The Privatisation of Water Utilities in Italy and the Associated Debate

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I. Introduction

Privatisation[1] per se has always been a highly controversial issue, but it becomes even more so when envisaging private sector participation in the provision of water services and sanitation. Due to the fact that water services are seen as such a key public utility, proposals for private sector participation often provoke strong opposition. Water is considered a common beneficial good, to be shared among all members of the community. It has to be safeguarded against waste and inefficient use, to preserve this resource for future generations.

Water has the characteristics of a natural monopoly[2] which is affected by asymmetric information[3] between regulators and regulated entities, more so in the form of moral hazard. Considering its particular nature[4], it cannot be governed simply through market rules, since private operators are naturally devoted to profit maximisation. Instead, it requires the public sector either to provide the utility directly or to regulate the private economic agent that provides water services for the common good.

II. A new Italian law for managing local public services

In Italy the debate over water privatization is now more intense than ever, largely due to the recent legal reform which has now come into force. The Italian legal framework for the operation and management of water supply services is the result of the combined provisions set forth in law no 36 of 1994, legislative decree no 152 of 2006 and the recent law-decree no 135 dated September 25th 2009, the so-called Ronchi act. The latter was converted into law, with some modifications, by Law 166, Article 1 paragraph 1 dated 20 November 2009. Article 15 of the Ronchi Act states that public service contracts have to be awarded to private operators whenever the service has economic relevance. According to this provision, local public services are essentially forced into privatisation, which will mean for Italy that the management of water supplies will shift from being mainly operated publicly-owned bodies to being exclusively operated by privately-owned or mixed-capital companies.

Furthermore, the law establishes that, except for unusual circumstances, public services contracts have to be ordinarily awarded to:

An undertaking

1. An entrepreneur or company, regardless of how established, selected by competitive public procedures in compliance with the Treaty principles and of the general principles regarding public contacts (in particular, the principles of transparency, equality of treatment, proportionality, mutual recognition, non- discrimination, cost-effectiveness, performance, fairness, objectivity, community-wide publicity and advertisement);
2. A mixed capital entity, conditional upon the private partner being selected through competitive

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1 The process of transferring ownership from the public sector to the private sector.

2 A type of monopoly that exists as a result of the high fixed or start-up costs. Because it is economically sensible, governments often regulate those in operation, ensuring that consumers get a fair deal.

3 A situation in which one party in a transaction has more (or superior) information compared to the other. This situation can lead to two main problems: adverse selection and moral hazard.

4 Water is a natural monopoly characterised by asymmetric information, and also a common good which has to be safeguarded also for the benefit of future generations. Water sustains life, so that "effective management of water resources demands a holistic approach, linking social and economic development with protection of natural ecosystems" as affirmed in the "Dublin Statement on Water and Sustainable Development", adopted during the International Conference on Water and the Environment, supported by the United Nations, in January 1992.

public procedures in compliance with the general principles of the Treaty on public contacts[5]. The criteria for the selection of the private partner should include not only its economic and financial standing but also its technical and professional capability. In addition, the private partner participation should account for at least 40 % of the subscribed capital.

Only under very restrictive conditions, local governments may decide to provide local public services directly through one of its offices or indirectly through a publicly-owned or affiliated undertaking[6]. This political choice is made possible only in the presence of exceptional circumstances related to specific economic, social, environmental, geomorphological characteristics of the territorial context, circumstances that prevent an effective and useful recourse to the market.

Also paragraph 3 of Article 15 of this law specifies that such departure from the ordinary local public service operation schemes is possible on condition that they are in compliance with the European Law requirements regarding in-house providing. Specifically, the control exercised by the public authority over the undertaking has to be analogous to the control that it exercises over its services, and the undertaking has to carry out most of its activities with the same authority which exercises analogous control[7].

Thus, from this moment on, if an Italian municipality wishes to manage water services in-house without subcontracting them to any privately-owned or mixed-capital company, it is required to participate in public procurement procedures in the same way as any other tenderer. This in turn raises problems of conflict of interests, human and monetary, resources, waste, asymmetric information. It also entails a risk that effective competition will be distorted. This solution seems to contradict reasonableness and the right to self-government of local communities arising from the EU and Italian Law.

III. The new law provokes a multiplicity of concerns throughout Italy

Law 135/2009 clearly enforces the privatisation of local public water services. This has raised many concerns throughout the Italian social and political environment, and alternative approaches have been put forward.

One such approach came from the *Forum italiano dei movimenti per l'acqua*[8] and the *SiAcqua-Pubblica*[9] committee. In particular, the *Forum italiano dei movimenti per l'acqua* called for a referendum to repeal Article 15 of the Ronchi Act.

