

Crisis-Ridden Water Systems Should Go Private

By STEVE H. HANKE

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Urban water systems are facing a crisis: They are unable to raise enough capital to properly maintain and expand these systems. The symptoms of this capital shortage are numerous. However two are particularly noteworthy: First, the market value of nearly all private water companies is below book value; second, most municipal systems need repair and renovation.

Price controls have caused the industry's capital shortage. Whether imposed by state public service commissions or local political bodies, these curbs have forced water purveyors to keep their prices far below their costs.

The effects of price controls are generally well understood. Products are rationed by nonprice methods; the situation in Poland provides a clear example. And revenues sufficient to maintain and expand productive capacity aren't generated by sales. Hence the ability to provide quality service and to continue production are destroyed. Even socialist economists acknowledge this. Yakov Usherenko, writing in the Aug. 10, 1978, issue of *Soviet Panorama* ex-

plained how the Soviets used price controls, not force, to eliminate the private sector during the 1920s.

With respect to price controls, water purveyors in the U.S. have reacted in much the same way as the state enterprises in Poland or the USSR's private sector in the 1920s. Under the banner of water conservation, private and public suppliers have instituted nonprice rationing. In addition, they have been forced to allow their capital plants and quality of service to deteriorate.

Two solutions to the capital shortage have been offered. Though the proposals take many forms, the first solution requires a federal subsidy or bail-out program.

Since the cause of the crisis (restrictive price controls) has been imposed by political or quasi political bodies, one must question the wisdom of an increased reliance on the political marketplace for solutions to the water industry's problems.

By further politicizing the provision of water, a federal subsidy would create great inefficiencies and inequities. Public systems would be favored over private,

and large systems over small. That is, systems with political power would be favored over those without it.

Moreover, the inefficient and financially irresponsible systems would be favored, since they could demonstrate the greatest "need." This would set in motion a series of perverse incentives, since financial irresponsibility would be rewarded.

The second option involves removing price controls.

This would put water purveyors on a self-financing basis in which users would pay the real costs of their water. It would remove the need for water conservation through nonprice rationing programs. Most importantly, it would improve the suppliers' ability to provide adequate, high-quality services.

The most desirable way to accomplish price decontrol and put the water industry on a sound footing would be to privatize and deregulate the industry. Under such a system, each city or service area would award a contract or franchise to the private firm that would guarantee, at the lowest price, a specific quality of service over the length of the franchise.

France has used such a system of private, deregulated water supply for many years. By doing so, the French have avoided the capital shortage that faces the U.S. industry. At the same time, they have provided high-quality service on an efficient and equitable basis. The private French water companies also have been among the world's leaders in technological and management innovations.

If we want to solve our urban water problems, we must move rapidly toward the privatization and decontrol of our water industry and away from its politicization.

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