

**Peter Becker\***

**Privatizing Public Enterprises in the European Union –  
The Impact of European Integration on European Water Markets**

December 2007

This research is part of the project  
*Understanding Privatization Policies: Political Economy and Welfare Effects*  
funded by the European Commission (contract n. CIT5-CT-2005-028647)

## CONTENTS

1. Introduction	2
2. Liberalisation and Privatisation in the Common Market – The European Dimension of Services of General Interest	4
3. The water market between market and welfare – the regulatory discussion	7
4. The European water economy between „local atomisation“ and global players	11
5. Liberalisation and privatisation through European incentives	17

## 1. Introduction

After the large-scale privatisation and liberalisation processes that have engulfed the energy, telecommunications, rail and postal sectors since the mid-1990s<sup>1</sup>, the water market has increasingly been scrutinised as a possible source of market openings. The water industry is a classic, network-bound service sector, which was long protected from competition and was characterised by monopolistic structures. Yet, the branch has, meanwhile, been subjected Europe-wide to enormous structural changes which have been marked, on the one hand, by possibilities for the exploitation of new international markets and, on the other, by internal economic and fiscal pressures.

The international development goals of the United Nations aim to ensure that 1.5 billion people have access to clean water by 2015 and that 2 billion can use a fitting sanitation system. According to estimates, water usage will grow worldwide over the next 30 years by 50%, and the required annual global investment in water supply and sanitation systems will hit 180 billion US Dollars.<sup>2</sup> In Germany alone, about 2 bn € are being invested each year in the water infrastructure<sup>3</sup>; annual investment levels of 5 - 7.5 bn € are foreseen for the coming years.<sup>4</sup> In France and England, the cost of the maintenance of the pipeline-system is estimated at 55 billion €. There is broad consensus that this enormous, global need for maintenance and investment will be impossible to meet without private capital and the know-how of private providers. The significance of the private sector in the international water market will thus grow - all the more so because the level of privatisation has significantly grown over the past 15 years. According to the estimates of the largest German provider, RWE, the turnover of private companies will expand from 90 billion € in 1999 to 430 bn € in 2010.<sup>5</sup>

However, the discussion to privatize European water providing enterprises came to a halt in the early years of this century. The European Parliament stated in its resolution from January 2004<sup>6</sup> that the water sector should not

---

1 See Bernardo Bortolotti, Domenico Siniscalco, *The Challenges of Privatization. An International Analysis*. Oxford University Press, 2004.

2 See the UNESCO Report: UNESCO, *Water for People, Water for Life*, March 2003, and the so-called Camdessus-Report, *Financing Water for all*. Report for the World Panel Financing Water Infrastructure, World Water Council et al. March 2003.

3 In the Federal German Republic, investment in 2001 was, according to the German Association for Gas and Water (BGW), around 2.44 bn €.

4 German Federal Environmental Ministry, *Naturschutz und Reaktorsicherheit, Privatisierung in der Wasserwirtschaft*, Berlin o.J., p. 17.

5 See German Bundestag, *Schlussbericht der Enquete-Kommission »Globalisierung der Weltwirtschaft – Herausforderungen und Antworten«*, Drs. 14/9200, 12. Juni 2002, p. 368.

6 European Parliament, P5\_TA-PROV(2004)0018, *Dienstleistungen von allgemeinem Interesse*.

become a subject of European liberalisation initiatives, and even a few years earlier in 2000 the Dutch government de facto prohibited the privatization of water supply in the Netherlands and also all attempts to privatize Swedish water enterprises had been stopped.

There are various forms of influence of the European integration on the decision making of governments to sell off state owned enterprises. Without doubt the deficit criteria of the Maastricht Treaty and of the Stability and Growth Pact had a crucial function. Governments willing to join the Euro-zone had to reduce the public spending and to cut their budget deficits to stay below the margins of 3 percent of GDP of the annual public deficit and 60 percent of GDP of public debt. These deficit criteria put the governments under strong fiscal constraints and enforced their decisions to privatize public enterprises. The second and perhaps in a midterm perspective more important European impact on privatisation is the liberalisation policy in the Internal market.<sup>7</sup> The opening up of markets for private enterprise in many sectors caused a new situation of intense competition for the public enterprises. This new situation forced the state owned enterprises to restructure, to increase their efficiency and to diminish other non-productive tasks. The legitimacy for state ownership faded and the governments decided to partly privatize the services and tasks or to fully privatize tasks and assets. The main arguments thus in favour for privatisation had been the hopes for better quality, lower prices and higher efficiency. "Finally, privatization was not a EU policy but, paradoxically, an unintended consequence of the process of EU integration, since, though privatization is distinct from liberalisation and deregulation, in practice, many EU governments used privatization as a tool to facilitate and accelerate liberalisation in the face of European legislation."<sup>8</sup>

If there exists this correlation between national privatization policies and the European Union's policy to push for liberalisation and to open up markets, as studies on the political economy of privatization show at least for the 1990s<sup>9</sup>, there also might exist a correlation between the stop of all attempts to privatize or the policy not to start the privatization of public water suppliers and the fact, that the European impact to open up national water markets decreased significantly.

---

Entschließung des Europäischen Parlaments zu dem Grünbuch der Kommission zu Dienstleistungen von allgemeinem Interesse; Berichterstatter: Philippe A.R. Herzog .

