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A critique of the 2001 PricewaterhouseCoopers report on water services in Austria

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Foreword

A study by PricewaterhouseCoopers entitled “Optimisation of municipal water supply and sewerage as part of a sustainable water policy”, commissioned by the Austrian Minister of Agriculture, Forestry, Environment and Water Management, Wilhelm Molterer, was presented to the public in the summer of 2001 (the paper can be downloaded from http://staedtebund.wien.at/service/pwc_endbericht.pdf). The covering letter sent out by the Ministry with the report said that efforts would be made to promote “a broad-based discussion” aimed at identifying means of implementing the proposals.

According to Chapter 10 of the study, Recommended scenario: “In the light of its qualitative assessment and cost estimates, PricewaterhouseCoopers recommends making a binding commitment to restructuring of the Austrian urban water management system according to a concession approach based on large areas (e.g. river catchment areas).” As the conclusions reached by PricewaterhouseCoopers are very far-reaching, it is only natural to ask what empirical evidence they are derived from. The Chamber of Labour therefore commissioned an investigation of the quality of the report. The authors reached the following conclusions, discussed in detail below:

“The study has serious weaknesses.

- It exhibits little knowledge or understanding of the international water business.
- It ignores the influence of geographical conditions on the structure of the Austrian water supply industry.
- It contains serious inaccuracies with regard to European law and international practice.
- It contains erroneous and incomplete information on the international situation.
- The forecast cost savings are based on conceptually flawed, exaggerated and in part even illegal assumptions.”

The Chamber of Labour has stated its opposition to the privatisation of water supply. The Ministry of Agriculture and the Austrian Federation of Industrialists have recently again made a joint call for increased private sector involvement in water supply. As the debate has chiefly been conducted by appealing to prejudice rather than fact, there is an urgent need to confront the nature of the argumentation and the justifications offered for it. That is the purpose of this study.

Vienna, November 2001 Wolfgang Lauber

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1.Introduction

This paper is a critique of the report “Optimisation of community water supply and wastewater disposal services as part of a sustainable water policy”, submitted to the Austrian Federal Ministry for Agriculture and Forestry, the Environment and Water Economy by PricewaterhouseCoopers (PwC) in March 2001.

The report proposes a fundamental restructuring of the water services in Austria, under which the state would replace the existing municipal water services with 10 large regional companies, which would be run as commercial concessions.

The report is badly flawed.

- It shows little knowledge or understanding of international water markets
- It shows no understanding of the relevance of an alpine topography to the structure of water operations
- It contains basic factual errors about European law and about international practices
- Its international information is incorrect and incomplete
- The projected savings are based on claims which are conceptually confused, exaggerated, or even illegal.

This paper considers the PwC report in three sections:

- its stated objectives (section 2)
- its critique of the present position (section 3)
- its proposed model (section 4)

2.The report's basis and intentions

2.A Objectives

The stated task of the PwC report is to propose a future structure for the Austrian water and waste water 'industry'. Its objectives are to

- lower the *economic* cost for the country of water and waste water services, both in state and regional (Länder) subsidies and water charges
- Increase competitiveness of Austrian water and waste water companies in neighbouring former Communist countries
- Maintain existing quality standards for drinking water and waste water
- Maintain supply security and existing coverage of the population
- Safeguard socially acceptable water and waste water charges
- Ensure that groundwater does not need to be treated for use as drinking water (this objective is merely stated in chapter 2.1, and not mentioned again)

2.B Independent of foreign influence

PwC state that a further central objective is "to achieve a high level of independence from (foreign) players who cannot be influenced and to achieve self-sufficiency" (chapter 2.4). At various other points the report returns to this general theme of protecting the independence of Austrian water and waste water operations. However, the treatment of this issue seems incomplete and incoherent.

Firstly, it fails to acknowledge that this objective is already achieved - under the present system, the whole system is controlled and owned by Austrian public authorities. To achieve this objective, no change is necessary.

Secondly, the report failed to make an obvious link - that Austria should look to the Netherlands, which shows how a national water industry can be protected from international takeovers while maintaining and improving its standards, by the simple provision of making it illegal for anyone other than a public authority to run a water company.[1]

Thirdly, the path towards private control actually proposed by PwC does not secure independence, it is a recipe for the contrary. Throughout the world privatised water operations have

[1] WaterForum Online, 7 Sep 2000 "Environment Minister, Jan Pronk, has introduced a bill that will prevent public water companies in The Netherlands from handing over shares or control to non-public bodies as of 1 September 2000. Public water companies will retain exclusive rights to the production and distribution of drinking water in their distribution area." (per WSSCC & IRC18 September 2000)

been taken over by multinational companies: this is most marked in the UK and Spain, and is happening in Italy at present.[2] PwC appear unaware of this (this may be partly due to their failure to realise the scale of multinational ownership of the UK industry: see section 2.C below).

This inconsistency in the report is difficult to explain without assuming that PwC are tacitly giving high priority to an unstated objective, namely making the now structurally (and hence financially) unattractive Austrian sector more attractive for private investment.