The possible text of the abrogative referendum, which contains three different questions, was pre-

5 The procedure is in line with EU public procurement law which states that the joint venture model for public-private partnership involves the establishment of an entity held jointly by the public partner and the private partner. When there is a transition to a public-private joint venture and when such a transition is accompanied by the award of tasks through an act which can be designed as a public contract (or even a concession), it is important that there be compliance with the rules and principles arising from the EU law on public contract and concession (the general principles of the Treaty or, in certain cases, the provision of the Directives). If a private partner is selected to undertake such tasks although functioning as part of a mixed entity, this cannot be done exclusively on the quality of its capital contribution or experience; consideration should also be given to the elements of its offer, assumed to be the most economically advantageous, in terms of the specific service to be provided. There is an obvious risk: in the absence of a clear and objective criterion through which the contracting authority selects the most economically advantageous offer, the capital transition could constitute a breach of the law on public contacts and concession.

6 An affiliated undertaking would have its annual accounts consolidated with those of the contracting entity (in accordance with the requirements of the Seventh Council Directive). Alternatively, it could be any undertaking over which the contracting authority may directly or indirectly exercise a dominant influence by virtue of ownership, financial participation or the rules which govern it. For an affiliated undertaking's legal framework see Directive 83/349 OJ L 193, 18.7.1983, p. 1. and Directive as last amended by Directive 2001/65/EC on the European Parliament and the Council, OJ L 283, 27.10.2001, p. 28.

7 For further information on the topic of in-house providing see the European Court's judgments in the following cases: C-107/98, *Teckal*,[1999]; C-26/03 *Stadt Halle* [2005]; C-29/04 *Commission v. Austria* [2006]; C-340/04 *Carbotermo* [2006]; C-231/03 *Coname* [2005 C-458/03 *Parking Brixen* [2005]; and C-410/04 *ANAV* [2006]. See also Christian Iaione, *Le società in house* (2007); Id., "Local public entrepreneurship and judicial intervention in a Euro-American and global perspective", in *Washington University Global Studies Law Review*, 2008, Volume 7, Issue 2.

8 The first *Forum Italiano dei Movimenti dell'acqua* was hosted in Rome from 10–12 March 2006. At the present time it is the main promoter of the referendum campaign for the re-publicisation of water in Italy. To find out more, please visit the website <http://www.acquabenecomune.org/spip.php?article=6137>.

9 This committee supports the referendum regarding the re-publicisation of the water service. It was set up during December 2009. For further details please visit the website <http://www.siacquapubblica.it/>.

sented to the *Corte Suprema di Cassazione*[10] of Rome for approval on 31 March 2010. In the introduction to this referendum text they affirm that water is a common good and propose to define water supply as a service without economic relevance. It is also stated that the providing organisation should be a public body, positioned within the locality of the general public demand; furthermore, all decisions should be taken at the lowest appropriate level, with full public consultation and involvement of users in the planning and implementation of water projects. This is in accordance with Protocol no 26 of the Lisbon Treaty and also the subsidiarity[11] principle arising from European Law.

In Italy, a certain political reaction against the prospect of water privatisation stimulated a great deal of discussion and also a law bill of citizens' initiative on water supplies containing "Principles for the safeguarding, governance, management and provisions for the re-publicisation of water services". The text of the *PDL*[12] was put forward by the *Forum italiano dei movimenti per l'acqua* national committee on 7 October 2006. The following year, a supporting petition with 406,626 signatures was presented. The draft law was subsequently submitted to the Parliament in 2007 and it is currently under discussion.

One other case worth mentioning is a law bill of parliamentary initiative, presented on 26 November 2008, which called for the modification of the public assets and estates legal framework as defined in the Italian civic code. The text of the proposed bill attempts to distinguish between water management *in se* and the management of water services. Based on these legal changes the municipality would be the only organisation having the competence to administer the service, either directly or through some in-house undertakings. In the latter case, such bodies should be entirely controlled by the local authority and be financed for the most part by public capital.

Some Italian municipalities decided to pursue alternative paths. One such was the campaign *L'Acqua del sindaco*[13] which proposed to change the municipal statute in order to include anti-privatisation clauses.