7 See Susanne K. Schmidt, *Liberalisierung in Europa. Die Rolle der Europäischen Kommission*, Frankfurt/New York 1998.

8 Judith Clifton, Francisco Comín, Daniel Diaz Fuentes, *Privatizing public enterprises in the European Union 1960 – 2002: ideological, pragmatic, inevitable?*, in: *Journal of European Public Policy*, 2006, Vol. 13, No. 5, pp 736-756, p. 752.

9 See Herbert Obinger, Reimut Zohlnhöfer, *Selling off the "Family Silver": The Politics of privatization in the OECD 1990-2000*, Center for European Studies Cambridge MA, 2004, Working Paper No. 121.

Hence, the fundamental question is: Does it need an external i.e. European and Internal market impact to convince national governments from the benefits of privatisation or are the domestic incentives i.e. fiscal and budgetary motives strong enough to encourage national, regional or local governments and administrations to privatize sensitive sectors.

## **2. Liberalisation and Privatisation in the Common Market - The European Dimension of Services of General Interest**

The European debate to liberalize key network bound services and to privatize public enterprises had been, and is still, closely connected to the definition of services of general interest and services of general economic interest as sectors of the European Internal market. Even though all European welfare states provide services of common interest for more than 200 years there is still no universal definition of these services. The European term services of general economic interest used in the EC-treaty is not equivalent to the *service public* in France, the *servizio pubblico* in Italy and the *Daseinsvorsorge* in Germany. These different national terms of public services in common interest were rooted in diverse judicial traditions and stand for different contents and tasks of these public services.<sup>10</sup>

The European common market melted all these traditions together and caused growing tensions between the European competition law, the case law of the European court of Justice and the wish of member states and their administrations to keep their discretion to subsidize public services. Although the fundamentals of the European competition law had been led in the founding years of the European Economic Community and in the EEC-Treaty the tensions came to the fore in the mid 80s when the European commission launched their Common market programme. With this economic integration project the virtual border between market forces and state regulation had been altered to break up formerly protected markets of public services.

However, the conflict is rooted in the “dilatory compromise”<sup>11</sup> 1956/57 when during the negotiations on the EEC-Treaty member states with a widespread public sector, public enterprises and state regulation on the one hand had been confronted with states with a strong private services sector struggling for liberalisation of markets on the other hand. The final compromise of the

---

10 See Rudolf Hrbek/Martin Nettesheim (eds.), Europäische Union und mitgliedstaatliche Daseinsvorsorge, Baden-Baden 2002 und Helmut Cox (ed.), Daseinsvorsorge und öffentliche Dienstleistungen in der Europäischen Union, Baden-Baden 2000.

11 Martin Nettesheim, Mitgliedstaatliche Daseinsvorsorge im Spannungsfeld zwischen Wettbewerbskonformität und Gemeinwohlverantwortung, in: Hrbek, Nettesheim (Hrsg.), a.a.O., pp. 39-64, p. 41.

difficult negotiations included three elements:

- a) The neutrality of the European Community concerning the property order in the member states – today fixed in article 295 EC-Treaty.
- b) Public enterprises will be treated equally to private enterprises especially in terms of subsidies and competition law. Article 86 foresees that in general subsidies are prohibited and only exceptions permitted.
- c) One exception from this general prohibition is granted to public services – today in article 86(2) EC-Treaty. This article states that all enterprises entrusted with the operation of services of general economic interest shall be subject of the rules of the European Competition law *“insofar as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them”*.

This compromise, however, did not answer the fundamental question and left the Community undecided between more market-oriented member states and more regulatory member states. Nevertheless it proved to be sufficient until Prime Minister Margaret Thatcher started her privatization programme in Britain and until the European Commission launched the Internal market program. This program essentially broke up formerly closed and secured markets. New markets arose for telecommunication, energy or postal services including besides the former state owned monopolies also new established private enterprises. These emerging new markets required the application of the European competition law and hence created tensions between the European Commission and the European court of Justice implementing European law and the member states trying to secure their public services provided by state owned enterprises.

As a reaction on these new tensions the member states used the Intergovernmental Conference 1995/96 to include the new Article 16 into the Treaty of Amsterdam, which should halt the pressure for more market liberalisation and hence for privatisation.<sup>12</sup> But this had been an additional formulaic compromise to meet French demands. Paris had forcefully tried to exempt all public services from the European competition law. The new article 16 EC-Treaty underlined the special *“place occupied by services of general economic interest in the shared values of the Union as well as their role in promoting social and territorial cohesion.”* The Community and the Member States shall *“take care that such services operate on the basis of principles and conditions which enable them to fulfil their missions.”* This had been the attempt to influence the market-oriented and liberal rulings of the ECJ and appeased the French position. However, to enable the consent the new article 16 stated this special acknowledgement of services

---

<sup>12</sup> Wolfgang Weiß, *Europarecht und Privatisierung*, in: *Archiv des öffentlichen Rechts*, 2003, Bd. 128, No. 1, pp. 91-133.

of general economic interest is only “without prejudice to Articles 73, 86 and 87” i.e. the European competition law and the general prohibition of subsidies.

In consequence this means that all public services, which are of economic nature and which are suitable to distort the Internal Market, are subject of the European competition law and the surveillance of the European Commission.<sup>13</sup>

However, there exists no definition in the Treaty or in secondary legislation what services of general economic interest could be and how to differentiate these services from other public services. Since the publication of its Green Paper of 21 May 2003 the Commission uses the term services of general interest<sup>14</sup>, without providing a final definition for both terms or distinguishing between services of economic or non-economic interest.<sup>15</sup>

The Commission, however, tried to define the terms in its White Paper on services of general interest from 12 May 2004 to clarify the legal framework and to provide judicial certainty:

- Services of general interest shall be broader than the term services of general economic interest and the term “covers both market and nonmarket services which the public authorities class as being of general interest and subject to specific public service obligations”.
- The term services of general economic interest as it is used in the articles 16 and 86(2) EC-Treaty refers to all services of economic nature and covers in particular big network services such as transport, postal services, energy and communications. However, the term can be extended to any other economic activity in future subject to public service obligations.