2.C Export opportunities

The report refers a number of times to the "opportunities for the export of know-how and for investment in neighbouring countries" (e.g. chapters 2.3, 2.4).

The report does not however acknowledge that there are plans for another type of export from Austria - the export of water itself. There may be a real market for Austrian water abroad, and the Austrian government is already setting aside certain waters for export.[3] At present, such exports would be state-run, but if PwC introduce private sector interests into the sector, they might expect to be allowed to exploit these opportunities for profit. PwC has nothing to say on this politically sensitive issue.

Instead, the report concentrates on the opportunities for exporting 'know-how and investment' to neighbouring countries, which refers to opportunities for private participation in water services in former communist Europe. However, no market analysis is given. If there were it would show that the potential market is very small and the possibility of any new Austrian regional companies entering it are almost zero.

- The market is already quite small – water services in the Czech republic and Hungary are already largely privatised to multinational companies (MNCs) [4]: Prague was the final major city to be privatised, last year; key cities further east are also already privatised - Sofia, Bucharest, Timisoara. In Poland, however, most cities are developing through municipal water services, despite efforts by the MNCs. Slovakia is the most realistic possible market, which is a small one, and in any case there is significant opposition to privatisation there.
- The MNCs have a distinct advantage of privileged loans from the EBRD - one each for Suez, Vivendi, and International Water.[5]
- The largest MNCs have a tight control of this market - Suez and Vivendi, joined lately by International Water, have established an oligopoly such that even large companies

[2] See for example PSIRU report on Water Multinationals October 1999 (www.psiru.org/reportsindex)

[3] ('Wiens gewagte Wasserspiele', in: Frankfurter Rundschau, 10 April 2001)

[4] See PSIRU report on water in CEE, October 1999.

[5] For the series of EBRD loans supporting the MNCs see for example: EBRD release 11/02/2000 Suez Lyonnaise des Eaux's investments in municipal services in Central and Eastern Europe supported by EBRD; EBRD release 22/12/99 EBRD supports first public-private partnership in Romania's municipal sector; Reuters 30 Jun 97 GLE DES EAUX, EBRD SIGN DOLLARS 100 MLN PACT: REUTER

such as SAUR and Anglian Water (UK) are sidelined. New entrants, worldwide, have failed to break into this tight oligopoly. For example Enron, despite being a successful energy multinational, failed to make its water venture Azurix profitable and competitive, which it attributed to the strength of the MNCs .[6] Thames and RWE looks like a big merger, but both companies' international expansion has been largely with Vivendi (or Suez), not in competition (e.g. Berlin, Budapest, Adelaide). Thames have been notably unsuccessful in many of their independent ventures.[7] PwC do not mention these features of the industry.

- The same points apply in EU countries: e.g. in Italy local Italian operators are finding it almost impossible to operate except in partnership with Suez or Vivendi.[8] No reason is given by PwC as to why Austrian companies should be better placed.

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[6] See Houston Chronicle 09 Jan 2000; UK Western Daily press 10/01/2000

[7] A range of problems include losses of over £95m written off in 1996; a non-profitable contract in Jakarta, and a lost contract in Thailand – see Asian Infrastructure Monthly 26/07/00 : U-turn forced onto rural water supply concessions

[8] For example by using legal action to prevent semi-privatised companies expanding Il Sole 30/04/97, 09/07/97

3.PwC criticism of the present situation

3.A Difficulty in finding weaknesses with present system

A multitude of arguments are brought forward by PwC to dismiss the current situation as unbearable and dangerous. Many of the points of criticism are however not in the responsibility of the water suppliers, but are politically determined (e.g. focus on quality not price, high subsidies, tax exemptions favouring public vs. private companies in order to strengthen the public sector).

The PwC analysts have difficulties in actually identifying major weaknesses in the Austrian water sector. It is running smoothly, with high to excellent drinking water quality, and high ecological standards for waste water. So to facilitate the deduction of their compulsory merging and concession model, they look elsewhere for potential problems. The key areas of their argument (in chapter 2.3) concern pressures from the future or abroad (from Brussels and elsewhere), supported by a review of experiences in other countries (in chapter 4). Both of these arguments have significant flaws.

3.B Invented pressures

The additional so-called 'pressures' listed in chapter 2.3 include: higher operating costs (combined with lower subsidies) creating higher water prices; pressure from the EC on Austria towards privatisation; and pressure from foreign multi-utility companies. All these points, however, rely on misconceptions, mistakes or exaggeration.

