IN THE US WATER INDUSTRY, YOU WADE INTO THE DEBATE OVER PRIVATIZATION AND "OUTSOURCING" AT YOUR OWN PERIL.

There are many contentious issues in the water market, but none is as divisive and polarizing as the debate over the appropriate role of private capital and the private sector in the provision of drinking water. In one corner, there are those who propose that the water industry would be better off if it were entirely privatized, whereas their opponents fervently argue that there should be no role whatsoever for private industry in water.

Some people argue that water should simply be viewed as a basic human right, often with the implication that clean water should somehow be equally and freely available to all. Others suggest that water should be viewed as a commodity—just like wheat, copper, or oil—and allow natural market forces to set its price and more efficiently govern its allocation. Unfortunately, the participants in this debate usually talk past one another and fail to move the discussion forward; indeed, such forums often serve as little more than soapboxes for airing the same old arguments between the advocates and opponents of privatization.

These aren’t simple issues—indeed, they are quite complex—and there is plenty of room for reasonable people to disagree. There is a very serious and imminent water problem on this planet, and there is a desperate need for those in the business of providing clean water to create a balance between these opposing viewpoints. More people need to recognize that the truth behind these rigidly held black-and-white arguments usually lies somewhere in the middle. Everyone is this industry needs to be more open-minded, to more carefully examine alternatives, and to work toward a more effective balance between these extreme points of view. It is time to move beyond the rhetoric that fruitlessly occupies both of the extreme ends of this spectrum.

THE ARGUMENT FOR PRIVATIZATION

In some situations, privatization or outsourcing may represent the best alternative for solving a complex water challenge—and the fact is, there are a number of fundamental economic drivers that strongly support greater privatization in the water industry. Few municipalities enjoy overflowing coffers, and few public officials who wish to be re-elected want large user fees or tax increases on their watch. Most public works managers are caught between a rock and a hard place—technical requirements, regulatory complexities, and overall utility costs continue to increase, but the general public remains resistant to increasing taxes or users fees.

Sometimes one solution to a local water supply challenge may be to turn to a private company and/or private capital to finance, build, and operate the water or wastewater system under a long-term contract instead of putting the burden entirely on the public. This can mean
turning over the day-to-day management of utility operations to a private company, or, in some cases, it can mean actually selling the water treatment and distribution infrastructure from the municipality to a private company.

One aspect of such a transaction that seems not to be widely recognized, particularly by privatization opponents, is that the private company has essentially no control over water pricing and rate-setting. A private operator generally has no control of or influence over water pricing; that remains the responsibility of the city council or other governing entity to which the private firm is simply a contractor. When a private utility owner sets prices, it does so in accordance with strict oversight and regulatory control from the state public utility commission.

In the United States, about 12% of the population receives its water from private organizations of one sort or another—publicly owned systems that are either operated by private contractors or systems that are actually owned by private companies. The comparable figure for wastewater services is much smaller.

In many parts of the world, the private operation of drinking water systems is the norm. The French, and more recently the British, are the world’s major players in terms of private water management and operation. Privatization and contract water operations are significant and growing in many other parts of the world. Global Water Intelligence reports that more than 45% of the population of Western Europe is now served by private operators, with rapid growth occurring in the Mediterranean and North African regions.

Thus it seems quite ironic that in the United States, which many consider the home of free enterprise and the bastion of democratic capitalism, there is seemingly a cultural aversion to private water systems. In European countries such as France and Germany (which many Americans tend to think of as marginally socialist), private water systems are common and widely accepted. Indeed, a recent European report accuses the United States of maintaining a “bunker mentality” in terms of being very close-minded to privatization and the possible solutions it could bring to a variety of water infrastructure problems.

**THE ARGUMENT AGAINST PRIVATIZATION**

There are, of course, plenty of well-known examples where privatization and outsourcing have not worked very well and where this approach was probably not the right answer. The unsuccessful attempt by the city of Atlanta, Ga., to privatize its water system is perhaps the most notable example. Privatization of the British drinking water infrastructure by the conservative Thatcher government in 1989 was initially widely opposed, and privatization of drinking water systems in certain cities in South America led to widespread protests—there were even riots in the streets—when prices were raised above the local population’s ability to pay.

The basic arguments against privatization of water assets generally revolve around concerns about the perceived motives of private, for-profit firms, and the belief that access to clean water should be equitably priced and provided to all. Most people understandably believe that water resources are a critical part of our natural heritage, and some have the philosophical sense that public water supply and wastewater treatment systems should never be entrusted to private companies to own or manage. There is a concern that private corporations will have little economic incentive to provide equitable access to water and that they will act only in their own very short-term interest.