Some regions reacted through their regional laws in order to avoid the privatisation of their water infrastructure. Puglia, for instance, established a regional law which defined water as a non-tradable good and water services as having no economic relevance. Implied through Italian law, this means that it is the region and not the state which has the competence to take decisions on the provision of water services, in accordance with the Constitutional Court's judgments in case no. 272 [2004][14]. Yet, we should not forget that several Italian regions appealed to the Constitutional Court in order to obtain the declaration of unconstitutionality of the Ronchi Act and of Article 23-bis of decree n.112, 25 June 2008, which became law on 6 August 2008 through law no. 133 of the same date.

IV. The debate

The new Italian law regarding local public services has created a deep division throughout Italian society between the promoters and opponents[15] of water privatization.

Those opposing privatization emphasise that water is a public and common good and that it should not be managed by private companies. This is because such companies are naturally devoted to short-term returns and are less concerned with issues such as the quality of the service, environ-

10 The *"Corte Suprema di Cassazione"* is the highest court in Italy's judicial system. Among its major functions, according to the main law on the Judiciary of January 30, 1941 No. 12 (Article 65), there is the duty "to ensure the correct application of the law and its uniform interpretation, together with the unity of the national objective law and the respect for the limits between the different jurisdictions." The Supreme Court also has competence to perform non-jurisdictional functions pertaining to the legislative elections and the referendum repealing the laws.

11 The principle of subsidiarity is defined in Article 5 of the Treaty establishing the European Community. It is intended to ensure that decisions are taken as closely as possible to the citizen.

12 *PDL* is a bill, i.e. proposed draft law under consideration by a legislature. A bill does not become law until it is passed by the legislature and, in most cases, approved by the executive. It could be presented by people with specific competences to take legislative initiatives as listed in Article 71 of the Italian Constitution. This states "The legislative initiatives belong to the Government, to any member of the Parliament and to any entity or organisation which is so empowered by the Italian constitutional law. The legislative initiatives can be exercised by citizens on the condition that they propose a test which is composed by articles and accompanied by 50,000 signatures at least."

13 Literally "The water of the mayor".

14 It is worth noting that recently the Constitutional Court's judgements in the case no. 307 [2009] seem to disagree with this line of reasoning.

15 See Christian Iaione, *L'acqua come bene comune* (2010), available on the Internet at <www.labsus.org>.

mental impact, the infrastructure, investment rate and certain social considerations. Therefore the opponents are calling for a re-publicisation of the service.

Conversely, those in favour argue that water will in fact be kept in public hands, since it is only the water supply, and not the water itself, which will be transferred to the private market. Perhaps this argument merely constitutes a democratic façade, contributing very little to the discussion.

In truth we are facing a market which has many peculiar traits owing to a natural monopoly affected by asymmetric information. On the one hand, this information is between the regulators and the regulated entities, and on the other hand, between ownership and management. These considerations influence the possibility of distinguishing between a genuine and purely formal ownership, due to the fact that it is very difficult for the ownership to seriously affect the governance.

Apart from the question of ownership, whether private or public, the core issue is how to regulate water supply. After several years of diluted and interconnected reforms, the Italian regulatory framework remains ambiguous. Consequently an efficient regulatory framework needs to be consolidated, defining a price cap to water tariffs and providing incentives to the private sector to act according to basic social desires.

V. An innovative approach to water management involving the participation of citizens

An innovative approach, suggested by some Italian academics[16] calls for a civic management of water, achieved through increased participation of citizens in managing common goods. In accordance with this notion, greater civic responsibility toward social and environmental issues will be induced. Simultaneously, policy makers should stimulate social actions while enabling social enterprises, charities and voluntary groups to play a leading role in delivering public services. Such an approach is in line with horizontal subsidiarity models for the management of public services, toward which the European Community has lately been shifting.

Although this may be difficult to apply at a larger scale, it appears to be well suited for smaller communities. To give an example of civic water management which has proved to be efficient, effective and successful, the citizens of Mezzana Montaldo[17] resisted the privatization of their aqueduct, opting instead for democratic water management. They established a consortium, called the *Consorzio acqua potabile Mazzana Montaldo*[18]. The citizens of Montaldo are both proprietors and users. They pay the tariff (which is below the national average), they make any decisions democratically through the consortium and are responsible for the management of the water services.

The *Montaldo* case is just one example of civic management in Italy and it offers an alternative solution to private and public management. These experiences are compatible with the idea of a civic and democratic management of the "common pool of resources". Such an approach is undergoing much scrutiny, while attracting the support of the notable scientist Elinor Ostrom[19], who justified it from an economic point of view[20].

