NEW REPORTS

Privatization of Water Services in the United States: An Assessment of Issues and Experience

by Jeffrey Jacobs

Although privatization of water services has long been an option for U.S. municipal governments, interest in the prospects for private sector participation in water utility ownership and operations grew markedly during the 1990s, both in the United States and abroad. A committee was appointed in 1999 to review the issues and experience with water services privatization in the United States. The committee's report was released in March 2002.

The term "privatization" covers a broad spectrum of water utility operations, ownership, and management, ranging from private provision of various services and supplies (e.g., laboratory analysis), to contracting with a private firm for operations or plant design and construction, to the outright sale of water utility assets to a private firm.

The report identifies and explains the factors that are driving municipal officials to consider privatization as an option, which include: a huge backlog of deferred maintenance to the nation's water storage, treatment, and distribution systems (some estimates place the cost for necessary investments for replacement at $250 billion over the next 30 years); municipalities are challenged to comply with increasingly stringent water quality standards; operations of water utility plants are becoming increasingly complex and it may be difficult to recruit and retain qualified professionals and to keep pace with technological changes; and several large water firms (based in both the U.S. and abroad) that possess ample resources, competent business and technical staff, and state-of-the-art laboratory and other facilities, are seeking market opportunities in the water utility sector.

Privatized water services have a long history in the United States, and the initial water systems in large U.S. cities were private ventures. As the nation's cities expanded, however, the resources required to adequately maintain and extend the water infrastructure generally grew beyond the means of the private sector. Today, investor-owned water utilities account for about 14 percent of total U.S. water revenues, a market share that has held remarkably steady since World War II. There are currently about 54,000 U.S. community water systems, the vast majority of which serve fewer than 10,000 people. These smaller to medium-sized utilities often face the greatest difficulties in meeting infrastructure needs and in satisfying water and wastewater effluent standards. For smaller communities—especially those located in remote areas—regionalization (consolidation of utility management and operations across several communities) has helped achieve economies of scale and improved performance. The regionalization option can be achieved through both public and private sector arrangements.

The report's key findings include:

- Water services privatization represents a viable alternative in many instances. Privatization also takes many forms, and no one form or structure best fits all situations.
- Pressure from large national and global water companies has motivated improved performance on the part of public water utilities in the U.S. Practices such as "benchmarking" and "reengineering" are being used in the public sector to help improve performance standards.
- Small to medium-sized water utilities face the greatest challenges, often have limited resources and access to contemporary facilities and training opportunities, and therefore are prime candidates for taking advantage of services from other sources. These other sources could include public water utilities as well as private firms.
- Not all water privatization efforts in the U.S. have been successful. Privatization efforts have in some instances led to repossession of contracts and litigation, and some contracts have not been renewed. By the same token, some public water utilities have experienced similar problems. Well-run and poorly-run organizations exist in both the public and private water sectors.
- The U.S. water services industry faces a very great need for water infrastructure maintenance and replacement. This need, driven by both low priorities assigned to water systems and past municipal budgets and by demographics, is an important driving factor in the interest in prospects of privatization.
- Liberalization of tax laws has partially leveled the playing field between the public and private sectors. Municipalities have enjoyed some tax advantages over the private sector—namely, the ability to issue tax-exempt bonds, assuring the public sector's ability to issue bonds at lower interest rates than taxable bonds. Recent legal changes have encouraged private participation in the operation of publicly owned plants.
- The Safe Drinking Water Act of 1974 has been a major factor in initiating management and operational changes to water utility operations; it has especially caused smaller to medium-sized utilities to improve operations or seek assistance.
- Continued public ownership and operation is the most likely future for the majority of water utilities. There has been a great deal of interest in and publicity surrounding the prospects for water services privatization. Nonetheless, the approximately 14 percent market share of private firms in the U.S. water business has remained steady over the past fifty years, and is likely to do in the near future.

The committee was chaired by Charles Howe of the University of Colorado in Boulder. A prepublication copy of the report is available through the WSTB at 202-334-3422.

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