Hence, the question still remained unanswered when and where public service will become subject of European competition law. The European Commission showed its strong commitment, that the Commission feels responsible to survey the complete sector of public services and then to decide in each single case, when an undertaking is entrusted with services of economic interest for which European law only is valid.

Nevertheless, it is this question which is crucial where and when the European Union, i.e. the Commission and the ECJ, can push for liberalisation of the former public monopolies, the creation of new potential markets and for

---

13 See Jürgen Schwarze, Daseinsvorsorge im Lichte des europäischen Wettbewerbsrechts, in: EuZW, No. 11/2001, pp. 334-339; Silke Albin, Daseinsvorsorge und EG-Beihilfenrecht, in: Die öffentliche Verwaltung, No. 21/2001, pp. 890- 898, Christian Koenig, Jürgen Kühling, Grundfragen des EG-Beihilfenrechts, in: NJW, 2000, No.15, pp. 1065-1074; Rüdiger Dohms, Die Vorstellungen der Kommission zur Daseinsvorsorge, in: Jürgen Schwarze (ed.), Daseinsvorsorge im Lichte des Wettbewerbsrechts, Baden-Baden 2001.

14 This term will be included into the European treaties for the first time with the new protocol on services of general interest to the Lisbon treaty.

15 See European Commission, Communication accompanying the Communication on "A single market for 21st century Europe": Services of general interest, including social services of general interest: a new European commitment. Brussels, 20.11.2007, COM (2007) 725 fin.

competition between public and private enterprises by prohibiting or at least reducing public subsidies. And the European impact then might influence a governmental decision to privatize public undertakings. On the other hand this means that in policies and sectors where the European pressure is missing or is diluted, the governments might easier decide not to privatize sensible sectors like services of general interest.

### **3. The water market between market and welfare – the regulatory discussion**

The water market should be distinguished from conventional network-bound universal services. In contrast to the telecommunications market, an increase in *per capita* use of water is not encouraged; instead, efforts are made to diminish levels of use for reasons of environmental policy, and, in Europe at least, the consumption of water is not supposed to grow.<sup>16</sup> This means that the effects of increased competition, which advocates of the privatisation of the water market might hope for (namely lowered prices and improvements in quality) will not be achieved via a rise in turnover. In general, the proportion of the cost of the provision of drinking water that is fixed is estimated at around 80%, independent upon the amount delivered.

Moreover, drinking water is no conventional trading good like electricity or telecommunications, but closer in form to a comestible. In the first entry in the preamble to the EU framework directive on water, the Community thus lays down that “[w]ater is not a commercial product like any other but, rather, a heritage which must be protected, defended and treated as such.” This understanding of the trading good water demands particular quality standards and control procedures, as well as forbidding the mixing of different types of water. Drinking water is no homogeneous good; rather, it can be disaggregated according to physical, chemical and microbiological makeup.<sup>17</sup> Due to reasons of hygiene and technology, the possibilities to offer third parties rights of access to existing pipelines are limited; different principles from those that underpinned the opening up of electricity and telecommunications markets are thus required, or additional costs must be reckoned with.

---

16 The Water Framework Directive allows for a rise in water prices as an ecological steering instrument and incentive for a modest, sustainable use of resources. See Directive 2000/60/EC, 23rd Oktober 2000, Journal Nr. L 327 of 22.12.2000, as well as the European Commission’s Communication, COM (2000) 477 final, 26.7.2000.

17 On this point see the study of the German Federal Office for the Environment: Holger Brackelmann et al., Liberalisierung der deutschen Wasserversorgung. Auswirkungen auf den Gesundheits- und Umweltschutz, Skizzierung eines Ordnungsrahmens für eine wettbewerbliche Wasserwirtschaft, Berlin, November 2000 (Texte des Umweltbundesamtes 2/2000).



The unfortunate ratio between the production cost of drinking water and the transport costs needed for it to reach the end-consumer means that parallel structures involving various providers for the production, preparation and transport of the water are, for the most part, uneconomical; ‘natural monopolies’ and, beyond these, decentralised networks have thus established themselves.<sup>18</sup> Against the background of these idiosyncrasies of the water market three forms of competition are imaginable:

1. competition for the market
2. competition within the market
3. competition around specific services

In the case of competition *for* the market, the services monopoly in one area – like for example the pipeline network – would not be broken up. Rather, the right to provide a service within an area would be accorded to private companies through long-term concessions; these companies would then take over the execution of water provision. The instrument by which competition would be created is, in such cases, the call for tenders giving market access. All the same, market access is often made dependent upon private companies investing in the network, so that the time period covered by the contract must often be particularly lengthy. Thus the advantages of competition can only be partially exploited during the call for tenders.

