed Swalec and created a new multi-utility company named Hyder.<sup>132</sup>

The multi-utility company Hyder was mostly financed by debt. However, Hyder became extremely successful during the 1990s and diversified into several other sectors next to water and electricity. Due to the high amount of liabilities, the interest rate that had to be paid by Hyder more than doubled during the late 1990s and a significant amount of jobs needed to be cut in order to save cost. Fees increased remarkably in comparison to industry competitors. Hyder's situation worsened when price cuts were imposed by OFWAT. Share prices, pre-tax profits and dividends distributed fell dramatically. Finally, it became clear that a takeover was necessary in order to keep Hyder alive.<sup>133</sup>

There were two parties willing to take over Hyder and neither of them wanted to give in. On one side, there was the Japanese bank Nomura International that wanted to take over Hyder and also assured that it would not change the brand name and that the headquarters would stay in Cardiff. On the opposite side, there

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<sup>131</sup> R. Fehr et al., (2003), Towards health impact assessment of drinking-water privatization – the example of waterborne carcinogens in North Rhine-Westphalia, p. 410, 412, Bulletin of the World Health Organization 2003, 81

<sup>132</sup> R. de la Motte, (2005), WaterTime case studies – Cardiff, UK and Leeds, UK, p. 25, WaterTime, London

<sup>133</sup> R. de la Motte, (2005), WaterTime case studies – Cardiff, UK and Leeds, UK, p. 26, WaterTime, London

### 3. Examples of privatization within the European Union

was the U.S.' Western Power Distribution Ltd, short WPD. They had a special interest in taking over Swalec. As they already owned the adjoining electricity distributor, they expected to generate synergies. However, it was necessary to take over Hyder as a whole and WPD was willing to do so. It has to be highlighted, though, that WPD had the intention to break up Hyder – as Hyder was much bigger than WPD altogether – and only keep Swalec. On grounds of these circumstances, Hyder had the idea to create a non-profit company, called Glas Cymru Cyfyngedig, in order to bid for the water assets in case of a break-up.<sup>134</sup>

Initially, the board of Hyder was in favour of Nomura International's offer and rejected WPD's offer due to regulatory issues concerning WPD's electricity and water bid. Nonetheless, both bids – the one of Nomura International and the one of WPD – were cleared by the Department of Trade and Industry, abbreviated DTI. It even declared that there was no merger situation regarding WPD, which previously proposed to outsource Dwr Cymru to another water services supplier, called United Utilities. It was even the case then, that Hyder's board favoured WPD's bid while initially favouring Nomura International's bid. WPD and Nomura International outbid each other until the Takeover Panel had to interfere and set up a sealed bid auction which was finally won by WPD.<sup>135</sup>

Indeed, WPD broke up Hyder and sold nearly 25 % of the associated companies within less than one year. WPD sold Dwr Cymru – concerned with water and wastewater services – to Glas Cymru Cyfyngedig, formerly created by Hyder. Glas Operation was then outsourced through contracts of 4-year-periods to other private water companies as United Utilities, Thames Water, Severn Trent and others.<sup>136</sup> In order to better understand the structure, the following figure is helpful.

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<sup>134</sup> R. de la Motte, (2005), WaterTime case studies – Cardiff, UK and Leeds, UK, p. 28, WaterTime, London

<sup>135</sup> R. de la Motte, (2005), WaterTime case studies – Cardiff, UK and Leeds, UK, p. 28, 29, WaterTime, London

<sup>136</sup> R. de la Motte, (2005), WaterTime case studies – Cardiff, UK and Leeds, UK, p. 29, 30, WaterTime, London

### 3. Examples of privatization within the European Union

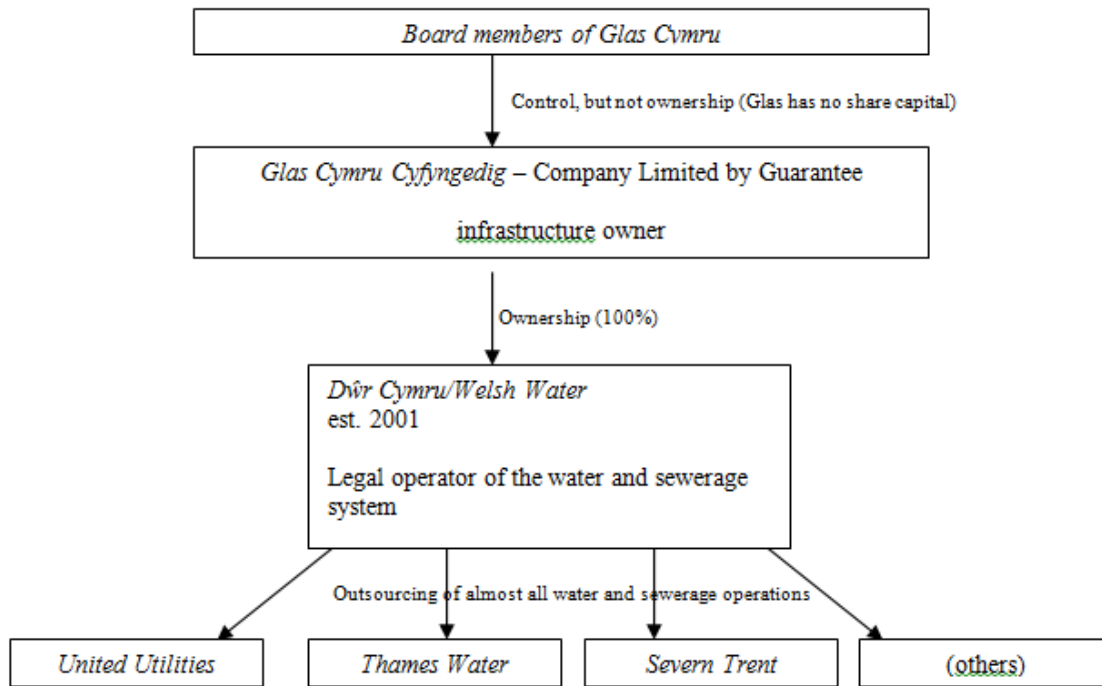


Figure 4: Ownership structure of Glas Cymru<sup>137</sup>

Finally, prices rose substantially, water quality decreased due to underinvestment, disconnections of households frequently occurred and manager's remunerations increased significantly, although jobs were cut which raises the question, if the failures of water privatization are not a driving force to take a reintroduction of public ownership into account.

#### 3.2. France

Private participation in the water sector has a long tradition in France. Grenoble will be considered in more detail, as the municipality of Grenoble basically disposed of high water quality and good infrastructure but due to investment needs and political ambitions, water supply as well as wastewater treatment, were privatized. Thus, Grenoble faced several problems concerning corruption, lack of transparency and inefficiencies.<sup>138</sup>

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<sup>137</sup> R. de la Motte, (2005), WaterTime case studies – Cardiff, UK and Leeds, UK, p. 8, WaterTime, London

<sup>138</sup> E. Lobina, (2006), Watertime case study – Grenoble, France, p. 4, WaterTime, London

### 3. Examples of privatization within the European Union

#### **3.2.1. Authorities and Laws**

In France, the state is highly involved in water policy. The Parliament sets the water's status, quality standards and is responsible for monitoring. The local representatives – e.g. the municipalities – are responsible for the water policy's administration. The “agences de l'eau” are public entities which enforce the polluter-pays principle in order to make sure that the scarce resource water is used economically among domestic and industrial users. Furthermore, the “agences de l'eau” are a financing body, there to ensure protection and purification of the resource. The water law established in 2006 had – among other things – the function of implementing the European Water Framework Directive. The competence of organizing water services is held by the municipalities while they also have the possibility to transfer this competence to inter-municipal bodies in form of co-operations.<sup>139</sup>

#### **3.2.2. Allocation of responsibilities**

In contrast to other European countries, private participation in the French water market already took place during the 19<sup>th</sup> century, due to the weak financial position of the French municipalities. It has to be recognized that in France a long tradition of private participation in the water market exists.<sup>140</sup>

Nonetheless, the French state is highly involved in water services. Responsibilities are allocated among several administrative levels. Water services are managed through decentralized partnerships between the private sector and public authorities.<sup>141</sup> Today, there are three large private French concerns operating in water supply, namely Veolia Water, Suez Ondeo and SAUR, from which 70 % of the French municipalities get their water provided. The French water market is

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<sup>139</sup> B. Barraqué et al.; (2007), Water Sector Regulation in France, p. 3, 4, CESifo DICE Report 2/2007

<sup>140</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 68, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>141</sup> B. Barraqué et al.; (2007), Water Sector Regulation in France, p. 3, CESifo DICE Report 2/2007

### 3. Examples of privatization within the European Union

therefore an oligopoly<sup>142</sup> – the number of companies is small and the volume sold by the individual companies is quite considerable<sup>143</sup>.