3.B.i Incorrect statement about WFD requirements

The report refers to Article 9 of the Water Framework Directive (WFD) as if full cost recovery for water services were mandatory. It is however optional, and anyhow allows for subsidies to safeguard socially acceptable water prices. It should be kept in mind that Article 9 of the WFD was originally intended to curb subsidies for irrigation farming, and finally ended up somewhat ambiguous, with a non-binding full cost recovery provision only for water services (not water use), although including environmental and resource costs. The WFD as an environmental directive does not (and cannot) aim at the structures of the European water industry, a fact which is most clearly stated in Recital 1 of the Directive (*'Water is not a commercial product like any other but, rather, a heritage which must be protected, defended and treated as such'.*)

3.B.ii Reduction in subsidies

Reduction of state subsidies and constraints on public authority finances are said to lead to private participation (because allegedly only the private sector has sufficient access to capital). PwC do not mention that state subsidies are a political decision, and that reducing them isn't necessarily the only option. Nor is it shown why this should involve more private participation, nor how this is connected with raising capital.

3.B.iii Misleading suggestions about EC pressure

The draft Commission Communication on services of general interest is quoted as though it requires progress towards privatisation. That paper does not, however, explicitly mention water or waste water. It is true that there is EC pressure towards liberalisation, but liberalisation should not be confused with privatisation, which the Commission cannot push. Moreover, the European Parliament is highly critical both of liberalisation and privatisation of water services in Europe. Recent attempts to turn the Commission Communication on water pricing into an instrument for water commercialisation have been consistently turned down by the European Parliament.

3.B.iv Suggestion of 'inevitable' trends

A 'global shift from the public to the private sector' is stated, as though it was a natural law.

While there has been a trend to privatisation in the last decade, some severe shortcomings of private operations have become obvious:

- There have been a number of serious problems and reversals of this trend in Europe (e.g. Grenoble, Potsdam) and elsewhere (e.g. Bolivia, Thailand). [9]
- It is implied that this trend is based on safeguarding the use of "latest technologies, management tools and private capital". However, technology is available, at a price, to all operators – in the words of a private water company manager, it is 'just shopping'; and private management may be better or worse, see for example major UK problems with drought (see below).
- As for capital, companies tap the same markets for loan capital as governments only at higher interest rates, while equity is much more expensive. UK private companies and financial analysts such as Warburgs are using this as an argument for mutualising assets – a trend not noticed by PwC. [10]

PwC suggest that 'developments abroad' (i.e. privatisation in D, F, UK) will increase pressure on the Austrian water sector. Certainly, the multinational companies exert pressure to extend their markets - Eon's takeover of hydroelectric generating capacity in Austria is a vivid reminder of this, especially as Eon wish to develop a water section.[11] But this development

[9] See PSIRU reports on Grenoble and water trends at www.psiru.org/reportsindex .

[10] FT 16/06/2000 Kelda Water group sets ownership trend

[11] 'Öffnung des Wasserschlosses Österreich', in: Neue Zürcher Zeitung, 19 July 2001

may be considered a challenge to be dealt with - it is not necessary to concede to this pressure.

3.C International comparisons – incorrect and incomplete

PwC's account (in chapter 4 of the report) of experiences in other countries is unreliable. The sections on the UK and France, specifically, are poor and inaccurate in many respects, including incorrect and incomplete information about the company structures, and ignorance of major developments in the sector.

3.C.i England and Wales

The paragraph on the 1974 structural reforms fails to mention that the new authorities were also responsible for river quality. These responsibilities were NOT transferred at privatisation but kept in a public authority (the NRA).

The description in chapter 4.1.3 of the restructuring of the ownership of the UK industry since privatisation contains factual errors, is incomplete, and is inaccurately and misleadingly summarised.

- Southern Water has not merged with South East Water, as stated by PwC. They have always been separate companies - South East is owned by SAUR.
- Southern Water is now owned by Scottish Power, not mentioned by PwC.
- Enron has not taken over Essex Water, as stated by PwC. Essex Water was a water-supply only company. Essex Water became part of the Northumbrian Group, now Ondeo, all owned by Suez.
- Enron did take over Wessex Water, one of the ten major water and sewerage companies privatised in 1989.
- PwC fail to mention that Northumbrian Water, one of the ten major water and sewerage companies privatised in 1989, has been taken over by Suez.
- PwC says that "Overall a certain amount of concentration can be observed amongst the small private water suppliers", and gives a table which mentions only three companies being taken over by other UK companies (one of these is incorrect). In fact nearly all of them have been bought by multinational groups, the great majority by Vivendi, SAUR, or Suez (see tables).
- PwC also fails to mention that Hyder, formed out of a merger between Welsh Water and local electricity company SWALEC, was bought by Western Power Distribution (a US-owned energy group) which then sold the Welsh water assets to a new non-profit 'community' company, while contracting out the operation of the water and sewerage services to United Utilities.
- PwC fails to mention that Kelda, owners of Yorkshire Water, also attempted to mutualise the water company in 2000, arguing that capital could be raised more cheaply

this way; a plan that was rejected because of public resentment at the company attempting to load its debts onto the proposed mutual. Other companies, e.g. Anglian, have considered similar moves.