In the case of competition *within* the market, direct competition should centre upon the end-user. This can occur through the development of a second main network or through third party access to the existing network. These options, however, throw up considerable technical problems, as already described above, and are expensive to realise. The direct competition for *specific services* (i.e. for individual elements of the entire production chain like labour services, repairs or maintenance of works) can, by contrast, be achieved relatively problem-free. In May 2003 in its strategy for the internal market 2003-2006<sup>19</sup>, and against the background of a possible opening up of the water market, the Commission highlighted how unusually large and heterogeneous the water market in Europe still is: “Water is an important sector in the economy, with an estimated annual turnover of €80 billion, which is larger than the natural gas sector. But annual water charges vary from €350 in Berlin to €50 in Rome (with no charge at all in Ireland).” The Commission announced that the legal and administrative situation in the water and sanitation sector would be evaluated with a view to increase competition, and the possibilities for legislative measures would be fathomed. It also planned to present a report on

---

18 On the global water market see the Policy Research Report of the World Bank: Ioannis N. Kessides, *Reforming Infrastructure. Privatization, Regulation and Competition*, Washington 2004.

19 Europäische Kommission, COM (2003) 238 final, 7.5.2003.

this subject, which will rely upon an analysis of a wide-ranging survey of the water markets in the member states.<sup>20</sup> The European Commission's behaviour was, however, not yet consistent: On the one hand, water supply was described in the Water Framework Directive as a public service, hence part of services of general interest, and water described as a non-typical trading good; on the other hand, the Commission explicitly subsumed water supply into the broader category of services of a general *economic* interest – something that would infer the use of control on state subsidies.

Developments in price and quality have gained central importance in the discussion about further steps towards the liberalisation of European water markets: advocates of an opening up of the market justify their demands by reference to the idea that prices will sink whilst quality remains at at least the same level.<sup>21</sup> Yet, it is important to remember that European environmental legislation has set high standards for the quality and security of water services and waste management; it has thus forced technological improvements which have led to higher running costs.<sup>22</sup> This, in turn, has led to a rise in consumer prices on the one hand, and a greater degree of specialisation and concentration on the part of the companies on the other. The EC's Water Framework Directive of December 2000 placed an even greater burden on water suppliers: they have to meet high ecological standards but also pursue a price policy that covers their costs.

Already in 2002 the DG Competition of the European Commission commissioned a huge report on the European water markets, which had been delivered in December 2002.<sup>23</sup> This showed the increasing interest in the DG Competition in this still closed sector of public services. It was noticeable that the Commission was seeking to employ European Competition Law in water markets in a way similar to its use in the area of local public transport (LPT). As such, it is not aiming at a privatisation of companies, which is not a task as European competition surveillance authority due to the neutrality clause of article 295 EC-treaty. Instead it seeks an increase in price transparency and a stronger competition for markets. In order to achieve this, the Commission considered a significant reduction in the length of concession periods as well

---

20 In May 2003, the member states were presented with a 31-page questionnaire, with which the Commission asked for information on the legal conditions and the structure of the water market – including about costs and investments.

21 See. Deutsche Bank Research, *Wasserwirtschaft im Zeichen von Liberalisierung und Privatisierung*, 25.08.2000, and Hans-Jürgen Ewers et al, *Optionen, Chancen und Rahmenbedingungen einer Marköffnung für eine nachhaltige Wasserversorgung*, BMWi-Forschungsvorhaben, End Report, July 2001.

22 Jan Byatt, *The Impact of Directives on Water Consumers in England and Wales*, in: *Journal of European Public Policy*, 3 (1996) 4, Pp. 665–674.

23 Wrc And Ecologic, *Study On The Application Of The Competition Rules To The Water Sector In The European Community*, December 2002, [http://europa.eu.int/comm/competition/publications/studies/water\\_sector\\_report.pdf](http://europa.eu.int/comm/competition/publications/studies/water_sector_report.pdf). For a harsh critique on this report see David Hall, *Water and DG Competition*, PSIRU-paper, May 2003

as of exclusive rights in local markets. Similarly, it weighted up the possibilities for a greater degree of differentiation in the areas of use when it comes to giving such rights. Further, the Commission looked at the benefits of a more intensive control of competition and state aid.<sup>24</sup>

By contrast, the European Parliament declared its opposition to a liberalisation on several occasions – most clearly in its Resolution on the European Internal Market Strategy and on the Commission’s Green Paper on services of general interest: “The European Parliament [...] considers that liberalisation of water supply (including wastewater disposal) should not be carried out in view of the distinctive regional characteristics of the sector and local responsibility for provision of drinking water as well as various other conditions relating to drinking water”.<sup>25</sup> This clear position of European Parliament on liberalisation restrained the European Commission from presenting initiatives to liberalize the European water markets.<sup>26</sup> The Parliament, however, had been not clear in spelling out what it meant with its demand to modernize the water economies instead to liberalize the markets and to privatize the undertakings.

Nevertheless the Commission tried to implant elements of transparency and competition into the national water markets. With two directives the Commission defined new rules for public tenders in energy, traffic, postal and water sectors.<sup>27</sup> This reduces the possibility of in-transparent and in-house selling; the legislation is thus a first, rather indirect step to break up and liberalize the national water markets by guaranteeing equal tender conditions in the market.

However, the straight attempts to liberalize the national water markets by European initiatives came obviously to a halt. A working group in the European Commission, established early in 2003, submitted a report in November 2005 in which the technical restrictions to install a competition within the market were named as main reason again a full liberalisation of the European water markets. The report based on a comprehensive picture of the

---

24 See Alexander Gee, Competition and the Water Sector, in: EC Competition Policy Newsletter, (2004) 2, pp. 38–40.

25 European Parliament, P5\_TA-PROV(2004)0018, Dienstleistungen von allgemeinem Interesse. Entschließung des Europäischen Parlaments zu dem Grünbuch der Kommission zu Dienstleistungen von allgemeinem Interesse, Ziffer 47.

