THE WALL STREET JOURNAL.
WSJ.com

October 8, 2012

Are We Better Off Privatizing Water?

Associated Press

More and more communities have shifted control of public water utilities to private companies in recent decades. A combination of forces is at work: shrinking public revenue, looming costs for long-overdue capital improvements, and a widening perception that private operators run systems more efficiently.

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Most Americans still get their household water from a public-owned-and-operated service. But nearly 73 million people now are served with help from a private company, according to a 2011 report by the National Association of Water Companies.

From the consumer's perspective, privatization's results have been mixed. In some cases, cities have retaken control of their water services. And not every private provider has delivered on promises of reduced rates. But to governments strapped for cash, the option is seen as increasingly attractive.

Here, two policy experts exchange views on what is best for our communities. Richard G. Little is a senior fellow at the Sol Price School of Public Policy at the University of Southern California. Wenonah Hauter is the executive director of Food and Water Watch, an advocacy group for food and water quality.

Yes: We Need the Investment

By Richard G. Little

Our nation's aging drinking-water systems will require staggering amounts of investment in the coming decades—as much as $1 trillion over the next 25 years, the American Water Works Association estimates.

USC Price School of Public Policy

Richard G. Little

As things stand now, this burden will fall mostly on the public water utilities that serve about 80% of the U.S. population.

But these bodies don't have the money to pay such bills. Many of them already have put off necessary improvements for years due to insufficient public funding. And there is little chance of meaningful federal aid, given the national focus on debt reduction.

The root of the problem is the artificially low rates the public utilities have charged for years. These rates, kept low for political purposes, don't come close to supporting the long-range capital investment we would expect of any well-run business. Indeed, given the enormous backlog of investment needed, perhaps a little "gold-plating," as my opponent calls it, is long overdue.

Rates With a Purpose

Broadly speaking, a privatized utility can be expected to charge rates that not only cover costs but also encourage investment, innovation and technological advancement. With privatized water, there is a new emphasis on fiscal responsibility—and measurable efficiency gains. This has been documented repeatedly in credible studies by objective academic researchers using real-world data.

The Wall Street Journal

Is privatization the solution in every case? Of course not. We must strive to find what works best for the customers in a specific situation. Mismanagement is not a problem limited to private operators, just as good management is not intrinsic to public systems.

But private management can be successful much more often than its critics would like to believe. Private-sector managers focus on the cost of service and return on capital. The new and innovative technologies in which they invest may have a higher initial cost, but they offer savings, too, which can be shared with customers while improving service and quality. Privatization offers economies of scale wherein a single company can provide the financial and human resources to serve many small systems in a far more cost-effective manner.

Government-owned enterprises, by contrast, often don't have rate structures that reflect the true cost of the service. Thus many small publicly owned water utilities lack the means not only to make capital investments but also to hire the professional staff needed to meet increasingly stringent water-quality standards.

Critics say private enterprise's desire for profits leads directly to overcharging (particularly of the poor), deterioration of service, and a loss of public input and transparency. In practice, however, this is not the case.

Years of Neglect

While it is true that rates often tend to rise following a privatization or the execution of a concession agreement, this is more often because the new operator must finally address decades of disinvestment. If the public operator had focused on efficiency and long-term financial responsibility as much as it focused on social and political goals, in most cases the rates likely would have risen already to much the same level.

The public interest is not well-served by keeping prices so low for everyone, including those who can well afford to pay, if it means there is insufficient revenue to support routine maintenance and renovation. On the contrary, a good system, public or private, keeps rates low for essential needs and increases consumption charges rapidly to discourage excessive use. The idea of asking commercial and industrial users to subsidize residential usage—as some privatization opponents suggest—only encourages wasteful practices such as watering expansive lawns, which disproportionately benefits the more affluent, not the poor.