- PwC fails to mention the problems of under-investment, high prices and excessive profits experienced after privatisation. This was reversed only by draconian action by a new Labour government through a windfall tax and then a very tough clampdown on prices.[12]

These errors and omissions seriously weaken PwC's analysis:

- A key objective for PwC is supposed to be independence for Austrian Water companies, but they underestimate the extent to which much larger private regional companies in the UK have fallen rapidly under multinational control.
- An advantage of private companies is said by PwC to be their ability to raise capital, but PwC fail to mention or address the financial crisis of the UK companies. Kelda and their advisers urged that debt financing through non-profit mutuals was a cheaper form of financing water investment.
- The UK problems with under-investment and excessive price rises seriously undermine the PwC argument that profit incentive will improve investment and avoid price rises.

3.C.ii France

PwC's account of the French water sector also contains omissions and errors, which undermine the conclusions of the report. PwC claim that under profit-oriented concessions, prices will fall, and transparency and efficiency will increase. Yet they fail to acknowledge evidence that France, the country with most experience with such concessions, has faced major problems with private concerns in respect of both prices and transparency.

The report fails to mention the problems of lack of transparency, corruption, and high prices revealed by a Cour des Comptes report in 1997, and highlighted by further reports since then (e.g. on Paris). The Cour des Comptes for example noted that accounts for private concessions were both unreliable and frequently absent, complaining of "*L'imprécision des comptes rendus annuels*", and that *"En particulier, dans les delegations de service public, les rapports de l'activité des fermiers et des concessionaires, lorsqu'ils étaient fournis, manquait souvent de précisions et étaient parfois très peu expliqués».* In a town the size of Metz, the municipality received no accounts for 20 years. [13]

The report does mention that price movements in France vary from place to place, but fails to mention that prices under private operation are consistently higher than under public ones (see Annexe, Table 3).

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[12] For some indications of the problems see PSIRU briefing on UK water at

[13] Cour des comptes ,1997,pp 109-118

PcW also fail to mention that the major city of Grenoble remunicipalised its water in 2000 because of these problems.[14]

The information on the major companies in France is also very out-of-date.

- The latest turnover and profit figures given are for 1997, relating to Lyonnaise des Eaux (now absorbed into Suez, with the water division named Ondeo) and Generale des Eaux
- Cise is listed as a fourth major water company, owned by St Gobain - the source quoted is "PwC research". In fact Cise was bought by SAUR as long ago as December 1996, a take-over ratified by the French authorities in March 1997 (four years before the PwC report was written in March 2001).

[14] See PSIRU paper on Grenoble www.psiru.org/reportsindex , and the Cour des Comptes report *La gestion des services publics locaux d'eau et d'assainissement*. Les éditions du Journal, Paris. (1997) at www.ccomptes.fr/Cour-des-comptes/publications/rapports/eau/cdc72.htm .

4.PwC's recommended models

4.A.i Artificial and untested model

The model proposed by PwC is highly artificial and entirely untested. The comparison with the situation in the Netherlands which is used to defend state organised re-structuring (from several 1000 units down to ten in two or three years) is not conclusive. The Netherlands have re-structured their industry over decades, and have done so because of massive quality and scarcity problems (Rhine river dependence, salt water intrusion, highly concentrated agricultural pollution). Austria has only local quality and no scarcity problems, and an entirely different social structure from the Netherlands with its long history of complex co-operative models in the water sector (e.g. in dyke construction and maintenance).

There are a number of obvious problems and contradictions with the choice PwC made.

- PwC reject the simplest solution to their stated objectives: keeping everything as it is (high standards, acceptable prices) by keeping the tax bias in favour of public companies, and by retaining communal responsibility by law (rather than the proposed forced concentration at the level of river basins). In this way, foreign companies could be effectively deterred. In order to lower costs, many different kinds of well tested measures from co-operations to bench-marking to limited mergers may be useful.
- Furthermore, PwC deliver a negative judgement on models that rely on market forces to change the structure of the water sector. PwC clearly states that without a mandatory re-structuring law, only a small percentage of the sector will be effectively transformed into larger privatised units. In other words, as long as a competition of operational systems is maintained, the public system is predicted to prevail. This, however, is not the outcome preferred by PwC - who hence recommend a state-enforced shift to private operation under concessions.
- The same is true of PwC's proposed structural changes. The recommended formation of only a handful of water companies would definitely not happen in response to the dynamics of the sector - such a system is not operationally favourable under the natural and geographic realities in Austria. PwC's recommendation must therefore be regarded as a weakening of the time-tested structures in the Austrian water sector, with the effect however of making it more attractive to private companies.
- Tacitly, the report also dismisses (or at least doesn't explicitly recommend) the full privatisation model, as used in the UK. A sale of the assets is only mentioned once, very much on the side: 'After a concession has been granted, the assets either remain in communal hands or are acquired by the company.' It is not clear if they just didn't consider physical privatisation, if they didn't like it (but didn't want to say so), or

if any mention of physical privatisation has been omitted from the report because of the political sensitiveness of the issue.