26 On the occasion of the plenary debate on the of the European Parliament’s opinion and the Rapkay-report on the White Paper on Services of general interest on September 26, 2006, the President of the European Commission stated that the Commission will proceed with the its approach of sector specific regulations. However, he didn’t mention the water sector but only health services, social services, energy and postal services.

27 See Directive 2004/17/EC of the European Parliament and of the Council of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors and Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts, in: Official Journal of the European Union, L 134, Volume 47, 30 April 2004.

national water markets in the European Union and on the position papers of the member states.

The process of drafting the report and the national reactions made very clear that the political resistance against attempts to liberalize the national water markets, to open the markets and to harmonize the organisation would be very strong. This implies that the momentum to privatize public water suppliers vanished. But although the external incentives diminished there might be enough domestic reasons to privatise the national water companies in the member states.

#### **4. The European water economy between „local atomisation“ and global players**

The European water markets are – with the exception of the English and French markets – still characterised by the historical dominance of local providers and public service companies. Despite the show of will on the part of the EU, not to privatize the water supply undertakings, one can identify in Europe as in the rest of the world a growth in the influence of the private economy on water markets. This can, however, be traced principally to Public-Private-Partnerships rather than to complete privatisations of a water supply undertakings. Nonetheless, the structures and legal foundations of the water economy differ strongly from EU member state to member state.<sup>28</sup> One may therefore differentiate between three types of privatisation in the European Union<sup>29</sup>:

- a) Full privatisation, i.e. the complete undertaking as well as its tasks are transferred as a whole to a private enterprise. This type can be found in England and Wales.
- b) Fixed-term or functional privatisation, i.e. the task to supply water and to operate the water networks are temporarily delegated to private suppliers via concessions. France is the best example for this type of privatisation.
- c) Organizational or formal privatisation, i.e. the task to supply water remains with the state resp. the municipalities and the supplier is formally transformed into an undertaking under private law for

---

28 The country studies in the Commission-funded study by the WRc Group (Water Research Centre) and Ecologic give a good overview over the positions in the EU-15, WRc&Ecologic, Study on the Application of the Competition Rules to the Water Sector in the European Community, Swindon/Wiltshire, December 2002.

29 See Johann Wackerbauer, Regulierungsmodelle für die öffentliche Wasserversorgung und ihre Wettbewerbseffekte, in: ifo – Schnelldienst, 2003, 56. Jg., Nr. 21, S. 9-18; Gerald G. Sander, Liberalisierung und Privatisierung im Bereich der Trinkwasserversorgung, in: Gerald G. Sander, Georg Becker (eds.), Aktuelle Probleme der Daseinsvorsorge in der Europäischen Union, Europäisches Zentrum für Föderalismus Forschung, Occasional Paper No. 33, Tübingen 2006, pp. 93-112.

example as municipal enterprise. This model can be found mainly in Germany, Austria and the Netherlands.

Parallel to the trend towards privatisation one can also identify a shift towards Europeanisation and towards concentration in the European water economy. The big French water companies are active in the German market via subsidiaries. Vivendi has, for example, become active thanks to its majority takeover of the Berlin water utilities. The German company RWE, was represented in England since 2001 until RWE changed its business strategy and sold its daughter company Thames Water in 2006. Companies that are active internationally increasingly pursue multi-utility-concepts, and as a result are present in the areas of water supply and waste management as well as energy supply (gas, electricity).

Nevertheless, the water markets in the European nation states differ fundamentally in respect to the legal status of the firms and the organisation of water supply. The water markets of *England and Wales* have undergone the most radical privatisation. With the Water Act 1989 ten regional water authorities had been completely privatised. The assets and liabilities of the water and sewerage authorities were transferred to ten private companies each of which was a subsidiary of a holding company; the shares in these holding companies were then sold. To regulate the new market the government employed a central supervisory authority, the Office of Water Services (OFWAT), to set upper limits for prices and to supervise the infrastructure. The Drinking Water Inspectorate (DWI) and the Environmental Agency (EA) shall control the quality of the drinking water and the environmental standards. However, the water prices have risen in real terms by 46 percent between 1989/90 and 1998/99. The formerly scheme of charging on an unmeasured basis changed to charging on a metered basis. This method enabled the companies to charge their costumers according their water use and to encourage them to use water more efficient. Private concerns are in direct competition with one another, although competition is mainly *for* markets and is only created *in* the market through the building of alternative networks for large-scale industrial customers.

Hence, the high hopes to benefit from the full privatisation could obviously not be met in this only fully privatised water market in Europe. In 2001 the regulating authority OFWAT had to force the private suppliers to lower the water prices by 13.7% on average. Though the new enterprises made high investments into the infrastructure in the first years, the investments had been insufficient and the water quality remained low compared with European standards. To pay the dividends of the share holders the investment

programmes had been cut significantly since the mid 90ties.<sup>30</sup> At the same time, however, the salaries of the directors and the company profits rose sharply, which led to criticism in the British public and the parliament.<sup>31</sup> Furthermore, in the first years after the privatisation the new enterprises reduced their work force by 40.000 people and this trend to cut the work force remained; since 1990 about 21,5% of the former employed lost their jobs.<sup>32</sup>