Contrary to the full privatization taking place in England and Wales, only certain tasks are privatized in the French water market. The municipalities keep the ownership of the networks and facilities and outsource only the day-to-day operations on a contractual basis, mainly by concessions. Prior to a reform, during the 1990s, concessions were awarded for 25 years, so a change in the water provider occurred very infrequently and there was no real competition. After the reform, though, there were some improvements and concessions were – from then on – only awarded for a period of 12 years.<sup>144</sup>

As it can be observed in Figure 4, prices charged by the private water suppliers in France were significantly and constantly higher than prices charged by local authorities. Moreover, independently whether regarding the public or private sector, prices for water consumption were steadily rising from year to year.<sup>145</sup>

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<sup>142</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 13, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>143</sup> Borrmann, Finsinger (1999), Markt und Regulierung, p. 60, Verlag Vahlen

<sup>144</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 68, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>145</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 69, Österreichischer Städtebund und Bundesarbeiterkammer

### 3. Examples of privatization within the European Union

Water bill in € for annual consumption of 120 m <sup>3</sup>	Management type	
	Public sector	Private sector
1994	227,00	271,97
1995	247,12	290,87
1996	261,60	303,83
1997	274,87	312,52
1998	281,73	320,14
1999	287,21	325,94
2000	288,59	334,78

Table 1: Difference between water bills of public and private sector<sup>146</sup>

#### 3.2.3. An example of privatization: Grenoble

Water sector privatization was strongly favoured by the Mayor of Grenoble, who was at that time Alain Carignon. When privatization of water supply and wastewater treatment took place in 1989, the municipality's water supply went along with low prices, good drinking water quality and satisfying profits for the municipality in spite of the low fees charged. There existed a lot of resistance against privatization from the public and opposition parties. Moreover, Grenoble's Mayor hid some information – crucial for the decision-making process – from the councillors. Finally, a lease contract with 25 years duration – which is an outstandingly long period for a lease contract – was assigned to the “Compagnie de Gestion des Eaux du Sud-Est”, abbreviated COGESE, a subsidiary of

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<sup>146</sup> Source: E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 68, Österreichischer Städtebund und Bundesarbeiterkammer, based on Schönback et al. 2003, p. 330



### 3. Examples of privatization within the European Union

“Lyonnaise des Eaux”, today called Suez Ondeo. The lease contract set out that the responsibility of making new investments remained with the municipality whereas COGESE was responsible for the maintenance and operation of the water infrastructure.<sup>147</sup>

Negative impacts of the privatization of Grenoble’s water supply and wastewater treatment were not long in appearing. Bribery, higher prices for consumers and low service quality were just some of the inconveniences.

The lease contract was established on the basis of bribery. In 1995, the Mayor of Grenoble, Alain Carignon and one of the executives of Lyonnaise des Eaux were even sentenced to imprisonment for several years due to corruption.<sup>148</sup>

The municipality of Grenoble and COGESE agreed upon a so called “entry fee” which COGESE had to pay to the municipality. In the end, the consumers had to pay this fee as COGESE significantly increased charges. Thus, the “entry fee” was just some kind of “hidden taxation”. The municipality’s administration gave in to fiscal incentives and continued to apply the same depreciation scheme, they used to apply before privatization was implemented, which resulted in a doubling of depreciation charges and consumers had to shoulder the burden through higher prices. Prices charged for water supply and sewage even rose by 63 % during the first five years of privatization. It has to be pointed out that price increases differed between consumers, dependent on the different areas where COGESE operated. Furthermore, the calculation of the price charges for water and sewage was quite unclear. ADES, the “Associaton Démocratie Ecologie Solidarité”, states: “*Une étude montre que si on enlève dans les tarifs les amortissements des droits d’entrée, les frais financiers abusifs, les charges exceptionnelles qui n’avaient rien à voir avec les tarifs on arrive à un juste prix*”. (cited from E. Lobina (2006), p. 11) This passage states that a study shows that if the “entry fee”, abusive financial

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<sup>147</sup> E. Lobina, (2006), Watertime case study – Grenoble, France, p. 7, WaterTime, London

<sup>148</sup> E. Lobina, (2006), Watertime case study – Grenoble, France, p. 8, WaterTime, London

### 3. Examples of privatization within the European Union

expenses and exceptional costs that do not have anything to do with water tariffs are not taken into account, one could arrive at a justifiable price.<sup>149</sup>

The prices, consumers had to pay, were not only too high but investment was also too low, so the high prices charged were even less appropriate. Underinvestment occurred, as the required renewal of water infrastructure was not undertaken and there were no new investments made, as far as buildings were concerned. Nonetheless, COGESE made excess profits and according to the “Chambre Régionale des Comptes Rhône-Alpes”, the regional audit institution, excess profits of 152,45 million Euro – to be paid by consumers – would go to COGESE during the 25 years, the lease contract as going to last.<sup>150</sup>

Another issue, privatization entailed, was the growing lack of transparency which led to the possibility for COGESE to invent costs and let their losses and consequently their budget deficit grow in order to recompense the shareholders for their capital provided to the firm, as the company did not have to take out loans in order to offset its accounts. However, the responsible authorities emphasized that distributing dividends would be the only legal way to compensate shareholders for their capital provided. Moreover, not all the receipts, generated from water services, were included in the annual reports of COGESE. Worse still, annual reports were simply unclear and inadequate for the municipality or consumers to retrace the company’s actions and monetary transactions.<sup>151</sup>

In the end, privatization created an additional burden on consumers’ financial positions. Worse still, prior to privatization, infrastructure was better maintained than during privatization, although profits generated were higher during privatization.<sup>152</sup>

In 1995, when the bribery case was discovered, re-elections took place and the Grenoble city council decided to re-negotiate with “Lyonnaise des Eaux”. ADES was in favour of terminating the contract with “Lyonnaise des Eaux” but there were

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<sup>149</sup> E. Lobina, (2006), Watertime case study – Grenoble, France, p. 9-11, WaterTime, London

<sup>150</sup> E. Lobina, (2006), Watertime case study – Grenoble, France, p. 9, 10, WaterTime, London

<sup>151</sup> E. Lobina, (2006), Watertime case study – Grenoble, France, p. 11, WaterTime, London

<sup>152</sup> E. Lobina, (2006), Watertime case study – Grenoble, France, p. 9, WaterTime, London