- The proposed model is a state organised compulsory re-structuring model plus compulsory concessions. According to PwC, about ten units on the basis of river (sub-)basins would be most favourable commercially . Furthermore, water and waste water services should be combined in one operation, and concessions internationally tendered. The justification for this model is exclusively economic (economies of scale, buying power for parts and know-how and outsourcing). The larger, the better, with PwC suggesting that only units above 150.000 to 200.000 inhabitants are commercially viable – or rather interesting for private investment.

4.B Confused concept of competition

PwC also seem to be working with a confused idea about competition in the water industry. The report talks (in chapters 2.2 and 2.3) about a 'paradigm shift' to a 'competition economy'. This is not however based on evidence, and remains a key weakness throughout the report.

- Competition as in the electricity or telecommunications markets is not feasible in water supply and wastewater treatment. Everywhere, public or private, it remains a (natural) monopoly.
- The claimed benefits of competition and 'transparency' are not supported by evidence. In the French system serious problems are encountered with transparency (see above, section 3.C.ii). Elsewhere, there are systematic problems with secrecy even of the terms of the contract agreement.
- 'Cost-efficiency' is not proven. Prices under private operation are 10-15 % higher in France than public sector prices; international comparisons on various bases are inconclusive or show e.g. the public water services in the Netherlands to be at least as efficient.

The report (in chapter 2.5) claims to see a development from "supply undertakings" to "competition undertakings". This section starts with a declaration of neoliberal faith: "The strengthening of overall conditions of close competition and the market economy should contribute to an increase in efficiency". But nowhere in the world does the water sector have any significant competition, close or otherwise – sanitation services still less. PwC appear to confuse privatisation with liberalisation or competition.

- Later, in chapter 3.2.7, the report includes another statement of faith which seems to confuse privatisation and competition, as well as ignore evidence, when it claims: "Because there is no competition in the water economy, the participants in the market are not under any pressure to introduce technologies that would reduce costs." But as stated, no water systems have any significant amount of competition. And public sector water systems utilise equally advanced technology as private companies, e.g. in the Netherlands or Nordic countries (and equally low costs).

- Another claimed advantage or private operation is of 'good customer relations'. Yet elected communes have electoral incentives for good customer relations; whereas a visit to the UK, especially Yorkshire, would show that private companies can enjoy very bad customer relations.
- PwC correctly suspect that water privatisation may be unpopular which can be proven in many countries. They describe this "low level of information of the public at large concerning the advantages of private participation" as an "entry barrier" (chapter 3.2.9). They do not take into account that in many cases the public may in fact be right.

4.C Outsourcing

The report's case for possible outsourcing (in chapter 3.2.4) is based on another statement of neo-liberal faith, without evidence: "All processes not contributing to the core competence of the undertaking can as a rule be carried out more efficiently and also more cost effectively by a specialised third party".

- One problem with this approach is in defining 'core', which implies that there is some crucial functions protected from outsourcing. In practice, even the most central functions can be contracted out under private regimes: for example in Wales, the WPD take-over of Hyder resulted in the new owners of Welsh water, Glas Cymru, contracting-out the entire operation of the system to another water company (United Utilities). Why create a private water company which then sub-contracts the service itself? And how could the PwC model stop this happening?
- The examples given of services which can be outsourced imply that this is entirely unproblematic. This is not true, with maintenance for example: Southern Water spun off its workforce into a separate contractor, but later wanted to buy it back in-house. For computing services the problems are also great: for example United Utilities had two expensive mistakes in contracting out computer systems.
- There are problems of 'sweetheart contracts' to companies' own subsidiaries - noted in the Cour des Comptes report in France, and by OFWAT as a problem in the UK.
- PwC's discussion of outsourcing also appears to assume that savings can be made by cutting pay and conditions. However, this is illegal (at the point of subcontracting) under EU law (see 4.G.i.3, below).

4.C.i Expensive consultants

One problem has been with outsourcing consultancy work. The UK pursued extensive subcontracting of government functions in the 1980s and 1990s, but a report in 1994 showed that the government had lost control over a 'bottomless pit'. A six-month inquiry into the use of consultants identified expenditure on consultants of over £500m – yet the resulting 'savings' totalled just £12million a year.[15]

4.D Structural characteristics important to the future of the Austrian water sector

The current structure of the Austrian water sector is the result of the historical societal focus on water supply and sanitation. Optimum quality of drinking water, highest concern for the country's groundwater, lakes and rivers, and maximum reliability, are objectives whose full endorsement by the population can take for granted by every politician: these have been the guiding principles of water policies up to the present day.

None of these prime concerns have been adequately factored in to the purely economically inspired framework of the PwC report. While mentioned in the objectives of the report, these central aspects of Austrian water politics are absent from the remainder of the report.

