The Fiscal, Economic, and Public Health Dangers of Water Privatisation

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- Sydney Water represents an essential public asset, important for both economic as well as public health reasons
- Sydney Water boasts total assets of almost $24 billion, public equity of $8 billion, annual revenues of $2.8 billion, and dividend and tax payments to the people of NSW that averaged $870 million per year since 2018
- The state earns far more from dividend payments arising from its equity in Sydney Water, than it would pay in interest on an equivalent amount of public debt
- Selling the utility would impose a significant fiscal cost on the state through lost dividend and tax revenues
- Experience with privately-owned water systems in other countries suggests water charges would rise significantly under private ownership, largely because of higher interest costs, higher debt, and higher dividend payouts
- Based on UK and US studies, Sydney Water customers could see their annual water bills grow under private ownership by 39% to 59% (or by an average of between $174 and $264 per customer per year)

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An Irreplaceable Public Asset

Safe drinking water and sewage services are one of the most essential elements of public infrastructure in our society. Communities cannot survive and thrive without reliable water services. Providing those services is core business for any municipal or regional government.

But beyond the obvious importance of good water systems to life, health, and well-being, the water system also constitutes a valuable economic asset in the overall portfolio of public enterprise (see box). Investments in high-quality water and sewage systems represent enormous sums of fixed capital. The financial and operational dimensions of water systems are significant to the fiscal and macroeconomic functioning of the whole state economy.

SYDNEY WATER BY THE NUMBERS

5.3 million customers (Greater Sydney, Blue Mountains, Illawara)

508 billion litres of drinking water delivered

Nearly 50,000 km of drinking & waste water mains

25 drinking and waste water treatment plants

3100 employees

$23.9 billion assets ; $2.8 billion annual revenue

In this context, suggestions that the Sydney Water system might be sold to private investors raise a wide range of significant concerns: regarding the efficiency and safety of their continued operation, access to healthy and affordable water services for state residents, and the economic implications for customers, workers, and state government itself. This brief reviews some of those concerns, and considers the likely consequences of Sydney Water's potential privatisation.

The Virtues of Public Water

As with other essential public services, there are solid economic and democratic reasons why maintaining water services in public hands is best:

- Water services are a natural monopoly, most efficiently delivered through a single provider operating in the public interest.
- Water services are heavily capital-intensive; governments are best able to stably finance long-term sunk investments in water infrastructure.

- Governments pay much lower interest rates than private firms, and this considerably reduces the cost of capital-intensive services such as water.
- Private suppliers require extensive, duplicative, and wasteful administrative, financial, and marketing overhead that is not relevant in public agencies.
- Private provision of a natural monopoly service necessitates a system of regulatory oversight to prevent exploitation of consumers or workers; this regulatory oversight is expensive, unproductive, and often 'captured' by the private interests it is supposed to regulate.
- On top of their higher interest costs for capital, private firms pay out significant dividends to their owners which adds further to the cost of water supply.
- To further supplement profit margins and dividend payouts, private owners have a direct incentive to cut back on operating costs, quality and safety practices, and working conditions and compensation for staff. This can jeopardise public health and social benefits.

The economic rationale for private ownership of essential public services is weak, and real-world experience with failed privatisations throws further doubt on the rationale for selling off a valuable, successful public service like Sydney Water. Why, then, would a government even entertain the idea? The explanation ultimately rests in politics, more than economics. The vested influence of powerful financial interests, who hunger for the opportunity to profit from the sale and operation of a lucrative, low-risk public asset, is the only reason why privatisation of this asset would even make it onto the policy agenda.