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some factors preventing the municipality from doing so. First, the “entry fees” would have been to be repaid to “Lyonnaise des Eaux”. Second, the judge of the arbitration tribunal would be an entrepreneur and last but not least, the annulation of the contract would subsequently lead to higher tariffs for consumers. Thus, contracts were not terminated but rather a public-private partnership was built between the council and the private company, “Lyonnaise des Eaux”. Actually, nothing changed to the privatized contracts of 1989 as COGESE – which was transformed into the “Société des Eaux de Grenoble”, abbreviated SEG, in 1996 – sub-contracted water services to a subsidiary of “Lyonnaise des Eaux”, the “Société Grenobloise de l’Eau et de l’Assainissement”, short SGEA. That is to say that operation was fully undertaken by SGEA which was entirely owned by “Lyonnaise des Eaux”. Hence, “Lyonnaise des Eaux” still had the power to insert a veto concerning decisions on how investments were made, on personnel, on agreements with the municipality and on the establishment of contracts.<sup>153</sup>

The public-private partnership turned out to be quite disadvantageous for both, the municipality and consumers. In 1996, ADES appealed against the validity of the re-negotiated contract forming the public-private partnership between the municipality and “Lyonnaise des Eaux”. In 1998, the re-negotiated contract was indeed revoked as the procedure of subcontracting services to SEG and SGEA respectively, had not been disclosed which was against French law. Even water sewage tariffs, charged to consumers during the period from 1990 to 1998 were annulled as the method of pricing proved to be illegal and excessive. According to French law, consumers should only pay for the service they receive, neither “entry fees” nor any invented costs.<sup>154</sup>

Finally, the city council of Grenoble decided to re-municipalize water supply and sewage services in the beginning of 2000. From then on, water supply was guaranteed by the entirely municipally-owned “Régie des Eaux de Grenoble”, short REG.<sup>155</sup> REG started its operations in 2001 and from then on efficiency

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<sup>153</sup> E. Lobina, (2006), Watertime case study – Grenoble, France, p. 12, WaterTime, London

<sup>154</sup> E. Lobina, (2006), Watertime case study – Grenoble, France, p. 12, 17, WaterTime, London

<sup>155</sup> E. Lobina, (2006), Watertime case study – Grenoble, France, p. 18, 19, WaterTime, London

### 3. Examples of privatization within the European Union

savings increased substantially and a clear increase in investments in water infrastructure can be observed in the figure below.<sup>156</sup>

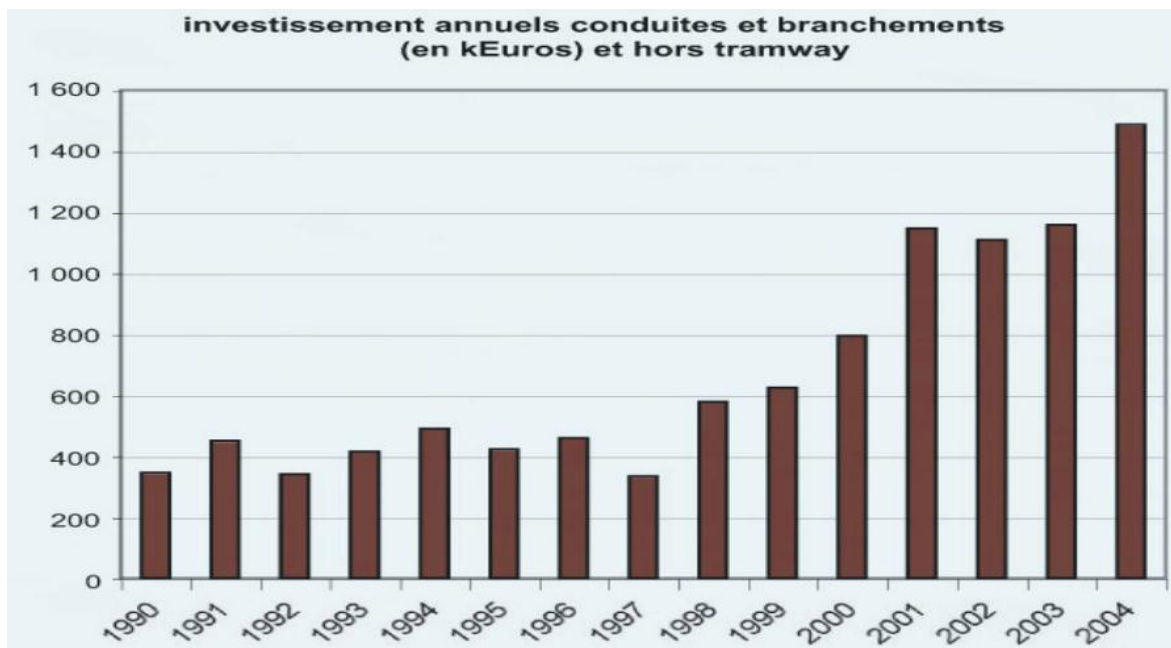


Figure 5: Evolution of water infrastructure investments<sup>157</sup>

### 3.3. Germany

Most of Germany's water supply is undertaken by its local authorities as well as municipalities. Private participation in water supply plays a minor role. However, the city of Berlin partially privatized its water supply. The reasons for and effects of this partial privatization will be analysed in this sub-chapter.

#### 3.3.1. Authorities and Laws

German environmental law requires that the communities are responsible for adequate waste water disposal. Nevertheless, the communities are allowed to form legal entities, managed under private law, which are controlled by the respective municipality – which constitutes only a formal privatization. Regulation on substantive privatization – the actual shift of public responsibilities to the private sector – is implemented in the Circulation Economy and Waste Act of 1996 and

<sup>156</sup> E. Lobina, (2006), Watertime case study – Grenoble, France, p. 22, 23, WaterTime, London

<sup>157</sup> E. Lobina, (2006), Watertime case study – Grenoble, France, p. 23, WaterTime, London

### 3. Examples of privatization within the European Union

the Alterations of the Federal Water Resources Act of 1996. This renewal of acts was necessary, as the city of Berlin considered partial privatization of its water and wastewater services. From then on, not only formal privatization was possible, where the actual responsibility was still in the hand of the public sector but also substantive privatization, that is to say a full takeover by private utility companies. Regarding privatization of water and wastewater services, the relevant regulation is incorporated in the Federal Water Resources Act of 1996. The respective Water Acts as well as Enterprise Acts implemented by the federal states have to be adapted accordingly if privatization is taken into account. There are as well various ordinances – which are legally binding for every individual and authority – to be complied with. One example is, for instance, the Drinking Water Ordinance which defines a value of threshold regarding the production of drinking water by the supplier.<sup>158</sup>

#### **3.3.2. Allocation of responsibilities**

As already mentioned, the water supply of the main part of the German nation is undertaken by local authorities or municipalities. Only 1,6 % of the German water providers are completely private. It can be highlighted that the local German water providers invest a significantly higher amount of resources in water networks and pipelines – short infrastructure – than it is the case of private water companies in other member states of the European Union. It has to be said, that also in Germany water prices rose on average by 40 % but simultaneously infrastructure as well as water quality were outstandingly high compared to other member states. Water leakages, which occurred as a result of network damages, accounted for only 7,3 % in Germany whereas water losses in England and Wales added up to 19,2 % and in France to even 26,4 %. Even though there exists a lack of comparability for prices and costs – as the settings vary substantially throughout the member states – in the water sector, the general opinion is that the rise in German water prices is adequate due to the high level of accessibility, water

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<sup>158</sup> T. Long (1999), Privatizations in the Utility Industry – Environmental Issues, International Law Office

### 3. Examples of privatization within the European Union

quality and the high quality of infrastructure.<sup>159</sup> The lack of comparability is therefore due to the different forms of water sector management, which differ in the allocation of responsibilities.