4.E Commercialisation, quality and environmental standards

In fact, evidence from privately run water and waste water companies elsewhere clearly indicates that the central concerns that have driven the development of the Austrian water sector (optimum quality, protection of all water resources, maximum reliability) are not in the interest of commercial operators:

- The philosophy of supplying highest quality drinking water (normally well above minimum standards) is replaced by making quality second to commercial considerations. To save costs, investments to protect and maintain water quality are decreased to a level which just suffices to keep within the maximum tolerable contaminant levels for drinking water (or even exceed them temporarily).
- Environmental protection of groundwater, lakes and rivers is not seen by commercial operators as their obligation. If such measures are politically wanted, they argue, the respective costs should be borne by the state (either from general taxes or from a levy on water consumption). [16]
- Maximum reliability of any technical system involves a fair level of redundancy in the system. In the case of the water sector, this implies for instance far-sighted investments to protect drinking water sources and to maintain the infrastructure. More safety simply entails higher costs – and who would argue against maximum safety of

[15] Daily Mail and The Mail on Sunday (05 Aug 94) Whitehall spending runs out of control

[16] Suez Lyonnaise enagaged in a lengthy legal process in Normandy to obtain a judgement in 2000 that agreed that as concessionaires they had no direct responsibility to minimise nitrate pollution – only that they should implement reasonable filtration practices.

drinking water. The private sector, focussing as it does mostly on reducing cost to increase profits, has no incentive to keep up such redundancies.[17]

- Indeed, to a large extent the lower costs claimed by PwC under private concessions stem from the elimination of such 'reliability redundancy' costs. As a result, water prices may temporarily fall slightly, but with the consequence that the lack of investment ultimately will be felt by the consumers – either as effective problems with drinking water supply or as overall societal cost to repair or upgrade the infrastructure later. In the long term, it seems unlikely that a highly complex system such as water supply and sanitation can be run at much lower cost than at present.

Hence, if the Austrian government followed PwC's advice, the likely result would be an erosion of the high standards that laid the foundation of the water systems that Austria is proud of and which consumers (as well as the numerous tourists) presently enjoy – good drinking water and intact aquatic environment. The alleged cost reductions – if they ever substantiate – will be a poor substitute for these achievements.

4.F Alpine topography

The Austrian topography adds another important factor to the equation. Natural plenty and highest quality of most Austrian waters allows running a low technology, decentralised water supply system without treatment. That's the main reason for the current structure, where a multitude of very small units deliver untreated water by simple technology. The only potential commercial interest in such systems would be to use the existing water rights to take the water elsewhere, or even to export it. Meanwhile, the local community might end up with lower quality water from the city to which it is connected in the course of the formation of larger (river basin) supply units.

It is relatively simple and inexpensive to supply water under the prevailing natural conditions in large parts of the country, hence the large number of small and very small operating units in Austria.

Neighbouring countries with a similar topography - Switzerland, Bavaria - have a very similar water supply structure. The report states (correctly) that neither Switzerland nor Bavaria see any reason to change that successful model or to introduce more private participation. In these regions merging and commercialisation are deemed counter-productive to the quality of these services. Both the (conservative) governments of Bavaria and Switzerland oppose attempts by international multi-utility companies to acquire assets or to run their water operations. It seems wise to take these neighbourhood activities seriously.

[17] A good example of this was the decision by Yorkshire Water not to invest in further reservoirs. As a result the region suffered exceptionally from water shortages during the 1995 drought in the UK.

4.G Cost savings in Public private partnerships (PPPs)

The results of PwC's cost profiles for the various models depend entirely on the assumed savings made. Since the assumptions are extremely doubtful, the savings figures are equally doubtful.

4.G.i Unjustified assumptions of savings in investment costs

In chapter 8.2, the report looks at the supposed extra cost-effectiveness in public private partnerships (PPPs). The claim here is for a saving of 25 % on investment costs and 7.5 % on operating costs, from the effect of privatisation alone (PWC emphasise at the end of chapter 8.2 that these "are based solely on the participation of a private partner", excluding any savings from regionalisation).

Three pieces of evidence to justify these strong claims are offered.

4.G.i.1 Unspecified evidence on purification plants

The report says there is evidence of savings on pilot PPPs in water purification plants in Austria, and private savings in Germany on network construction. This evidence is not spelt out or even referred to.

There is however experience where private involvement has increased construction costs dramatically (e.g. Grenoble), or threatened to (e.g. Lodz Poland, Szeged Hungary) not least because the MNCs give work to their own subsidiaries at inflated rates.[18] OFWAT has identified similar problems with 'sweetheart' subcontracting in the UK. The PwC report shows no awareness of these problems and no suggestions as to how Austria might avoid them. The UK experience also shows that what private companies call 'cost reduction' may simply be cutting back on the necessary investments.

4.G.i.2 Errors and oversights in table of international experiences.

The second piece of evidence is a short table of international cases (in chapter 8.2). Once again it contains errors and incomplete reporting.