In *France*, the 19th century witnessed the foundation of the first private water service firms, when the dominant system was private concessions. In the 1970s the dominant mode of privatisation in the French Water sector is the delegation by lease contracts between the municipalities and private suppliers. Today the French market is dominated by three large concerns: the world's largest water concern, Veolia Water (formerly known as Vivendi Waters); SUEZ-Lyonnaise des Eaux (SLE) and Bouygues/SAUR. These three companies serve around 80 percent of the French water market. Veolia serves about 25 Mio. people and possesses about 4000 supply-contracts, Suez delivers water to about 14 Mio. customers and has 3000 contracts and Saur serves about 6 Mio. with about 6000 contracts. About 70% of the municipalities have entrusted these three private enterprises to provide water. Only in some small and agricultural local areas, the local authorities provide services through their own operations. Since the April 1993, water service contracts have had to be made public, particularly concession contracts that last for long periods (between 12 and 25 years). Almost all the contracts lay down that private water providers take on all investment costs, but remain free to set their own price levels. Water plants remain, for the most part, public property. The French water market is not comprehensively liberalised, but rather constitutes an oligopoly, dominated by the market leaders. Various studies have pointed to the fact that the water prices of the individual operations of the local authorities are lowest, whilst the prices charged by the private-concession providers are on average 30 per cent higher.<sup>33</sup>

There is a clear contrast between the French water market – highly concentrated and oriented towards the world market – and the German “atomistic”<sup>34</sup> market, which is characterised by small and medium-sized companies.

---

30 See Gerald G. Sander, p. 97.

31 House of Commons, Research Paper 98/117, Water Industry Bill, 10 December 1998.

32 David Hall, Emanuele Lobina, Employment and profit margins in UK water companies: implications for price regulation proposals, PSIRU-Reports, No.: 9911-W-UK.doc, November 1999.

33 See Hans-Jürgen Ewers et.al., Optionen, Chancen und Rahmenbedingungen einer Marktöffnung für eine nachhaltige Wasserversorgung. Juli 2001.

34 See Deutsche Bank Research, Wasserwirtschaft, p. 4.

The *German* water market is the largest in Europe with a turnover of around 17 bn. €/year. There are nearly 90 water providers in Germany for every million inhabitants; around 60 percent of the water volume is produced by just 3.6 percent of these companies. The provision of drinking water is taken care of by around 7,000 water-provision companies, which in turn operate around 8,600 water works and 10,800 water making plants. Sewage service is undertaken by around 8,000 waste management firms with 10,273 management plants and 450,000 kilometres of pipeline. These companies too are almost completely in the possession of local authorities.<sup>35</sup> More than 90 percent are run as the property of local authorities or as fusions of municipal supply firms. The special form of voluntary cooperation in municipal water and sewage associations, which is in some cases demanded by public authorities, dominates the German market. Just 1.6 percent of the providers are completely privatised and are run without any kind of public participation.

In Germany, the price of drinking water rose between the beginning of the nineties and 2001 by around 40 percent, although it should be mentioned that the biggest leap was at the beginning of the nineties. Since the end of the last decade this rise in prices has slowed. On the other hand, the German water providers are investing steadily and obviously more than private supply companies in other member states into the infrastructure. The security of supply and the network infrastructure as well as the water quality are in good shape. The water losses due to damages of the networks add up to about 7.3% whereas the losses in England and Wales total about 19.2% and in France about 26.4% of the water.

A Europe-wide price comparison does certainly show that German drinking-water prices are at the top end of the scale along with the Dutch. This is also the case with German waste costs which are at the peak alongside those in Austria. On the other hand, prices are scarcely comparable either worldwide or in the EU, since the price structure and the criteria for price-setting and for the quality of drinking water, water consumption and the security of supplies as well as for covering costs are very different.<sup>36</sup> Thus, the prices in many countries are state-supported – in Germany this subsidy lies at approximately 17 percent of the actual cost; in France it is about 20 percent; in Italy, anything up to around 70 percent. Whilst in France, Italy and England water loss through defective pipe networks lies at around 20 - 30 percent, in Germany and Denmark it is below 10 percent. Although in Germany, Austria and the Netherlands almost all households have meters which allow measurement of

---

35 Report of WG III »Fortentwicklung der kommunalen Wasserwirtschaft« zur 172. Innenministerkonferenz der Länder vom 28./29.4.2003.

36 According to the Federal Association for Gas and Water (BGW).

consumption, only 18 percent of British homes have a meter. Water costs in Great Britain are currently calculated for the most part on a flat-rate basis. In Ireland, water costs are not allocated through fees or calculations but rather they are financed as a state service. As for Germany, the opinion is generally accepted that the water prices are appropriate given the high degree supply-security, of water quality as well as the density of the pipe network and the high standards that underpin it (as indicated by the small levels of water loss). In fact the small water providers are locally restricted monopolies, which are only allowed to provide water in their secured area. The costumers don't possess the option to change the water supplier. Thus, there is no real market competition in the German local monopolies and due to the small, framed markets and the missing possibility to expand there is no incentive for private water companies to invest. Only in cities or conurbations, like Berlin or Stuttgart or in the Ruhrgebiet private water suppliers were committed on the German market and bought shares of the municipal water supply companies. This extreme fragmentation is a result of the traditional local competencies for water provision and waste management within the public service framework. The "atomisation" of the German market has acted as a block to the stronger participation of German supply companies in the growth potential of the water market. Alongside the limited size of the companies, commentators identify in the separation between water provision and waste management, as well as in the differentiation of the various related markets (plant construction, engineering services, controlling, labour, accountancy etc) a failing that explains the limited competitiveness of the German water market. The German Bundestag, Federal Government, Länder and associations of local authorities as well as the relevant associations of water providers are all opposed to a further privatisation and liberalisation. Since 2002, they have advocated the same aim – namely energetically restructuring rather than further liberalising the German water market. Already in 2001, the German Bundestag recommended in its resolution on a sustainable water economy for Germany a strategy of modernisation for national providers in order to reinforce the international competitiveness of the German water economy. The federal government then, after various hearings and consultations, presented in March 2006 a comprehensive modernization strategy for the German water market.<sup>37</sup> The three central elements of this strategy are a transparent and inclusive benchmarking, the possibility to open the regional monopolies and to break up the local structure with small municipal providers and finally public support to increase the export capacities and to support the German firms to expand on international markets.