One of the reasons, why private participation in the German water market is so low, might be the fact that the market is extremely fragmented and there is no real possibility for expansion, so the incentives for private water suppliers to invest are mostly insufficient. It seemed that the German government even desired a lack of interest in the German water market by private companies as the “Bundestag” states that the supply of drinking water is a “*core public service and thus a task for local authorities*”<sup>160</sup> (cited from P. Becker (2007), p. 16). This stands in contradiction to the aim of the German government to abolish local monopolies and end with the fragmented structure of the market, which they published in their “*comprehensive modernization strategy*”<sup>161</sup> from 2006.<sup>162</sup>

#### 3.3.3. An example of privatization: Berlin

The actual reason why water supply got partially privatized in Berlin – the German capital – was not only an obvious one as for instance lacking funds. The main reasons were the neo-liberal ideology emerging during the 1980s within Europe – England and Wales being the first European country to fully privatize water supply under Margaret Thatcher – and the pressure of multi-utility companies that were seeking to expand and to find new investment opportunities.<sup>163</sup> Another main factor for partial privatization was indeed the burdened budget of the city of Berlin

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<sup>159</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 14, 15, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>160</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 16, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>161</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 15, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>162</sup> P. Becker, (2007), Privatizing Public Enterprises in the European Union – The impact of European Integration on European Water Markets, p. 15, 16, Research Unit EU Integration, German Institute for International and Security Affairs, Berlin

<sup>163</sup> H. Werle (2004), Between Public Well-being and Profit Interests, p. 5, Brot für die Welt, Berlin

### 3. Examples of privatization within the European Union

which occurred mainly due to the bankruptcy of an important municipally owned bank.<sup>164</sup>

In 1995, the Christian Democrats first brought up the topic of privatization but the majority of the Social Democrats were vehemently against privatizing public services. Only when Social Democrat Annette Fugmann-Heesing became financial administrator, she achieved a change in thinking among the majority of Social Democrats. She suggested that increased saving was required and that would be possible by selling traditionally publicly-owned services to private companies. The newspaper "Berliner Morgenpost" even wrote on the 16<sup>th</sup> of August 1997: "*She came, saw and sold.*" (cited from Werle (2004), p. 6).<sup>165</sup>

In April 1999, the Christian Democrats and the Social Democrats finally agreed upon partial privatization of water supply in Berlin. Already during the same year, 49,9 % of Berliner Wasserbetriebe's (BWB) shares were sold to the German RWE group and the French Veolia company, respectively, by creating the Berlinwasser Holding S.C. (BWH).<sup>166</sup> The remaining 50,1 % of the shares were still held by the city of Berlin.<sup>167</sup> Other political parties, as for example the Greens, were strictly against this privatization. One of the Greens, M. Schreyer, argued that the privatization of water supply would create a private monopoly, leading to a substantial increase in water prices and probably to the loss of thousands of jobs.<sup>168</sup> The privatization process was furthermore criticized – due to the fact that public participation was not possible – as not transparent. Public resistance was quite strong due to fears of investment decreases in infrastructure and water quality, increases in water fees, the loss of jobs and environmental pollution.<sup>169</sup>

Only five actors were of relevance during the partial privatization process – the relevant political parties, employees of BWB and the public services union called ÖTV, the management of BWB, the private multi-utility companies RWE and Veolia and last but not least legal as well as business consultancies. The relevant

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<sup>164</sup> K. Lanz et al. (2005), WaterTime Case study – Berlin, Germany, p. 11, WaterTime, London

<sup>165</sup> H. Werle (2004), Between Public Well-being and Profit Interests, p. 6, Brot für die Welt, Berlin

<sup>166</sup> H. Werle (2004), Between Public Well-being and Profit Interests, p. 6, 7, Brot für die Welt, Berlin

<sup>167</sup> K. Lanz et al. (2005), WaterTime Case study – Berlin, Germany, p. 5, WaterTime, London

<sup>168</sup> H. Werle (2004), Between Public Well-being and Profit Interests, p. 6, 7, Brot für die Welt, Berlin

<sup>169</sup> K. Lanz et al. (2005), WaterTime Case study – Berlin, Germany, p. 4,11, WaterTime, London

### 3. Examples of privatization within the European Union

political parties were the coalition partners of that time, namely CDU and SPD. The opposition parties never got the chance to participate in the decision-making process. The public services union (ÖTV) and the BWB employees took a very clear stand against the partial privatization of BWB. It was even intended to provide an alternative solution which was quickly rejected by the senate, though. Only the ÖTV negotiators eventually agreed to the privatization package, not to the amusement of their members and the BWB employees. BWB management, as well, was against partial privatization. Nevertheless, it could not enforce its point of view. It is not clear to what extent private companies influenced the privatization process and their actions were not visible for the public. Both private companies involved, RWE and Veolia, used lobbyists that gave advice to SPD members as well as ÖTV members before the actual privatization process started, which had severe impacts on its development. Finally, various legal and business consultancies were involved in order to incorporate contracts and laws, which made the process quite expensive.<sup>170</sup>

The effects of the partial privatization were mainly negative ones. The impacts on infrastructure investments, water quality and fees as well as the burden on consumers – Berlin’s inhabitants feared that partial privatization would have negative consequences concerning these factors – need to be highlighted.<sup>171</sup>

Infrastructure investments actually decreased substantially – by € 232 million – from the period of 1997 to 1999, when privatization was initiated, until the period of 2000 to 2002. The contracts agreed upon with the private utility companies contained minimum investment levels in order to maintain the infrastructure of the water sector. It has to be emphasized that these minimum levels were substantially lower than those BWB entertained prior to partial privatization. The question which needed to be raised here is whether it would be possible to maintain the required infrastructure. There already has been underinvestment in the infrastructure of the water sector. Thus, even leakages occurred which harmed the environment. Nevertheless, BWH’s infrastructure strategy indicates: “*Since the existing leakages in the water net play no role economically or technically, the*

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<sup>170</sup> K. Lanz et al. (2005), WaterTime Case study – Berlin, Germany, p. 7-9, WaterTime, London

<sup>171</sup> K. Lanz et al. (2005), WaterTime Case study – Berlin, Germany, p. 12, WaterTime, London



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*approach for renewal and repair is based on rupture statistics.*<sup>172</sup> (cited from K. Lanz et al. (2005), p. 12)<sup>173</sup> Obviously, this is not consistent with the precautionary principle implemented by the European Union, which says:

*“When human activities may lead to morally unacceptable harm that is scientifically plausible but uncertain, actions shall be taken to avoid or diminish that harm. Morally unacceptable harm refers to harm to humans or the environment that is*

- threatening to human life or health, or*
- serious and effectively irreversible, or*
- inequitable to present or future generations, or*
- imposed without adequate consideration of the human rights of those affected.*<sup>174</sup>”

Clearly, leakages harm the environment – sewer pipes which are leaking could lead to contaminated wastewater which in turn may pollute groundwater<sup>175</sup> – which also threatens human health due to decreasing water quality. The environmental pollution might be irreversible and affect present and future generations. Finally, the contracts, agreed upon with the private utility companies, set investment limits. That is to say, that BWH’s is not investing when it is actually required but only according to contractual requirements. As private companies want to maximize their profit and not social welfare, it can be assumed that they will not exceed minimum investment levels, set in the contract, when investing.<sup>176</sup>

The problem, concerning water quality in Berlin, is that the water exchange rate is very low, so that it comes to the issue that contaminants cannot be properly diluted. As Berlin’s drinking water is substantially influenced by the quality of surface water, it is strongly affected by wastewater, which is discharged into surface water. Consequently, the adequate treatment of wastewater is crucial for water quality – significant technology investments and a precautionary strategy

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<sup>172</sup> K. Lanz et al. (2005), WaterTime Case study – Berlin, Germany, p. 12, WaterTime, London

<sup>173</sup> K. Lanz et al. (2005), WaterTime Case study – Berlin, Germany, p. 12, WaterTime, London

<sup>174</sup> Precautionary Principle, accessed on 10<sup>th</sup> November 2014