Furthermore, people worry that private operators will overwhelm or control the agencies that they contract to or that private owners will somehow be able to influence the regulators who must oversee and approve their operations. Given the isolationist attitudes that have evolved in the United States since 9/11, the fact that many US contract operators and water service firms are ultimately foreign-owned companies tends to lead to further concern and suspicion.

To be fair, the situation here is not the “greed gone wild” scenario of faceless, evil corporations jacking up prices and flagrantly gouging the poor—the scenario that is, unfortunately, often portrayed by privatization opponents. As mentioned, contract operators are solely responsible to the town council or city manager that hired them, and private water utilities fall under extensive regulatory control from the local public utility commission. Also, it is generally not recognized that private water utilities are far more closely regulated in terms of rate-setting and consumer prices than are municipally owned utilities. A public water agency can raise rates by a majority vote of its board of directors, whereas a private utility has to go through a lengthy and complex approval process with the state public utility commission.

It’s not as if all municipally operated systems are inefficient or in need of some kind of private assistance. On the contrary, it is clear that most larger and well-financed cities are among the national leaders in terms
of running efficient and fiscally profitable water and wastewater systems. Although an early driver of the water privatization movement was the desire to improve productivity and efficiency in municipal agencies, after a decade or two of living under the potential “threat” of privatization, many public agencies and utilities have made substantial progress in terms of undertaking needed productivity improvements and cost reductions—a sort of “de facto” privatization. One way or another, water and wastewater agencies are gradually becoming more competitive and efficient.

**FINDING THE RIGHT BALANCE**

The key must be in evaluating each individual circumstance and striving for an appropriate mix between public and private participation in order to bring people the clean water they need. Some situations will tend toward privately provided or supported solutions, whereas others will tend toward public solutions.

Without question, access to clean drinking water must be viewed as an inalienable human right. Poorer people, particularly in the developing world, should not and cannot be denied the right to water simply because they may be unable to afford to pay for it. Subsidies and other types of government involvement must always be geared to protecting those at the bottom of the income scale; no serious industry observer or market advocate would argue with this assertion.

We also, however, have to be practical and remember that clean drinking water costs hundreds of billions of dollars a year worldwide to store, treat, and distribute and that we as a society must somehow pay those bills. Despite what some observers may claim, clean water certainly isn’t—and can never be—free. The fact that access to water should be viewed as a fundamental human right does not imply that private capital and private companies shouldn’t be involved in water.

There will undoubtedly be continuing cries and concerns from labor organizations and various public interest groups that are aligned against the private sector in water. However, the urgency of infrastructure needs and the political difficulty of increasing taxes or fees make it likely that privatization—perhaps under a less inflammatory name—will continue to become a more important factor in the water business. Although the growth rate of outsourcing has slowed a bit over the past few years, the fundamental drivers behind privatization and consolidation (such as huge capital needs, technological and operational synergies, limited public funds, and a widespread aversion to higher taxation) remain strong. Thus it seems likely that private or outsourced solutions to water challenges will continue to grow. At the same time, it is clear that private owners and operators are going to be judged by a very demanding and critical public and projects must walk the walk, not just talk the talk, of public–private partnerships.

Leaders on both sides of this divide need to stop wasting time by arguing ideological extremes—our water problems are pressing, and time is short. Free-market advocates who reflexively disparage any and all government and municipal systems as inherently inferior or inefficient have no place in this debate. Neither do the so-called human rights activists who imply that all water quality problems or shortages are somehow the direct fault of private interference in the marketplace.

We must strive to become more efficient in producing and allocating scarce water resources. At the same time, we must provide water at a reasonable and regionally competitive cost to all. A more market-oriented approach to water supply and management, overseen and directed by well-informed and empowered regulatory agencies, can go a long way toward making that possible.

Privatization, under whatever guise or form, should not be viewed as the answer to all problems, nor should it be viewed as the enemy in helping clean water flow for all. In the end, it should not particularly matter whether the water provider is a private or public entity. What matters is that people have access to clean water, that prices and profit levels are at a reasonable level and sufficient to sustain the necessary infrastructure from a longer-term life-cycle perspective, that the quality of that water is acceptable, and that natural hydrological systems are preserved for future generations to use. A more thoughtful and balanced approach within the industry could go a long way toward making this goal a reality.

—Steve Maxwell is managing director of TechKNOWLEDGEy Strategic Group, a Boulder, Colo.–based management consultancy specializing in merger and acquisition support services, strategic planning, and market research for water and broader environmental industries. Maxwell is also the editor and founder of The Environmental Benchmarker and Strategist, the environmental industry’s most comprehensive source of competitive and financial data. He has advised dozens of environmental services and water firms on strategy and transactional issues, and he can be reached in Boulder at (303) 442-4800 or via e-mail at maxwell@tech-strategy.com.