---

37 See Deutscher Bundestag, Drucksache 16/1094.



However, the Bundestag termed the provision of drinking water a “core public service and thus a task for local authorities”. This gave rise to a contradiction between the efforts to safeguard the fragmented local water economy and the aim of creating efficient companies, with the potential to exhaust international water markets.

In *Sweden*, there are approximately 2,000 local water providers delivering water to around 90 percent of the Swedish population at relatively low prices. Since the 1990s, water services have been partly privatised in individual cities; complete takeovers of water service operations by private companies have only occurred since 2000.

In the *Netherlands*, a state initiative led to the controlled concentration of water provision. The number of water providers sank from an initial 110 to around 20 companies. A further reduction to 5-8 firms had been planned. The local authorities remain the owners of the companies. However, the concentration and de-municipalisation of the Dutch water industry did not lead to privatisation. In 2000 the Dutch government emphasized the public character in water supply in the Netherlands and all attempts of privatisation had been stopped. The reason had been obviously the concerns of government and municipal and regional authorities of rising prices. Thus, the Netherlands are a rare example with a centralised but public water supply. Hence, the Netherlands tried to combine public ownership and responsibility with concentration and efficiency gains.

In *Austria*, water provision is organised by around 4,000 small and very small water provision companies at local level. Only about 200 of these firms service areas with more than 200 inhabitants. The privatisation of some municipal water supply companies aimed at the concentration of the small and very small enterprises and to make the Austrian water supply system more effective. In 2001 the consulting company PriceWaterhouseCoopers submitted a study on the need to reform the Austrian water market to the Austrian ministry of Agriculture, Forestry, Environment and Water Management.<sup>38</sup> The study proposed to liberalize the water market by diminishing public subsidies and by merger the small firms. The study came to the conclusion that cost savings of max. 20% could be feasible. After some attempts to privatize parts of the municipal firms in some mayor Austrian cities the emerging public debate stopped the full privatization. In Vienna the public debate led in 2001 to the legal prohibition to privatise the drinking water supply and the inclusion of this prohibition into the municipal constitution of Vienna.<sup>39</sup>

---

38 See PriceWaterhouseCoopers, *Optimierung der kommunalen Wasserver- und Abwasserentsorgung im Rahmen einer nachhaltigen Wasserpolitik*, Endbericht, Wien 2001.

39 See Andreas Höferl, *Privatisierung und Liberalisierung öffentlicher Dienstleistungen in der EU-25*.

In *Italy* too, first steps towards the participation of private firms have been underway since the end of the 1990s. The ca. 13,000 local water operations underwent a process of restructuring similar to those introduced in *Spain* and *Portugal*. In the new EU member states, concessions have been granted to private water suppliers above all of French, British and German concerns, albeit often without a call for tenders. The market share of private providers, nevertheless grew only slowly. The *Czech Republic* is something of a trailblazer where the local water works have been progressively privatised, in tandem with sometimes considerably price increases for consumers.<sup>40</sup>

## 5. Liberalisation and privatisation through European incentives

For more than a decade, one has been able to identify a strong trend towards the privatisation of water providers. The trend towards further privatisation, towards a concentration of a few internationally competitive multi-utility companies and thus towards an Europeanisation of competition has unleashed a fundamental structural change, which accelerated the processes.

The global water market becomes a more dynamic in the face of a constantly expanding world population and the indispensability of clean drinking water and healthy waste management. Given the enormous need for investment and financing in order to cover these basic needs, poorer countries will not be able to avoid resorting to private capital. Even in Europe, the proportion of private water and waste firms will increase, not least in order to cover the need for modernisation in the European water economy – in particular, in the new member states.

In Germany for example, the biggest water market in the European Union, there is a tendency for more private and less public undertakings. Private law form of organisation prevail, in 2003 the German water supply firms under private law provided 30.2% of water quantities against 12.7% in 1986. However, the pure private water suppliers are still on a low level with 3.5% water supply in 2003 and the dominating form of organisation are public private companies operating under private law with a percentage of 28.8%.<sup>41</sup> These figures

---

Zusammenfassung. Österreichische Gesellschaft für Politikberatung und Politikentwicklung - ÖGPP  
Wien 2005 [[www.politikberatung.or.at/wwwa/documents/Zusammenfassung.pdf](http://www.politikberatung.or.at/wwwa/documents/Zusammenfassung.pdf)].

40 See Dave Hall/Emanuelle Lobina/Robin de la Motte, Water Privatisation and Restructuring in Central and Eastern Europe and NIS Countries, 2002, Public Services International Research Unit (PSIRU) Report, March 2003.