<sup>175</sup> K. Lanz et al. (2005), WaterTime Case study – Berlin, Germany, p. 13, WaterTime, London

<sup>176</sup> K. Lanz et al. (2005), WaterTime Case study – Berlin, Germany, p. 13, WaterTime, London

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would be necessary. As already mentioned, the precautionary principle, designed by the European Union, was not followed by the management of BWH and most of the leakages which lead to contaminated wastewater were neglected. Moreover, BWH did not consider itself responsible for groundwater management. It argued that the city of Berlin would be responsible for making such investments, thus the taxpayers. To make it even worse, BWH took the investment level, agreed upon in the privatization contract, as ceiling for investment – not willing to invest more than that – which led to underinvestment and negligence of the whole water infrastructure. A further economic factor, from which water quality suffers, occurred due to the reconnection of water supply and wastewater treatment after Berlin's reunification. Even though, BWH would have the possibility to provide uncontaminated drinking water, it continued to provide drinking water from a plant which supplied drinking water that contained traces of contaminants. The reasons were – as already mentioned – economic ones. First, that plant was not yet amortized and second, BWH would lose income generated from the so called Berlin groundwater levy, paid by taxpayers. To sum up, the commercialization of the scarce resource water led to a decrease in Berlin's water quality.<sup>177</sup>

Initially, it was agreed upon in the privatization contract that BWH was not allowed to raise fees until 2004. In 2004, fees were then actually raised by 15,1 %. In contrary to what BWH argued, personnel costs decreased after privatization, still fees were raised – clearly due to the necessity of paying “adequate” dividends to shareholders. The city of Berlin even refused to its income from supplying water in order to enable the private utility companies to make their “required” profit to pay their shareholders. In the table below, it can be observed how the dividend payments in relation to BWH's operating costs increased from 1999, the starting point of partial privatization, until 2003.<sup>178</sup>

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<sup>177</sup> K. Lanz et al. (2005), WaterTime Case study – Berlin, Germany, p. 13-15, WaterTime, London

<sup>178</sup> K. Lanz et al. (2005), WaterTime Case study – Berlin, Germany, p. 15, WaterTime, London

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Year	1999	2000	2001	2002	2003
Dividend payments in relation to BWB's total operating costs	0,75 %	7,1 %	7,3 %	7,4 %	10,9 %

Table 2: Dividend Payments in relation to BWH's total operating costs<sup>179</sup>

Fees definitely rose due to privatization, which increased the burden on the taxpayers and proved the fears of Berlin's residents to be true.<sup>180</sup>

The burden on residents did not only increase because of the rising fees. Other issue were the severe job cuts, which had already been prospected by the Greens, starting just prior to privatization and continuing afterwards. Furthermore, consumers had to subsidize other subsidiaries of BWH which made losses by paying higher fees and charges, as already discussed.<sup>181</sup>

Partial privatization had negative effects on municipal finances as well. Even though the city of Berlin held 50,1 % of the shares, the distribution of profit to the private utility companies RWE and Veolia was strongly prioritized and the municipality got a negligible proportion of the profit, if any.<sup>182</sup>

Finally, it can be deduced that the aim of privatization – to reduce the budget deficit and to improve Berlin's financial situation – was not achieved. Privatization even had negative effects on Berlin's residents in terms of their financial situation as well as on water quality. As the private utility companies were prioritized regarding profit distribution, the initial payment for 49,9 % of the shares was like a drop in the bucket as far as Berlin's budget was concerned.<sup>183</sup>

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<sup>179</sup> Based on: K. Lanz et al. (2005), WaterTime Case study – Berlin, Germany, p. 15, WaterTime, London

<sup>180</sup> K. Lanz et al. (2005), WaterTime Case study – Berlin, Germany, p. 15, WaterTime, London

<sup>181</sup> K. Lanz et al. (2005), WaterTime Case study – Berlin, Germany, p. 18, WaterTime, London

<sup>182</sup> K. Lanz et al. (2005), WaterTime Case study – Berlin, Germany, p. 16, WaterTime, London

<sup>183</sup> K. Lanz et al. (2005), WaterTime Case study – Berlin, Germany, p. 19, WaterTime, London

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#### 3.5. Sweden

In Sweden, the municipalities are by law responsible for water and wastewater treatment services. Nonetheless, the number of private participation increases. One of the 290 municipalities, Norrköping, even fully privatized its supply of water services.<sup>184</sup> The effects of this privatization will be examined in detail.

##### 3.5.1 Authorities and Laws

As far as public water provision is concerned, one can divide between the central, regional and local level when talking about regulation in Sweden. On the central level, the Parliament is acting whereas on the regional level County Administrations and on the local level the municipalities lead the decision-making process. In Sweden, the 290 municipalities are responsible for providing water services.<sup>185</sup>

The Swedish municipalities have to comply with the Municipal Act (SFS 1991:900). Water provision is especially regulated in the Public Water and Wastewater Plant Act (WWA) concluded in 2006. It is furthermore regulated as foodstuff in the Food Act, in the Health Act and last but not least in the Environmental Act. As Sweden is a member of the European Union, it also has to follow the EU directives concerning water provision. Except for these regulations, the Swedish municipalities can make their decisions independently, implying the provision of public services, that is to say the provision of water as well. Each municipality is allowed to decide on its own about the amount of taxes and fees consumers have to pay, so they can differ among the Swedish municipalities.<sup>186</sup>

By law, it is forbidden that fees for water provision would exceed the costs necessary for that provision. Moreover, the amount of money generated through the fees can only be re-used within the water sector. That is to say, private

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<sup>184</sup> A. Holmqvist (2004), Restructuring of public water utilities: A case study from Norrköping in Sweden, p. 25, Royal Institute of Technology, Department of Land and Water Resources Engineering, Sweden

<sup>185</sup> O. Mattisson et al. (2010), The water sector in Sweden, p. 5, School of Economics and Management, Lund University, Sweden

<sup>186</sup> O. Mattisson et al. (2010), The water sector in Sweden, p. 6, School of Economics and Management, Lund University, Sweden

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companies taking over water provision services would not be able to pay their shareholders dividends based on profit.<sup>187</sup>

It has to be emphasized that the Swedish municipalities differ geographically as well as demographically. In the North, municipalities are only scarcely populated and it is expensive to build the necessary infrastructure for a comparatively small amount of inhabitants. This and also the factor of increasing technological and environmental challenges led to inter-municipal co-operations. The formation of such co-operations enables those municipalities to reach economies of scale, which means that they are able to generate cost advantages due to decreasing average costs.<sup>188</sup>

Another possibility, to cope with the increasing financial, environmental and technological challenges, is to put water provision services out for tender, that is to say involving private companies.<sup>189</sup>

#### **3.5.2. Allocation of responsibilities**

In Sweden, municipalities are responsible for water provision. Two exceptions form the municipality Karlskoga, which provides water in form of a public-private joint venture and Norrköping, which has even fully privatized water supply. Municipal operation regarding water provision – which still is the case in 85 % of the municipalities – takes the form of direct administration.<sup>190</sup>

There is an increasing number of municipalities operating in the form of inter-municipal or regional co-operations and limited companies – often multi-utility companies, combining some traditionally public services as water, heating or electricity. Some municipalities are even engaging into management contracts of

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<sup>187</sup> M. Lannerstad (2002), European Water Management between Regulation and Competition, Country Report Sweden, AQUALIBRIUM, Stockholm International Water Institute (SIWI), Sweden

<sup>188</sup> O. Mattisson et al. (2010), The water sector in Sweden, p. 5, 7, School of Economics and Management, Lund University, Sweden

<sup>189</sup> O. Mattisson et al. (2010), The water sector in Sweden, p. 7, School of Economics and Management, Lund University, Sweden