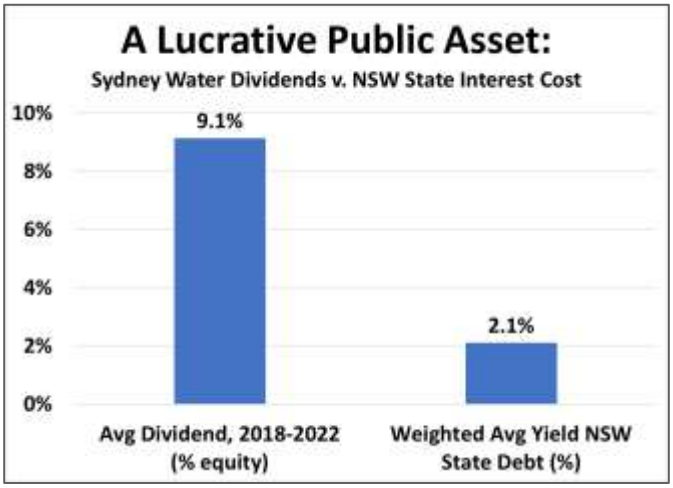
Healthy Returns from a Valuable Public Asset

The most important priorities for Sydney Water (as codified in its founding legislation) are to deliver safe, affordable water services to its customers, and protect the natural environment from which water is sourced and ultimately returned. A secondary goal is to operate a successful public enterprise, including generating reasonable returns for the utility's owners: namely, the people of NSW.

Sydney Water has done that consistently. After paying operating costs and interest costs on its debt, the utility rebates a significant dividend each year to the state. Those dividends fluctuate each year, depending on economic and environmental conditions. Over the last 5 years, Sydney Water has paid an annual divided averaging $680 million per year.

That annual income supports the capacity of the state government to sustainably fund vital public services. For example, that average annual dividend exceeds the $612.5 million amount announced recently by the state Treasurer to strengthen COVID-19 responses within the state's health care system in 2023-24 (Kean, 2023). If that flow of income is foregone as a result of privatisation, revenues to support health care and other vital services will have to come from other taxes and fees – or else state residents will face equivalent reductions in those public services.

Some advocates argue that using the initial proceeds of privatisations to reduce public debt is a better use of a publicly-owned asset. This view reflects a lack of financial understanding. The average annual dividend paid by Sydney Water to the state government over the last 5 years represented an average return of over 9% on the state's equity in the utility: over 4 times as high as the average weighted interest rate currently paid on state debt (reported in the state budget). Selling the utility, even if the proceeds reduce state debt, will impose a significant and ongoing financial loss on state taxpayers – even before considering the negative impact of privatisation on water bills (discussed below).



Source: Author's calculations from Sydney Water Annual Reports and NSW 2022-23 State Budget (p.6-6).

There is a second important revenue loss that the NSW state government would also incur if Sydney Water was privatised. At present the company's annual income tax is paid to the state government (not the Commonwealth), in accordance with the *State Owned Corporations Act 1989*. This 'notional' tax is paid in order to ensure a level playing field between state corporations and private firms, but it in effect represents a second source of income for the people of NSW from their ownership of this asset. Over the last 5 years, this notion tax payment to the state government has averaged $190 million per year. Under privatisation, that revenue would be diverted to the Commonwealth.

The combined loss of the annual dividend (averaging $680 million) and the notional tax (averaging $190 million) would represent a substantial and ongoing fiscal cost to government from the sell-off of this public asset: reducing state revenues by some $870 million per year.

Privatisation in Australia: Private Failure, Public Cost

Australians have ample experience with the broken promises of privatisation, in many different areas of economic life and public service. Promises that selling public institutions and services to private investors would lead to lower costs for taxpayers, greater efficiency, and higher quality service have been disproven repeatedly. The real economic efficiency of these operations has been undermined through rent-seeking behaviour by investors and their highly-paid executives, and by the unproductive financial and administrative overheads associated with private ownership. Regulatory agencies tasked with overseeing the operation of private monopolies are expensive and ineffective – and ultimately unnecessary, if these services were run in the public interest from the outset.

