

**Energy Probe Research Foundation's Recommendations for Public Hearings 7 and 8:
The Management of Water Providers
September 20-25, 2001**

Revenue and Financing

The government should promote full cost pricing of water and wastewater services. Consumers should pay the full costs of constructing and operating water and wastewater systems. Full cost pricing and user pay encourage the efficient use and conservation of water resources, provide the means to support the provision of the service, rationalize investment, and encourage private sector investment.

Despite decades of broad support from governments, scholars, and NGOs, full-cost pricing has not been implemented. There has been no mechanism to implement it. Pricing has been in the hands of municipalities whose short-term priorities have been inconsistent with the long-term needs of the system. The implementation of full cost pricing will require that decisions be taken out of the hands of municipal politicians. Decisions on pricing should be made by an independent economic regulator. (See below.)

The government should phase out all direct and indirect subsidies to water and wastewater systems. Removing subsidies improves accountability, disciplines providers, reduces the existing dependence of municipalities, reduces perverse incentives (including the incentives to overbuild facilities and to allow facilities to run down), encourages conservation, and rationalizes decisions regarding where individuals and industries locate.

If particular users cannot afford to pay the full cost of water and wastewater services, the provincial government should provide these individual users with cash subsidies unrelated to their usage. This will encourage equity, efficiency, and conservation. Individuals will use their subsidies as they see fit.

Water systems should be financed privately. There is an acute need for replacement and upgrading of water and wastewater systems. Public sector financing is limited and is likely to be insufficient to meet infrastructure needs. Furthermore, public sector investment undermines the independence of public sector regulation. Reliance on private capital facilitates independent regulation.

The government should establish an independent, quasi-judicial economic regulator. The future safety of water supply in Ontario requires capable oversight of financing and revenue. Determining revenue requirements, allocating costs to customer classes, and designing rate structures is a demanding task and the expertise required to do so is not widely available to municipalities. The Ontario Energy Board's oversight of the province's natural gas distribution sector until 1998 provides a model of successful regulation.

The regulator should be charged with determining just and reasonable rates and with protecting the public interest. It should encourage public participation in the regulatory process. Due process should be available to all parties. The regulator's decisions should be subject to judicial review. Regulators need adequate resources; regulatory costs should be recovered from users.

Just and reasonable rates should include reasonable returns on capital.

Utility assets should be financed through efficient capital structures. The balance between equity and debt should be overseen by the economic regulator.

Privatization

The private sector should finance, operate, manage, and in many cases own water and wastewater systems. The benefits of the private provision of water and wastewater services may include: access to expertise; access to private capital; de-politicization of management decisions; staffing and operating efficiencies; willingness to charge prices that fully reflect costs; direct liability; and increased accountability.

The provincial government should not operate water and wastewater facilities. It should disband the Ontario Clean Water Agency (OCWA). If the government chooses to maintain OCWA, it should level the playing field to avoid undermining competition and discouraging private-sector involvement in the industry. It should create an arms-length relationship with the agency, withdraw all subsidies to it, impose a dividend policy that requires it to turn over surplus cash to the public, and hold it accountable for its performance by strictly enforcing environmental and health standards at its facilities. If the government does not remove OCWA's special privileges, and if it insists on maintaining the agency as an operator of last resort, it should allow it to accept contracts only if there is insufficient competition among other bidders.

The government should endorse privatization. It should issue a policy statement explaining the benefits of privatization. The government should distribute the policy statement to the media and to all municipalities.

The government should facilitate privatization. It should prepare case studies of privatization to illustrate how different approaches to privatization have worked best in different circumstances. It should prepare model Requests for Expressions of Interest and Requests for Proposals, along with information to guide municipalities through the bidding process. It should distribute model contracts. It should provide advice on how to make privatization work for labour, so as to reduce opposition to it from that sector.

The government should remove barriers to privatization. It should strictly enforce laws protecting public health and the environment. It should remove liability limitations on municipalities, municipal utilities, and their employees. It should stop subsidizing water and wastewater services.

It should remove the requirement that municipalities that sell their facilities repay grants. It should disband OCWA. (See above.)

Privatization will be most effective when it occurs in a competitive environment. Municipalities that privatize should avoid the sole-sourcing of sales or contracts.

Corruption must be avoided – and be seen to be avoided – if privatization’s benefits are to be realized. Privatization processes should be open, transparent, fair, and free of opportunities for influence. Robust access to information laws will increase transparency and accountability. Prohibiting campaign contributions from corporations and trade unions will reduce opportunities for influence. Restrictions on municipal politicians’ and bureaucrats’ freedom to take contracts or employment with those they have assisted while in government will further enhance the integrity of the privatization process.

Water and wastewater utilities should be subject to thorough, routine disclosure requirements for economic and quality data.

Privatization will require effective economic and environmental regulation. (See previous recommendations.)