<sup>190</sup> A. Holmqvist (2004), Restructuring of public water utilities: A case study from Norrköping in Sweden, p. 25, Royal Institute of Technology, Department of Land and Water Resources Engineering, Sweden

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10 years as for instance the municipality Norrtälje in 2001.<sup>191</sup> Even though direct administration dominates among Swedish municipalities, they have been cooperating with the private sector, already for many years, regarding construction or consultancy.<sup>192</sup>

#### **3.5.3. An example of privatization: Norrköping**

The Swedish municipality named Norrköping was the first and until now only Swedish municipality to be fully privatized.<sup>193</sup> The Norrköping Environment & Energy Company (NME) was initially founded in 1904. In 1997, it finally became a multi-utility company that started operating in 1998, still entirely owned by the Norrköping municipality. The reason for becoming a multi-utility company – meaning that electricity, water supply, heating and waste disposal were merged into one company – was mainly the generation of synergies and thus economies of scope, in order to create cost advantages.<sup>194</sup>

During the 1990s difficulties arose, though, and the municipality of Norrköping had to face budget deficits and a lack of funds for education, elder and health care. A disputed question was whether to let a private company participate in order to raise liquidity of NME and cope with investment needs. Another challenge was that the energy market got deregulated during that time which increased competition. As NME wanted to keep its comparative advantage, it had to increase investment and know-how. NME could not expect to get financial support from the municipality

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<sup>191</sup> A. Holmqvist (2004), Restructuring of public water utilities: A case study from Norrköping in Sweden, p. 25, Royal Institute of Technology, Department of Land and Water Resources Engineering, Sweden

<sup>192</sup> A. Holmqvist (2004), Restructuring of public water utilities: A case study from Norrköping in Sweden, p. 26, Royal Institute of Technology, Department of Land and Water Resources Engineering, Sweden

<sup>193</sup> A. Holmqvist (2004), Restructuring of public water utilities: A case study from Norrköping in Sweden, p. 9, Royal Institute of Technology, Department of Land and Water Resources Engineering, Sweden

<sup>194</sup> A. Holmqvist (2004), Restructuring of public water utilities: A case study from Norrköping in Sweden, p. 35, Royal Institute of Technology, Department of Land and Water Resources Engineering, Sweden

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as the latter had to deal with budget deficits and a lack of funds for core activities.<sup>195</sup>

Possible scenarios to solve these unfavourable conditions were proposed by the Merita-Nordbanken Group, with the intention to maintain a multi-utility company:

- the maintenance of all shares within NME and the rationalization of activities
- the partial selling of activities
- the formation of a joint-venture with a minority partner<sup>196</sup>

Eventually, the Merita-Nordbanken Group advised the municipality of Norrköping to form a joint-venture with Sydkraft – which out of ten companies won the tender – that should hold a minority share of 49 %. The municipality accepted the advice and actually sold 49 % of the shares to Sydkraft, which of course supported the municipality's budget with 1.350 billion SEK. It should be emphasized that the contract gave the municipality the opportunity to sell the other 51 % of the shares during the following three years while guaranteeing a minimum selling price. Only a year after the selling of 49 % of the shares to Sydkraft, the municipality took the opportunity, specified in the contract, to sell the remaining 51 % of the shares to Sydkraft. Most of the inhabitants of Norrköping felt betrayed, as the governing politicians initially promised in their campaign not to sell any of the shares of NME. The profit made out of that sale amounted to 1.405 billion SEK.<sup>197</sup>

Sydkraft started its operation as owner of NME in 2001. One of Sydkraft's 35 subsidiaries, called Sydkraft Water, was from then on the owner of water supply services in the municipality of Norrköping. According to the WWA, the municipality was still responsible for the adequate provision of water for all

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<sup>195</sup> A. Holmqvist (2004), Restructuring of public water utilities: A case study from Norrköping in Sweden, p. 36, Royal Institute of Technology, Department of Land and Water Resources Engineering, Sweden

<sup>196</sup> A. Holmqvist (2004), Restructuring of public water utilities: A case study from Norrköping in Sweden, p. 37, Royal Institute of Technology, Department of Land and Water Resources Engineering, Sweden

<sup>197</sup> A. Holmqvist (2004), Restructuring of public water utilities: A case study from Norrköping in Sweden, p. 38, 39, Royal Institute of Technology, Department of Land and Water Resources Engineering, Sweden

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inhabitants. As Sydkraft Water was the owner of water supply services, though, it was responsible for making decisions regarding the levels of fees, charges but also investments. Sydkraft Water of course had to fulfil the requirements of the WWA. The conflict of competence was solved by determining a separation of control and operation – the municipality being responsible for controlling the activities and Sydkraft Water being responsible for operating.<sup>198</sup>

Despite some positive effects of the privatization of NME – the money earned by the sale and thus the possibility to invest in core activities as education or health care and the elimination of the conflict of competences which created incentive problems – negative effects dominated.<sup>199</sup>

One of the most obvious negative impacts, privatization of water supply entails, is the loss of control over an essential asset, necessary for life. Neither is it possible for the municipality to control the levels of fees and charges set, nor technological or environmental aspects. In other words, Sydkraft possesses the bargaining power which forces the municipality in an inferior position.<sup>200</sup>

Another issue, which needs to be highlighted, is the one of the municipality's right and responsibility to control or monitor Sydkraft's activities in water supply services. The ability to monitor the activities through a supervisor is extremely restricted and it is difficult to make valid assessments as he or she is allowed to inspect Sydkraft's activities only once every year. This course of action suggests that control is not desired in practice – for whatever reason – which does not increase confidence in the privatization activities.<sup>201</sup>

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<sup>198</sup> A. Holmqvist (2004), Restructuring of public water utilities: A case study from Norrköping in Sweden, p. 39-41, Royal Institute of Technology, Department of Land and Water Resources Engineering, Sweden

<sup>199</sup> A. Holmqvist (2004), Restructuring of public water utilities: A case study from Norrköping in Sweden, p. 45, Royal Institute of Technology, Department of Land and Water Resources Engineering, Sweden

<sup>200</sup> A. Holmqvist (2004), Restructuring of public water utilities: A case study from Norrköping in Sweden, p. 45, 46, Royal Institute of Technology, Department of Land and Water Resources Engineering, Sweden

<sup>201</sup> A. Holmqvist (2004), Restructuring of public water utilities: A case study from Norrköping in Sweden, p. 46, Royal Institute of Technology, Department of Land and Water Resources Engineering, Sweden



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A crucial factor – especially nowadays – is the fact that private companies are profit-oriented – the higher the profit and the lower the costs, the better. Hence, environmental issues and sustainability are no priorities. In the context of water supply, that is to say that higher consumption rates entail higher profits. Thus, private companies actually want consumers to consume as much as possible in order to maximize profits. They have no incentives to help reduce consumption in order to deal in a responsible way with a scarce resource, as water is one. To make it even worse, increased water consumption consequently leads to higher sewerage production, being a burden for the environment.<sup>202</sup>

Another argument against the privatization of Norrköping's water supply is the fact that the often used justification for privatization – that increased competition would lead to a decrease in prices and increased efficiency – is not valid in the case of the Swedish municipality. In fact, more than two thirds of the goods, which are needed to provide water services, were already purchased on the market under competition before Sydkraft bought 100 % of the shares from the municipality of Norrköping. Private ownership can even be seen as an obstacle for competition in this case, as Sydkraft might buy the necessary goods from its subsidiaries.<sup>203</sup>

#### 3.4. Austria

As Austria is a member of the European Union, it has to implement the relevant directives – most importantly, the Water Framework Directive and the Drinking Water Directive. On the national level, the most important act, regarding the scarce resource water, is the “Wasserrechtsgesetz” of 1959.<sup>204</sup> Even though some private-public partnerships exist, Austria mainly supplies water through the municipalities or inter-municipal co-operations.<sup>205</sup>