- The first line refers to a UK treasury study (done by Andersens in 2000) which claimed average savings of 17-20 % from projects in various sectors under the UK's private Finance Initiative (PFI). This report has been heavily criticised: the savings are based on comparison with a 'notional' public sector, not real comparisons; 80 % of the savings all came from just three projects, in the rest the average was 6 % ; one case where 'risk transfer' is claimed is an expensive failed IT project (by Andersen itself) where the company paid compensation of only a fraction of the actual costs

[18] See PSIRU papers on Grenoble and on public water companies www.psiru.org/reportsindex .

incurred by the government. Most information on UK PFI concludes that the savings are tiny or non-existent: a recent parliamentary estimate is that health service PFIs saved on average 1 %.[19]

- Line 2: the Moncton water treatment plant in Canada - water prices in Moncton have already doubled in 2 years since the scheme was signed (with US Filter/Vivendi).

4.G.i.3 Assumption of operating costs savings based on illegality

The *only* justification given for the claim that operating costs fall by 7.5 % is a reference to the profit 'incentive' working through "recruitment of new personnel within the framework of a more favourable collective agreement".- i.e. replacing existing workers and their collective agreement with different workers and a worse agreement. This is clearly illegal.

- It is illegal under a 24-year-old EU law: the Acquired Rights Directive – 77/187 EEC , as amended by Directive 98/50 EC. This law requires that when there is a change of ownership (or transfer) of any undertaking, workers employment contracts and conditions, and the collective agreements under which they are determined, must be transferred to the new owner/employer.[20]

- The Thatcher government in the UK attempted to ignore this law when implementing its programme of privatisation of council services through contracting-out. Subsequently the UK was declared in breach of community law by the commission and the European Court of Justice, and legal action by trade unions forced the UK government into paying millions of pounds in compensation to workers whose jobs, pay and conditions had been illegally cut under the Thatcher government.

4.H Cost savings under compulsory regional concessions

The claimed savings for PwC's preferred regional concession model (chapter 8.3) are greater than under PPPs. PwC uses different arguments to support the claim. The estimated savings are also exaggerated.

4.H.i Unjustified claims for savings in investment costs

The investment cost savings are claimed to be 35 % - partly the 25 % savings claimed under PPPs (see above), plus an extra 10 % for economies of scale from moving to regional bo-

[19] *Public Finance 07-09-2001* PFI offers minute returns, says MP

[20] A text of the combined directives is at the website of the Federation of European Employers: http://www.euen.co.uk/feu13.html . A summary of the provisions of this directive can be found at the EC's legal information site: http://europa.eu.int/scadplus/leg/en/cha/c10809.htm .

dies. This includes claims of greater capacity utilisation, and two audit reports on specific Austrian water undertakings are quoted in support of this.

The potential economies of scale from moving to regional level are not an advantage peculiar to PwC's model, however: Moreover, the risks of simply reducing capacity should at least be acknowledged, not silently assumed not to exist.

4.I Operating costs

The operating cost savings are expected to be 20 % under this model - much higher than the 7.5 % under PPPs. This is attributed to the 'strong incentive for efficiency improvement' either through defined cost reduction targets or 'competitive conditions'.

The regional model is also assumed to impose administratively determined cost savings equivalent to the theoretical savings of the 'competitive' licence model. In effect, this seems to accept that efficiency can be improved just as much through public administration as through profit-oriented processes. This is probably true (e.g. the Dutch self-benchmarking model) but contrary to PwC's repeated claims that profit incentives lead to greater efficiency.

4.I.i Incorrect use of evidence on labour productivity

In effect the first category of operating cost savings are labour productivity. A number of examples are given in evidence of the potential savings here, which include a 57% claimed gain in productivity over 5 years at Severn Trent, and productivity gains in the UK, German and Austrian electricity sectors. The evidence is used in a way that cannot be justified.

- The 57 % gain at Severn Trent is in terms of sales per employee. This figure is a function of both labour productivity and real price rises, not a measure of cost reduction. In the UK price rises were excessive over the period, as widely recognised by consumers, the government and OFWAT. What is reflected in PwC's figure is mainly excess price rises, not usually regarded as a good thing.
    - The actual change in employees in water in Severn Trent was a drop of 25.7 % in the 9 years from 1990 to 1999 (the overall drop in all UK water and sewerage companies in that period was 21.5 %), including reductions in direct staff which were replaced by contractors. Since output remained roughly the same, this is an annualised growth in labour productivity of no more than 2.5 % per year, not a very remarkable performance. And this should be compared with the labour productivity growth in non-privatised water companies for the same period.
- The other examples are all in the electricity sector, which is a different business. In all countries in the 90s there were major savings from lower fuel prices and also from new technology (CCGTs). Labour was reduced in the UK much more sharply than in other EU countries [21] so there was a significant increase in labour productivity. But the private companies kept prices at such a high level to sustain dividends that the

[21] See PSIRU "Restructuring and privatisation in the utilities - Europe" report for ILO July 1997; at www.psiru.org/reportsindex

net contribution of privatisation has been estimated to be negative, i.e. increasing the financial burden on consumers.[22] The price reductions in the UK were actually less marked than in other EU countries over the same period, e.g. in France.[23] So the examples fail to establish that private profit, even in electricity, is itself a force that reduces costs from the perspective of consumers: if anything, the evidence clearly points to privatisation being associated with higher prices than would otherwise be the case.