41 See Arbeitsgemeinschaft Trinkwassertalsperren e. V. (ATT), Bundesverband der deutschen Gas- und Wasserwirtschaft (BGW), Deutscher Bund der verbandlichen Wasserwirtschaft e. V. (DBVW), Deutsche Vereinigung des Gas- und Wasserfaches e.V. Technisch-wissenschaftlicher Verein (DVGW), Deutsche Vereinigung für Wasserwirtschaft, Abwasser und Abfall e.V. (DWA), Verband kommunaler Unternehmen e.V. (VKU), Branchenbild der deutschen Wasserwirtschaft 2005, Bonn 2005, p. 13/14.

illustrate a twofold development – first, a strong tendency to private law providers and away from public municipal firms and second, the negligible role of fully privatized supply firms.<sup>42</sup>

Hence, it is most important to differentiate between purely formal and material or functional privatisation. In every member state there has been an increase in the different models of company, although the type that dominated was still the public company – for the most part, owned by the local authority -, whilst private companies remained the exception. Three models can be identified in Europe:

- ▶ the German-Austrian model in which the water economy is a key task of public services and self-administration at local level,
- ▶ the model of the purely private economy in England and Wales, in which the regulatory authorities monitor the protection of the water, environmental and quality standards as well as price levels. In this, providers subject themselves to a strict competition, and
- ▶ the French model of concessions which has led to an oligopoly of a few internationally competitive large concerns beyond the structure of services run and owned by local authorities.

Although the experiences gained with the liberalisation of other network-based universal services – such as in the energy and communications markets – have had at first a signal effect in favour of similar changes in the water sector, the experiences and international comparisons in this sector have cast doubt upon the positive effects of opening up the market. The prices of drinking water supplied by privatised undertakings developed not better than the prices of public enterprises.<sup>43</sup> Overall there seems to be little difference between public and private water organisation.<sup>44</sup>

What is more important than the question of ownership is apparently the problem, how to introduce elements of competition into the market. To change the organisation of providers from public to private monopolies or oligopolies does perhaps fulfil formal criteria for privatisation, however it does not fulfil the criteria of an open market economy. Thus, the distinction between competition *inside* and *for* the market is essential. However, the speciality of water as trading commodity makes competition inside the market

---

42 See Matthias Egerer/Johann Wackerbauer Strukturveränderungen in der deutschen Wasserwirtschaft und Wasserindustrie 1995 – 2005, München, Oktober 2006.

43 See Matthias Egerer, Marktstrukturveränderungen in der Trinkwasserversorgung - Eine Analyse ökonomischer, ökologischer und sozialer Auswirkungen am Beispiel Deutschlands, ifo Beiträge zur Wirtschaftsforschung Band 22, München 2005.

44 For the US water market see Scott Wallsten/Katrina Kosec, Public or Private Drinking Water? The Effects of Ownership and benchmark Competition on U.S. Water System Regulatory Compliance and Household Water Expenditures, AEI-Brookings Center for Regulatory Studies, Working paper 05-05, Washington DC, March 2005.

very difficult. Water as food stuff reduces the possibility to mix different types of drinking water and to use a common pipe network by different providers; hence, the option of unbundling distribution nets and production of drinking water is almost impossible. Water as traditional natural monopoly and the high fix costs make it furthermore not efficient to build a second parallel distribution system. Thus technical, economic, biological and health obstacles prevent the competition for the consumer between various suppliers. This had obviously also been the analysis of the European Commission interservice working group which recommended in 2005 to abstain from the traditional instrument to liberalise a market sector, i.e. not to submit a sector specific regulation.

Accordingly, the only option to implement more competition is the competition *for* the market. The aim here is to establish more transparency and rivalry when calling for tenders, for example to regulate the maximum duration of concessions. These elements of competition might lead to fixed termed or functional privatisation of water supply. The European Commission obviously opted for this path by submitting its new sector regulation for public tenders. The European Commission's approach to bring the granting of concessions and other forms of public-private partnerships in the area of services of general economic interest in line with the precepts of European tender law will increase the competition. The Commission had been assisted from the ECJ, which restricted the option for in-house contracts and demanded official tenders also with just partially privatised undertakings in its ruling<sup>45</sup> against the city of Halle.

Even if open liberalisation and privatisation in the European water markets came apparently to a standstill after the European Parliament denied all efforts for market liberalisation and after the European Commission felt the strong commitment of the member states sticking on their national structure and organisation of water supply in 2004/5 the influence of European legislation remains noticeable. The Commission no longer follows the classic way to open up markets by sector legislations but now tries to introduce competition elements with respect to tenders and restrictive In-House businesses. In order to create economic conditions that are increasingly equal, this policy will not necessarily lead to a change in ownership structures, but it will certainly be conducive to a fundamental reform of market structures. It is also thinkable that the current principle of locality that structurally underpins German local authorities, and which geographically restricts the market for local service providers, will be abandoned in favour of large-scale fusions of local providers.

---

45 See EcJ, 2005, C-26/03

However, it is not the current situation that is of importance for increased private capital interest in the water sector, but the potential for development of a dynamic market seems to be of much more relevance. And here even worse the initially high hopes for new global markets seem to disappear. Since 2002 the big multi-utility supply companies reduced their engagement in the water sector because of reduced profit expectations.<sup>46</sup>

As a result of this development, one may predict that the small local monopolies could survive the hard competition with huge multi-utility firms at least in continental Europe. Nevertheless also these small water suppliers have to improve their market robustness and their efficiency. This process of modernising the traditional structures and organisation of water distribution seems to be the strategy of the European Parliament and member states. The aim to modernise the water industries implies the orientation at efficiency and competitiveness of the undertakings and will somehow via the backdoor open up the previously monopolistic markets. Private capital is welcomed, especially in municipalities with massive budget constraints but this process is not expected to lead to a comprehensive and full privatisation of water supply companies in Europe.

---

<sup>46</sup> The German global player on water markets, RWE, sold its daughter Thames Water in England and the French global player Veolia sold its holding Southern Water.