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<sup>202</sup> A. Holmqvist (2004), Restructuring of public water utilities: A case study from Norrköping in Sweden, p. 46, Royal Institute of Technology, Department of Land and Water Resources Engineering, Sweden

<sup>203</sup> A. Holmqvist (2004), Restructuring of public water utilities: A case study from Norrköping in Sweden, p. 47, Royal Institute of Technology, Department of Land and Water Resources Engineering, Sweden

<sup>204</sup> Bundesministerium für Land- und Forstwirtschaft, Umwelt- und Wasserwirtschaft. accessed on 1<sup>st</sup> December 2014

<sup>205</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 69, 70, Österreichischer Städtebund und Bundesarbeiterkammer

### 3. Examples of privatization within the European Union

#### 3.4.1. Authorities and Laws

The water law in Austria is based on the “Wasserrechtsgesetz” of 1959, abbreviated WRG 1959. The objectives of the WRG 1959 are mainly the use of water as well as the protection of water sources and the prevention of pollution of the latter.<sup>206</sup> Further laws implemented are the “Wasserbautenförderungsgesetz”, short WBFG, established in 1949 – which regulates for instance the agricultural use of water or flood protection – and the “Umweltförderungsgesetz”, short UFG, established in 1993. Since the adhesion to the European Union, Austria had to comply with its relevant requirements, among other things with the Water Framework Directive and the Drinking Water Directive.<sup>207</sup>

#### 3.4.2. Allocation of responsibilities

The legislative power is split between the federal government and the nine federal states, the so-called “Länder”. The “Länder” are charged with the execution of the water laws whereas the municipalities are responsible for water supply and wastewater disposal. The principle of municipal self-administration, which is in force in Austria, allows the municipalities to freely choose an organizational form. Water supply is nearly entirely operated by municipalities and inter-municipal co-operations. However, they are partly organized as companies operating under private law – meaning formal privatization. Especially municipalities with a relatively great amount of inhabitants choose the organizational form of formal privatization.<sup>208</sup>

Despite municipal self-administration two thirds of the funds, dedicated to investing, came from national and state promotion, so few incentives for cost efficiency were provided. Promotions were steadily decreasing as well as municipal budgets. That was the reason why the transformation of some public enterprises into enterprises operating under private law became necessary. There were even some heated political debates about private participation in the water

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<sup>206</sup> Bundesministerium für Land- und Forstwirtschaft, Umwelt- und Wasserwirtschaft, accessed on 1<sup>st</sup> December 2014

<sup>207</sup> Kommunalkredit Public Consulting, (2009), Report on measures to cope with over-fragmentation in the water supply and sanitation sector, p. 12, 13

<sup>208</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 69, 70, Österreichischer Städtebund und Bundesarbeiterkammer

### 3. Examples of privatization within the European Union

sector which were clearly dismissed by public resistance. Private participation is solely embodied through EVN-Wasser and Salzburg AG.<sup>209</sup>

A trend of cutting jobs in the water sector cannot be observed in Austria. Moreover, there are no disconnections of households that cannot afford to pay the water tariffs. Austrian residents are mostly satisfied with water and water provision quality and the majority is against a privatization of the water sector. Nevertheless, heated debates are held due to endorsements of liberalization and privatization by the European Union and tight municipal budgets.<sup>210</sup>

#### **3.4.3. An example of privatization**

The two private companies, participating in the Austrian water sector, only own minority shares and just a minor part of the population, namely no more than 6 % of the Austrian residents, receive water supply or wastewater treatment from those companies.<sup>211</sup> Therefore, a representative example of privatization cannot be given in the case of Austria.

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<sup>209</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 70, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>210</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 70, 71, Österreichischer Städtebund und Bundesarbeiterkammer

<sup>211</sup> Kommunalkredit Public Consulting, (2009), Report on measures to cope with over-fragmentation in the water supply and sanitation sector, p. 14

#### 4. Conclusion

### **4. Conclusion**

Water is not substitutable and moreover it is essential for sustaining life and health. This makes it scarce and extremely valuable – hence, a matter of interest for individuals as well as for groups.<sup>212</sup>

In the Western world a neoliberal ideology is ruling and politicians want to liberalize and privatize nearly everything possible, claiming that the liberalization and privatization of public services would provide welfare and have many positive effects, as for instance efficiency increases, cost and therefore price reductions, employment opportunities and even the poor would benefit as infrastructure investments would lead to an extension of the network, providing access to safe drinking water.

As the example of the European Union shows, it indeed promotes liberalization and privatization but it prefers third countries to open up their markets and break up their trade barriers, so that the European Union can expand their operations abroad. In contrast, the European Union is eager to keep up its trade barriers with regards to third countries. This behaviour clearly indicates that getting hold of water resources means power. Furthermore, it shows that it might not be that desirable to get public services privatized, especially those ones that are crucial for life, as the European Union wants to get shares in third countries but forbids third countries to get stakes within the European Union.

It can be deduced from the literature that public provision would fit best for water provision services. Namely, the water sector itself owns some characteristics that do not favour private sector involvement. These are – as mentioned in Chapter 2 – that the water sector represents a natural monopoly and that urban development substantially depends on water infrastructure – underinvestment in water infrastructure would be deteriorating for a country concerning development and innovation. In addition, the water sector is characterized by high sunk costs. Already these characteristics lead to the conclusion that cost advantages and

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<sup>212</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 117, Österreichischer Städtebund und Bundesarbeiterkammer

#### 4. Conclusion

therefore efficiency will not occur with private sector involvement. Obviously, higher fees will be charged as high sunk costs lead to higher cost of capital. In the attempt of governments to reduce risk for private companies in order to make the investment more attractive, the possibility of opportunistic behaviour by the private company increases due to less control and increased market power. Very often, a lack of transparency occurs during the privatization process after which private companies will not want to give insight into their accountancy any more. The issue here is that giving private companies increased power over a good which is indispensable to life may be very dangerous as it leads to a loss of control by regulators, which in turn may lead to corruption, abuse of power through unjustified price increases, under-investment or excessive remuneration for managers and dividends for shareholders.

The findings draw a clear picture. In countries or municipalities, where private companies operated and undertook water supply services, negative impacts obviously outweighed positive ones. All factors, privatization advocates argued to improve through privatization as efficiency, costs, prices, investment and employment actually got a lot worse. In reality, efficiency decreased whereas costs, prices and manager's remunerations increased. Moreover, underinvestment occurred leading to leakages causing water quality to decline, which in turn brought up the health issue. In case of privatization, workforce was significantly reduced and even household disconnections took place when consumers were not able to afford paying water fees. These findings are not surprising as private companies intend to maximize their profit. They consequently try to minimize their cost and as infrastructure investments and water quality represent such cost factors, infrastructure investments and quality are minimized as well. A further impact of water sector privatization is that sustainability and environmental issues are definitely no priority for private firms. There is even an incentive problem – as higher water consumption leads to higher profits, private companies will therefore promote a higher water consumption of the scarce resource.

However, one cannot generalize these findings. There is no strategy that fits everywhere as cultural, economic and political circumstances differ among the world.