Other examples of municipalities sharing the same approach as the one Montaldo took are the *Manifesto sull'acqua del sindaco*[21] and the *Case del-*

16 See Labsus.org, a laboratory for the enforcement of the principle of subsidiarity. Here volunteers elaborate ideas, gather cases and materials of any sorts and promote new initiatives. The main idea of the association is that people have not only needs but also capabilities, and it is possible that such capabilities are offered to the community to contribute to finding solutions to issues of common interest, in alliance with the government. For further details visit the website <http://www.labsus.org/>. See Christian Iaione, Editorial no. 58, "*L'acqua come bene comune*" (http://www.labsus.org/index.php?option =com_content&task=view&id=2073&Itemid =40).

17 A small town situated in the Alps of Northern Italy.

18 See <http://www.acquedottomontaldo.biella.it/>.

19 Elinor Ostrom (born 7 August 1933) is an American political scientist. She was awarded the 2009 Nobel Memorial Prize in Economic Sciences, which she shared with Oliver E. Williamson, for "her analysis of economic governance, especially the commons".

20 Elinor Ostrom has challenged the conventional wisdom that common property is poorly managed and should be either regulated by central authorities or privatized. Based on numerous studies of user-managed fish stocks, pastures, woods, lakes, and groundwater basins, Ostrom concludes that the outcomes are, more often than not, better than predicted by standard theories. She observes that resource users frequently develop sophisticated mechanisms for decision-making and rule enforcement to handle conflicts of interest, and she characterizes the rules that promote successful outcomes.

21 This is an initiative promoted by Hera (an holding established in 2002 through merging eleven public service companies in Emilia Romagna, Italy) in order to support the use of tapwater instead of bottled water, with the aim of preserving the environment. The manifest was signed during the "Water World Day", 22 March 2010, by several Italian mayors.

l'Acqua[22]. Both of these cases favoured implementing widespread and efficient use of water sources among citizens, believing that this would allow for the saving of public money and an enhanced protection of the environment.

In addition to managing the water service in small communities, citizens are also able to control the quality and efficiency of the service, for example implementing civic audit tools. This increases the accountability of the service provider towards society, regardless of whether they are private or public bodies.

Citizen participation in the management of public services, especially in relation to water supply, is not a new concept. For instance the "Dublin Statement on Water and Sustainable Development"[23] states that "Water development and management should be based on a participatory approach, involving users, planners and policy-makers at all levels. The participatory approach involves raising awareness of the importance of water among policy-makers and the general public. It means that decisions are taken at the lowest appropriate level, with full public consultation and involvement of users in the planning and implementation of water projects."

VI. A brief survey of Italian law relating to water

As a brief survey of Italian regulation of public water services, we may go back to 29 March 1903, when Law no. 103 proposed by Giolitti was approved. The purpose of this law was to municipalise certain local services, including the water service. The provisions of this law were successively collated in the *Testo Unico*[24] no.2578[25], of 15 October 1925. The resulting legal framework remained unchanged for almost a century and some of the provisions were upheld after the reform of local authorities signed by Law no.142 of 8 June 1990. Different rules relating to specific public services such as water, waste, etc. then followed in Law no. 142/1990.

Within the context of those rules, Law no.36 of 5 January 1994 was established to modernise and reorganise the supply of water. Acknowledging that the fragmentation of water services needed to be resolved in order to boost investment, the law extended the area over which a water authority could operate. Thus the Optimal Territory Areas (OTAs[26]) were established, with the aim of maximising efficiency. After OTAs become defined through proper regional laws, local Authorities[27] were subsequently introduced to preside over the OTAs.

Another aspect of the reform was that the service should be integrated, merging all the processes related to the delivery of water, into the hands of one manager only. Furthermore, for the first time in Italy, this manager could also be a private operator.

At the turn of the millennium the *TUEL*, *Testo Unico* on the Local Entities, was established. It contains three possible approaches to award water services: to private companies selected by public procurement procedures, to mixed-capital entities and to public undertakings through in-house providing.

Six years later the main points of the Galli Act, titled "Rules about water sources management" were included in the decree enforced by Law no.152 of 3April 2006, "environmental rules".

Decree 112 of 25 June 2008 introduced some changes to the legal framework in relation to the subject of water supply regulation. Public service contracts should normally be awarded to private entities through public procurement procedures and only with derogation to public undertakings through in-house awarding procedures.

Nevertheless the Italian legal framework relating to this subject has changed once again: on one hand, Article 1, paragraph 1-quinquies, of the Law no. 42 in 2010 provides for the abolition of the OTAs and, on the other hand, the Ronchi Act states that the water service supplier is required to privatise (at least for the 40 % of the subscribed capital) by the end of 2011, unless exceptional circumstances[28] occur.