Some of the most glaring examples of the failure of private owners to reliably and fairly deliver essential public services include:

Electricity: Australia's fragmented, mostly privatized electricity system has become a boondoggle for electricity consumers and workers alike. Costs have skyrocketed, with consumers footing the bill for enormous increases in management, administration, and marketing expenses (Chester, 2015; Richardson, 2019a). Productivity in the industry has plummeted, dragged down by the deadweight cost of inefficient, duplicate corporate bureaucracies. The NSW state government's sale of the Vales Point generating station for $1 million to private owners, who in turn revalued it at $730 million, ranks as one of the most outrageous mismanagements of public wealth in Australian history (Latimer, 2017).

Vocational Education: The marketisation and private delivery of publicly-funded vocational education and training has degraded Australia's VET system from what was once among the world's most developed and successful, into a confusing morass of private profit and rorts (Pennington, 2022).

Employment Services: The privatisation of employment services to fragmented, often under-capitalised private providers was supposed to result in great accountability, flexibility, and customization of employment support functions. In fact, the opposite has occurred (Considine et al., 2011). Private providers game inconsistent performance metrics in order to cream greater profit from the stream of public funding for these services.

Ports and Airports: Critical pinch points in Australia's transportation infrastructure have also been sold off to private investors, who again take any opportunity to maximise their profits at the expense of public access, reliability, and user fees. Sydney's airport has been an especially lucrative cash cow for its private owners (Richardson, 2019b), yet despite its vast profitability the traveling public has experienced repeated episodes of extreme delay and congestion. The NSW state government's privatisation of Botany Bay port included restrictive monopoly terms that prevented the badly-needed expansion of container traffic through the Port of Newcastle (Ashokan, 2022). Once again, instead of promoting competition and efficiency, privatisation explicitly interfered with it.

Buses: The NSW state government has expanded private operation of urban bus services in Sydney, with negative effects on reliability and working conditions. A NSW legislative committee recently documented the reductions in service frequency and quality associated with private ownership, and recommended bringing the services back under public delivery (Rabe, 2022).

In all of these cases, and others, private ownership inevitably elevated the interests of financial investors and CEOs over the goals of public service delivery, safety, good jobs, and affordability. Where public services are concerned, the profit motive does not enhance genuine efficiency or innovation. Rather, it distracts and distorts the operation of public service institutions, spurring managers and owners to find ways of extracting more surplus – at the expense of both taxpayers and service users.

Some Australian jurisdictions have already had experience with the privatisation of water services, also with unhappy results. After 25 years of private delivery, Western Australia recently decided to bring water supply for Greater Perth and several other regions back into direct public delivery – including insourcing 420 jobs in both core operations and operations and maintenance work (Jenkins, 2019; Government of Western Australia, 2019). The government expects repatriation of ownership to save taxpayers at least $2 million per year.

In South Australia, in 1995 the state government tendered a 15-year contract for water supply in greater Adelaide to United Water, a consortium led by French company Veolia. 40 per cent of the workforce was made redundant after privatisation, with consequences for both water quality and the health and safety of workers. In 1997, the privatized sewage treatment plant experienced a major failure, involving release of hydrogen sulphide gas and requiring emergency responses from state services. In August 2009 the South Australian Government lodged a claim in the Supreme Court against United Water alleging deceptive and misleading conduct, breach of contract, and systemic overcharging. The lawsuit was settled in 2012, with payment of millions of dollars in damages by United Water to the public SA Water agency (ABC News, 2012). The contract with United Water was ended, and all major parties in the state now agree the state water system must remain in public hands (Evans, 2019).

In the ACT, some water services through ACT Energy and Water (ACTEW) were outsourced in 2000. Analysis at the

time warned the sell-off badly undervalued the public's ownership of both water and energy assets (Quiggin et al., 1998), but the government went ahead. However, after just a dozen years of disappointing private operation, the water system was taken back under full public ownership and control in 2012; water services are now provided through Icon Water, wholly owned by the ACT government.