#### 4. Conclusion

As water is scarce and valuable, all parties concerned are eager to get hold of it as in the 21<sup>st</sup> century not oil represents power but water does. However, shouldn't one recognize that water – indispensable to life – is a human right to which everyone should and must have access whenever and wherever possible?<sup>213</sup>

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<sup>213</sup> E. Schenner, (2006), EU und Wasserliberalisierung: Eine Analyse auf internationaler und europäischer Ebene, p. 117, 119, Österreichischer Städtebund und Bundesarbeiterkammer

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## Appendix

### German Summary

Privatisierung: eine adäquate Form des Wassermanagements? - Die Auswirkungen der Privatisierung des Wassersektors anhand von Beispielen ausgewählter EU-Länder

Die Debatte, ob ein lebensnotwendiges Gut wie Wasser privatisiert werden soll, besteht bereits seit Jahrzehnten und ist auch heute noch ein hitziges Diskussionsthema. Immer wieder gibt es Bürgerproteste gegen die Privatisierung der Wasserversorgung. Die Europäische Union sowie viele Politiker, vor allem jene mit neoliberalistischer Sichtweise, drängen jedoch auf eine Privatisierung des Wassersektors. Es ist hervorzuheben, dass die Europäische Union zwar die Handelsbarrieren von Drittländern fallen sehen will, ihre eigenen jedoch unbedingt erhalten möchte, um mögliche negative Auswirkungen durch eine Privatisierung der Wasserversorgung zu vermeiden. Dies ist vor allem dahingehend widersprüchlich, da die Europäische Union versucht, Drittländer mit dem Argument zu überzeugen ihre Handelsbarrieren abzubauen, dass eine Privatisierung der Wasserversorgung Wirtschaftswachstum und neue Arbeitsplätze schaffen, Know-how bringen und den Zugang zur Infrastruktur in Entwicklungsländern erheblich verbessern würden.

Mithilfe der bereits vorliegenden Theorie wird die Frage, ob eine Privatisierung der Wasserversorgung eine adäquate Form des Wassermanagements darstellt, beantwortet. Die Literatur zeigt, dass dies nicht der Fall ist, allein schon aufgrund der Charakteristika, die der Wassersektor aufweist. Zuerst stellt der Wassersektor ein natürliches Monopol dar. Dies bedeutet, dass ein Versorger ein Gut oder eine Dienstleistung immer zu geringeren Kosten produzieren könnte als zwei oder mehrere dies könnten. Ein weiterer Punkt ist der, dass die Stadtentwicklung wesentlich von der Entwicklung der Infrastruktur des Wassersektors abhängt und man damit rechnen muss, dass profitorientierte Unternehmen ihre Kosten und somit auch Infrastrukturinvestitionen so niedrig wie möglich halten wollen und werden. Zu geringe Investitionen in die Wasserinfrastruktur können negative Auswirkungen auf Entwicklung und

Innovation haben. Nicht zuletzt birgt der Wassersektor zusätzlich hohe versunkene Kosten. Dies bedeutet ein hohes Risiko für private Unternehmen und daher sind damit auch höhere Kapitalkosten verbunden. Um das Risiko zu senken, bieten manche Staaten privaten Unternehmen spezielle Vorteile, die zu mehr Marktmacht und weniger Kontrolle führen. Dies ist nicht wünschenswert, da anzunehmen ist, dass opportunistisches Verhalten seitens der privaten Unternehmen auftreten wird und im Vorhinein vereinbarte Verträge nicht eingehalten werden.

Anhand von vier EU-Ländern – nämlich England und Wales, in denen seit 1989 die Wasserversorgung voll privatisiert ist, Frankreich, in welchem eine Teilprivatisierung mit Konzessionsvergabe implementiert wurde oder Deutschland und Schweden, in denen vereinzelt Gemeinden vollprivatisiert wurden oder es eine Beteiligung von Privaten (Public-Private Partnerships) gibt – werden die Effekte einer Privatisierung der Wasserversorgung untersucht. Die Resultate zeigen ein klares Bild. Die negativen Effekte überwiegen eindeutig die positiven Effekte der Privatisierung der Wasserversorgung. Alle Beispiele anhand der EU-Länder zeigen, dass die Effizienz drastisch gesunken ist, Kosten und Preise dafür jedoch deutlich gestiegen sind. Es ist zu chronischen Unterinvestitionen gekommen, die unter anderem zu Lecks geführt und damit das Grundwasser verseucht und die Trinkwasserqualität verschlechtert haben. Dies zieht dann häufig Gesundheitsprobleme nach sich. Arbeitsplätze werden oftmals deutlich wegrationalisiert und auch Ausschlüsse vom Netz sind keine Seltenheit, wenn Haushalte ihre Wasserrechnung nicht bezahlen können. Des Weiteren ist nicht anzunehmen, dass für private Unternehmen Umwelt und Nachhaltigkeit eine übergeordnete Rolle spielen, unter anderem aufgrund von Anreizproblemen. Da höherer Konsum auch einen höheren Profit nach sich zieht, befürworten private Unternehmen einen höheren Wasserkonsum durch die Konsumenten.

Die Ergebnisse sind nicht verwunderlich, wenn man bedenkt, dass private Unternehmen ihre Gewinne zu maximieren versuchen und daher ihre Kosten so niedrig wie möglich halten wollen. Da Qualität und Investitionen Kostenfaktoren darstellen, werden diese folglich minimiert.

## Appendix

Schlussendlich lässt sich ableiten, dass eine Privatisierung der Wasserversorgung schon aufgrund der Charakteristika des Wassersektors nicht wünschenswert ist. Darüber hinaus zeigen die Praxisbeispiele, dass Privatisierung tatsächlich keine adäquate Form für das Wassermanagement darstellt, da die negativen Effekte klar überwiegen.

### **English Summary**

The debate, whether a resource as water – indispensable to life – should be privatized, is rather heated and long-lasting. Public opposition against the privatization of the water provision system is persistent. The European Union and politicians with a neoliberal bias promote such a privatization, though. It has to be emphasized that the European Union promotes the abolishment of trade barriers of third countries but does not want to open-up its own market because of possible negative impacts, privatization of the water provision system could entail. This is contradictory, as the European Union intends to convince third countries to open-up their markets with the argument that privatization would stimulate economic growth, provide new job opportunities as well as know-how and better access to infrastructure for developing countries.

On the basis of the available literature, the question, if privatization is an appropriate form of water management, will be answered. From the literature, it can be deduced that privatization is not an adequate form of water management, already due to the characteristics of the water sector. The water sector represents a natural monopoly which means that one operator can always produce a good or service at cheaper cost than two or more operators could do so. Moreover, the urban development depends significantly on the development of water infrastructure. Underinvestment, which often occurs under privatization, would have negative impacts on development and innovation. Furthermore, the water sector is characterized by high sunk costs. This entails high risk for the private companies and therefore higher costs of capital which are often passed on to consumers in the form of higher water tariffs. Private companies may obtain certain advantages from governments in order to make the investment more attractive. This often entails more market power for the private company and less control by the government. The lack of transparency leads to opportunistic behaviour by the private company and the possibility that private companies won't comply with former agreements rises as well.

Using representative examples of privatization from countries of the European Union – namely England and Wales, France, Germany, Sweden and Austria – the effects of water sector privatization were examined. The results show that negative

## Appendix

effects clearly outweigh the positive ones. Efficiency tended to decrease significantly in all of the state governments or municipalities, where privatization was implemented. Costs and water tariffs rose remarkably. Underinvestment occurred which led to leakages and subsequently to a contamination of groundwater, worsening water quality, having severe health impacts. Work staff was reduced and managers' salaries were increased. Disconnections of households, that could not afford to pay the water bill, were undertaken. Furthermore, the environment and sustainability are not a main concern for private companies, among other things due to incentive problems. As higher consumption leads to higher profits, private companies promote higher consumption of water by consumers.

These findings are not surprising, if one takes into account that private companies intend to maximize their profits and try to keep their costs as low as possible. Quality and investment represent cost factors, subsequently those factors are minimized.

Finally, it can be deduced that privatization of water supply is not appropriate – already due to the characteristics of the water sector. Moreover, the examples of privatization within the European Union show that, indeed, privatization is not an adequate form of water management as the negative effects prevail.

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