Other operating costs are expected by PwC to also fall by 20 % due to synergies of common operation of water and wastewater.

4.J Balancing the costs of cost savings

Even the claimed savings need to be evaluated against other factors.

- From the point of view of the consumers, the potential financial gains in terms of lower water prices (and/or lower subsidies paid through taxes) are far outweighed by the potential risks.
- The potential financial gains can be contested and are by no means assured.

Since water and waste water are relatively cheap and only make up approximately 1 – 2 % of the average household income, the proposed radical changes to the very successful organisation of the sector in Austria are not justified (especially from a consumer point of view). Sharply rising prices are not to be expected under the status quo, and even if there is potential for rising costs, these can be curbed by means other than forced concessions (e.g. by cooperations in laboratory expertise, accounting, bench-marking).

[22] See S. Thomas: Has Privatisation Reduced the Price of Power in Britain? 1999 (Unison)

[23] J-M Glachant "Le Nouveau Systeme electrique brittanique" in CIRIEC Cox H. (ed) "Services publics, missions publiques et regulation dans l'union europeenne" (Paris, 1997)

5.Conclusions

The proposals brought forward by PwC are not geared to the needs of the Austrian water sector nor the Austrian consumers. PwC have applied theoretical market models indiscriminately to the water sector, drawing conclusions that will predictably lead to

a) full-fledged commercialisation of the Austrian water sector
b) loss of national control not only over the operation, but also over the quality of the services
c) medium-term decreases of drinking water quality and lower concern for the aquatic environment

The report is written with a lack of understanding for the peculiarities of water supply and sanitation as a service, as well as a lack of understanding of the distinctive features of the Austrian water sector.

Its conclusions and recommendations should not be relied on or used as a basis for decisions on restructuring the Austrian water sector.

6.Annexe: selected data on the UK and France

- ***Takeovers and mergers in UK water companies since privatisation***

The 10 water and sewerage companies were protected from takeover for 5 years by the government's 'golden share'. The smaller water-supply only companies were however the subject of takeovers straight away, and nearly all are now owned by multinationals, mainly the three French groups Vivendi, SAUR, and Suez-Lyonnaise.

Since then, half the water and sewerage companies have been purchased by multinational companies. Two are now owned by USA companies, I by a French company, 1 by a German company, and 1 by a Scottish company.

Apart from the take-over by Suez-Lyonnaise of Northumbrian Water, all the other take-overs have been by energy companies who wish to expand into water – Enron, Scottish Power, Southern Company (which is also present in Berlin electricity) and RWE. In addition, one of the water-only companies, Cambridge Water, has been taken over by the Spanish electricity company Union Fenosa.

Table 1: Ownership of major water and sewerage companies in UK, 2001

Company	**%**	**Parent Group**	**Country**
Anglian Water	100	Anglian Water	UK
Northumbrian Water	100	Suez-Lyonnaise	France
North West Water	100	United Utilities	UK
Severn Trent Water	100	Severn Trent	UK
Southern Water	100	Scottish Power	UK (Scotland)
South West Water	100	Pennon Group	UK
Thames Water	100	RWE	Germany
Welsh Water	100	Glas Cymru (non-profit)	UK
Wessex Water	100	Azurix (= Enron)	USA
Yorkshire Water	100	Kelda	UK

Table 2: Ownership of Water-only companies in England 2001

Company	Per-cent	Parent Group	Country
Bournemouth Water	50	Biwater	UK
	50	Nuon	Netherlands
Bristol Water	24.1	Vivendi	France
Cambridge Water Company	100	Union Fenosa	Spain
Dee Valley Water		(independent)	UK
Essex & Suffolk	100	Suez-Lyonnaise	France
Folkestone and Dover	100	Vivendi	France
Mid Kent Water		Swan Group	UK
Mid Southern Water	100	SAUR	France
Portsmouth Water		Brockhampton	UK
South East Water	100	SAUR	France
South Staffordshire	32.8	Vivendi	France
Sutton and East Surrey		(independent)	UK
Tendring Hundred	100	Vivendi	France
Three Valleys	100	Vivendi	France

Table 3: Water prices in France under municipal provision, delegated management and public-private joint ventures, 1994-1999

(average prices for yearly consumption of 120 m^3 in French Francs, water supply and sanitation)

Management type		1994	1995	1996	1997	1998	1999
Public	Municipal/Régies	1,489	1,621	1,716	1,803	1,848	1,841
Private	Delegated/Private	1,784	1,908	1,993	2,050	2,100	2,100
PPP	Public-Private Joint Venture	1,734	1,812	1,963	2,014	2,076	2,101
Average	Average all modes	1,689	1,799	1,910	1,974	2,015	2,049

Source: DGCCRF [24]

[24] DGCCRF (Direction générale de la consommation, de la concurrence et de la répression des fraudes); published in "la Réforme de la politique de l'eau" Conseil Economique et Social ; Journal officiel de la République Française 2000 No. 14 ; November 2000