Other water privatisation schemes have been rejected by Australians, including occasional calls to sell the Snowy Hydro water storage and hydro power complex to private investors (James, 2018). It seems that Australians have developed deep and justified skepticism about the effects of private ownership of this vital public service.

Some of Sydney Water's operations already incorporate needless and worrisome dimensions of private ownership: including outsourced maintenance work, private ownership of the desalinisation plant (which experienced major increases in costs last year), and Build Operate Own (BOO) schemes for infrastructure investments in new developments that create profit opportunities for investors while ensuring that the public sector carries the risk. Proposals to further privatise Sydney Water are bucking a strong trend that is visible in both Australia, and internationally. Many jurisdictions have experimented with private ownership of this vital public service – and a growing number are rejecting it.

International Experiences with Water Privatisation

Many countries sold off water systems to private investors during the hey-day of privatisation in the 1980s and 1990s – including the U.S., several countries in Europe, and many developing countries. Soon, however, strong public opposition to private water ownership emerged: in response to deteriorating water quality, operational failures, and price-gouging by private suppliers.

Empirical studies have shown there is either no difference in genuine operational efficiency under private ownership, in contrast to the assumption that private businesses are naturally more 'efficient' (Hall and Lobina, 2005), or else that management efficiency actually deteriorates under private ownership, with managers' attentions diverted toward financial and marketing schemes rather than core water supply priorities (Le Lannier and Porcher, 2013). Numerous studies confirm marked increases in consumer water charges under private water delivery systems (discussed further below). Public health concerns regarding private water – including the social and health impacts of low-income households being cut off from water service for inability to pay inflated bills – have also been documented in many locations, including in the context of the COVID pandemic (Zhang and Warner, 2021).

More recently, a new trend has featured local and regional governments taking back public ownership of water systems (along with other public services), through a process called remunicipalisation (Kashimoto, 2015). Between 2000 and 2020, a documented total of over 330 municipal and regional water systems around the world were remunicipalised (Chambers et al., 2022). The most dramatic in-sourcing occurred in Europe (including in major cities like Paris and Berlin).

Even in developing countries, where the reduced fiscal capacity of local governments make them more vulnerable to pressure for privatisation (often dictated by 'structural adjustment' requirements from international agencies like the IMF and the World Bank), the clear trend is toward insourcing water supplies. Notable examples of remunicpalised water include Jakarta, Indonesia, and several cities in Latin America. Repeated incidents of corruption and price-gouging by private water suppliers have reinforced growing popular demands for public water.

Private Water in England: A Litany of Failure

A powerful and cautionary tale of the dangers of water privatisation is provided by the experience of privatised water in England. Under the Thatcher government in 1989, 9 water systems were sold to private firms. The government received £7.6 billion for the sale. However, the government also took on £4.9 billion of the companies' former debt, and also provided them with £1.5 billion in initial working cash (Plimmer, 2017). So there were hardly any net proceeds to U.K. taxpayers at the time – but English water customers have paid mightily for this failed experiment in private delivery ever since.

Since privatisation the English water companies have paid out close to £20 billion in dividends to their owners – equal to almost all of the profit reported by the firms. As a result of those excessive cash disbursements, capital spending must be financed almost exclusively through new borrowing and higher debt. Interest costs for private owners are higher than those paid by government, so the impact on debt service costs is exacerbated. Regulators have allowed the firms to pass on higher debt charges to water customers through higher rates.

Other concerns with private water delivery in England include health violations (including venting of untreated sewage), inflated CEO compensation (with private water CEO salaries soaring to over £2 million per year, despite the low-risk, and regulated nature of this business), and degraded working conditions and safety standards (Ford, 2017).

Water was not privatised in Scotland. Customers there pay less than in England, yet the public utility has invested more in improved water infrastructure than in England (Yearwood, 2018). Even original architects of the English water privatisation now condemn it as "little more than an organized rip-off" (Portes, 2022).