Similarly, establishing a federal trust fund to maintain public water systems would leave communities with little incentive to pursue best practices for capital investment or financially sustainable rate structures. In essence it would penalize customers of well-run systems, public or private, and reward those of poorly managed ones—requiring federal assistance for whatever the local body chooses not to pay for.

Ultimately, the best water provider is the one that is best able to deliver safe, reliable and accessible service. If the provider can also make a profit, that should be of less concern than its ability to deliver safe and affordable drinking water.

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No: The Public Won't Be Served

By Wenonah Hauter

Privatization is not the solution for deteriorating public water systems already feeling the double-pinch of dwindling local and federal funds.

Private water providers are businesses. They are motivated mainly by their bottom line. The pressure to deliver high rates of return for shareholders drives them to cut corners when they are operating under contracts, and to drive up costs when they are operating as regulated utilities. The latter is a well-established phenomenon known as the Averch-Johnson Effect,

Food & Water Watch

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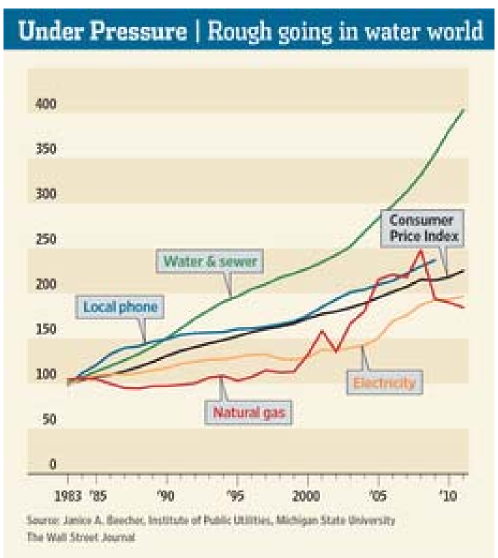

named for the economists who first modeled it in the 1960s. Under rate-of-return regulation, investor-owned water utilities make more money when they invest in infrastructure, giving them an incentive to "gold plate" systems. Yes, they are investing in improvements. But they may build an unnecessarily large treatment plant or choose a more capital-intensive treatment process, such as desalination.

Private companies that operate water systems have appalling track records of rate increases, poor system maintenance, faulty billing practices and other failures, sometimes even jeopardizing the health and safety of local residents.

Pulling Back

Some municipalities have taken their water systems back from private water providers. Indeed, some are realizing what cities like New York, Baltimore and Boston realized a century ago—that water is best controlled by an entity that is accountable to the public, not outside shareholders.

Water service isn't a business enterprise; it's a basic human right, and what privatization proponents refer to as "political pressure" is actually our democratic processes at work. Our elected leaders should absolutely respond to public concern about the affordability of their water service. The provision of water service is a natural monopoly, and the public can exercise choice only at the ballot box through the election of the officials who oversee the service. How government-run utilities decide to allocate costs among different users is a local decision that should be made in an open and democratic manner.

Those who advocate privatization say it's not in the public interest to keep rates low for everyone, thus hurting a system's ability to afford capital improvements. But it can be administratively cumbersome to design rates in an equitable way that charges higher-income households more while ensuring that water service is affordable for low-income households. It is especially difficult in dense urban areas where outdoor water use is minimal and lower-income households tend to use more water because of their older homes and larger household sizes.

Too Big

But while customers can and should provide some portion of the funding for water systems, it isn't possible for them to fully fund large capital-intensive infrastructure projects. Full cost pricing would disproportionately burden low-income households, possibly making water service unaffordable for many families.

Rather than privatizing water systems or asking household users to pay more, why not ask commercial and industrial water users to pay more for the services they profit from? We should also ask the federal government to establish a dedicated source of federal funding in the form of a clean-water trust fund, similar to the program that provides funding for highways. This would provide a guaranteed source of funding for replacing and maintaining public infrastructure systems, thereby alleviating communities of the burden of having to finance improvement projects on their own.

When it comes to efficiently and affordably providing water to our communities, public control trumps private profits.

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