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22 This is a public network infrastructure for water distribution, both still and sparkling. Water is taken from the public aqueduct and then delivered from private facilities.

23 The "Dublin declaration" was adopted during the International Conference on Water and the Environment in January 1992 and supported by the United Nations.

24 It is the framework law which includes all the provisions regarding a specific subject.

25 This is the framework law regarding the direct award of public services by municipalities and provinces.

26 *OTAs (*Optimal Territory Areas) are pre-defined geographical areas over which organised public services (such as water, waste, etc.) are integrated. This means that all the processes of the delivery are carried out by one entity only. OTAs are defined by proper regional laws.

27 These local authorities were called *Autorità d'Ambito*. They were entities with juridical personality and they had the competence of organising, awarding and controlling the management of the integrated services.

VII. Requirement to increase the investment rate within water infrastructure

In the water service markets, it is essential to have an effective and efficient management system. This is because water infrastructure is capital-intensive, requiring a continuous improvement on investments. Especially in Italy, it became important to invest in water infrastructure in order to avoid waste during delivery. For example, *ISTAT*[29] in 2008 accounted for a water waste averaging 47 %[30]. This percentage reaches the peak of 80 % in regions such as Puglia, Sardegna, Molise and Abruzzo. It is also possible to make a distinction between the South and the North of Italy both in terms of waste and tariff: these remain higher in the South of the country.

The recent reform will probably have an opposite effect than the one intended. Due to the legal uncertainty caused by continuous changes in the legal framework on water supply, it is likely that the infrastructure investment rate will decelerate[31]. This is even more true in the water sector since it is characterised by high fixed costs (usually sunk costs[32]) which can only be supported over the long term. Thus any undertakings operating in the provision of water need constant and sure income flows in order to gain an appropriate investment rate. This means they also need a certain regulatory and legal framework on the subject.

VIII. Conclusion

Water is an unusual product in many senses. First of all, it is a common good which sustains life and governments should at the very least ensure that the basic human need is satisfied[33]. Given the scarcity of this natural resource, water should also be safeguarded for the benefit of future generations,. Secondly, as public economists have long known, water and wastewater systems are natural monopolies that cannot compete in the usual way. Customers served by enormously capital-intensive networks of underground pipes connected to facilities with large economies of scale (e.g., dams and reservoirs, water and wastewater treatment plants, etc.) cannot stop purchasing from an inefficient or low-quality service provider. Natural monopolies cannot compete for customers in the usual way because customers cannot usually switch suppliers.

Monopoly is usually defined by economists as a market failure which needs to be regulated by a public sector intervention. Yet, this is not the only market failure which involves the provision of water services. In fact, asymmetric information and the principal-agent problem[34] both operate in this sector and this make it even more difficult to set efficient regulatory systems, effective controls and "carrot and stick" schemes.

The debate "Public versus private" continues to stimulate a great deal of rhetoric. However, the crucial point lies beyond the mere colour of the ownership. Instead, we should focus on the issue of creating the right conditions to ensure the best operational method for providing a water service whether the ownership is private or public. We do not need to decide whether private players are superior to public players, in the abstract. We need to implement and enforce the "rules of the game" under which private or public utilities or operators are made efficient and responsive to social needs and desires. The role of the public sector is just as important when the utility operations are handed over to the private sector. For privatisation to work, the public sector needs to provide effective oversight, monitoring, and regulation of the private economic operators. In turn, effective regulatory systems, including those that regulate other public entities, require adequately trained and paid staff in economic, environmental, and water quality fields.

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28 The exceptional circumstances are due to specific economic, social, environmental, geo-morphological characteristics of the territorial context, stating that they do not permit an effective and useful recourse to the market.

29 *ISTAT* stands for The "Italian National Institute of Statistics".

30 See the Blue Book edited by *Proacqua* (subsidiary of the German "ProMinent" Holding) about the distribution of tariffs throughout different geographical area and the census returns about water for civil use conducted by *ISTAT* in 2008.

31 For the sake of clarity, we should say that the Italian investment rate for water infrastructure was also far below the optimum rate before the recent reform. This was due principally to the fact that at that time Italy was experiencing years of legal uncertainty due to the slow implementation of Law no.35, 1994 (the Galli Act).

32 Sunk costs are costs that have been incurred and cannot be reversed.

33 According to OMS and UNICEF it amounts to 20 litres each day per person.

34 In political science and economics, the principal – agent problem or agency dilemma treats the difficulties that arise under conditions of incomplete and asymmetric information when a principal hires an agent. Various mechanisms, and namely incentive schemes, may be used to try to align the agent's interests congruently with those of the principal.