Impact of Privatisation on Sydney Water Customer Bills

International research confirms that privately-owned water systems tend to extract higher service charges from customers, as investors and CEOs make operational and financing changes to maximise dividend payouts and capital gains. The impact of privatized water systems on customers is especially well-researched in the UK and the US, given the extent of private water ownership in those countries.

Financial analysis of 9 private water monopolies in England by Bayliss and Hall (2017), over the 10 years from 2007 through 2016, indicate an extra average cost to consumers of £111 per year, out of a total annual bill of £395 per year. The deadweight costs of private ownership (especially excessive dividend payouts and excess debt accumulation by private providers) thus raised average bills by 39%.

Meanwhile, a survey of 500 municipalities in the U.S. (Food and Water Watch 2015) found an even larger negative impact on household water bills. Average annual water bills in cities with private water utilities were $185 (U.S.) higher than in municipalities with publicly-owned systems. That represents an increase in average cost of 59% associated with private water supply.

The table below applies these findings to the case of Sydney Water's potential privatisation. We take the U.K. experience (39% increase) as a low case, and the U.S. experience (59% increase) as a high case. Those incremental costs associated with privatisation are applied to the aggregate regulated service availability and usage fees collected by Sydney Water in 2021-22, totaling some $2.4 billion. (We exclude other sources of Sydney Water revenue, including non-regulated fees and government grants, from this calculation).

Simulated Impacts of Privatisation on Sydney Water Bills		
	Aggregate ($mil)	**Per Customer ($)**
2022 Regulated Availability & Usage Charges ($m)	$2,368	$447
Low Case (UK)	39% increase	
	$924	$174
High Case (US)	59% increase	
	$1,397	$264
Source: Author's calculations from Sydney Water Annual Report 2021-22, Bayliss and Hall (2017), Food and Water Watch (2015).		

If privatisation lifts average costs the same amount as the U.K. experience, total water fee collections will grow by $924 million per year, or about $174 for each of Sydney Water's 5.3 million customers. If privatisation has similar impacts as the U.S. experience, fees will grow by almost $1.4 billion per year, or $264 per customer per year. Those extra costs will swell even further in subsequent years as a result of normal inflation and possible population growth.

Conclusions

International experience with the privatisation of municipal water systems provides a sobering caution about proposals to sell off critical public water infrastructure to private investors. There is no evidence that the fundamental economic efficiency of privately-owned water systems improves, and indeed some evidence that it deteriorates (as management becomes more focused on financial engineering and restructuring than delivering safe water to the community).

By artificially reorienting the balance sheets of privatized providers to maximise dividends and capital gains for investors, private water utilities tend to have higher debt loads and interest charges (made worse since private firms pay much higher interest rates than governments), higher dividend payouts, and less capital investment. Working conditions for those who maintain water systems are undermined by the drive for profit.

The costs of excess debt, dividend payouts, and managerial overhead are inevitably passed on to water users in the form of higher fees. International experience suggests that privatisation of Sydney Water would likely lead to an increase in annual water bills to the utility's customers of $1 billion or more per year – or between $174 and $264 per customer per year.

The fiscal impacts of privatisation for the NSW state government are also dubious. Sydney Water returns a healthy and important flow of dividends and income tax revenues to its public owners, averaging some $870 million per year over the past 5 years. Transferring the utility to private hands will eliminate that flow of annual revenues to the state government, requiring an increase in taxes from other sources. That would penalise the utility's customers a second time: they will not only pay higher water bills, but will also have to pay incrementally higher taxes (or, alternatively, endure reductions in state-funded services) to offset the loss of dividend revenue to the state government.

However, the greatest risk from privatising water systems cannot be measured in dollar terms. Water is an essential public service, vital to public health and livable communities. Jeopardising this critical element of community infrastructure, to deliver a new profit opportunity to investors, at a moment in history when the importance of protecting public health is perhaps better appreciated than ever, reflects badly misplaced economic and social priorities.

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