

# EC Internal market strategy – implications for water and other public services

by

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<b>1</b>	<b>INTRODUCTION</b> .....	<b>2</b>
<b>2</b>	<b>OPENING UP WATER, HEALTH AND OTHER SERVICES</b> .....	<b>2</b>
2.1	WATER: A BUSINESS OPPORTUNITY.....	2
2.2	TRADE BEFORE HEALTH SERVICES.....	3
2.3	PPPS: STATE AID AND EXEMPTION FROM COMPETITION FOR THE PRIVATE SECTOR.....	3
2.4	UNSUPPORTED ASSUMPTIONS.....	4
2.4.1	<i>Rail – market opening and passenger safety</i> .....	4
2.4.2	<i>Energy – households do not benefit from retail competition</i> .....	4
2.4.3	<i>Fiscal constraints – inefficient distortion, not modernising</i> .....	4
<b>3</b>	<b>COMMENTS</b> .....	<b>4</b>
3.1	A BIASED NEUTRALITY.....	4
3.2	FREE MARKET LAWS AND EXEMPTIONS FOR PUBLIC SERVICES.....	5
3.3	POLITICAL AGENDAS AND ADMINISTRATION OF EC LAW .....	5

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## 1 Introduction

On 7<sup>th</sup> May 2003 DG Markt released a paper setting out their strategy for the entire internal market of the EU for the next three years. The paper identified services of general interest, and water in particular, as sectors where the DG wants to open more of the market to private sector operators.<sup>1</sup> DG Markt also chose to highlight the sections relating to SGI, and especially water, in its press release (PR)<sup>2</sup> and FAQ<sup>3</sup> on the strategy paper. This note highlights some of the key points, and key problems, in the strategy's impact on public services, especially water.

## 2 Opening up water, health and other services

### 2.1 Water: a business opportunity

The paper says that water is a sector where 'new proposals' may be necessary, to open up the market opportunity whose potential is being limited by widespread municipal providers. A box emphasises the size of the business prospects, by stating that water sales in the EU are larger than the gas industry, as though this proves some necessity to privatise or liberalise (education and healthcare are even bigger – should they then be subject to the same liberalisation regime?). However, whereas gas is a commodity which is traded across borders in large quantities, cross-border trade in water remains minimal, so size alone cannot be used to infer EU-wide competence. 'Fragmentation' is a repeated complaint: "*the competition situation in the water sector ... remains fragmented*" (PR), the sector is "*fragmented and dominated by local monopolies*" (FAQ). This is due to the fact that water is run by municipalities in nearly all EU countries: it might be described, more positively, as local or 'community-based'.

DG Markt is certain that private sector competition for water business would result in some improvement, but is uncertain about the evidence. The PR and FAQ assert, without support, that "*there are potential gains to be had from modernisation*" (where 'modernisation' is clearly a euphemism for privatisation). The paper offers the naïve suggestion that there must be some market imperfection because water prices vary across Europe: "*Performance and pricing vary considerably from one Member State to the next, which can often not be explained by reasons such as water availability or other objective external factors (e.g. the weather)*" (FAQ); and "*annual water charges vary from €350 in Berlin to €50 in Rome (with no charge at all in Ireland)*".

It is not clear what DG Markt concludes from this. Do they think that it is possible to create a market which leads to price convergence by enabling people to choose their water supplies from different countries, through water being piped – or perhaps flown? – from Rome to Germany? Do they think that the Irish, who pay for their water supply through taxation, should be forced to pay for it differently – a proposal that was discussed and rejected in the formulation of the Water Framework Directive?

Curiously, the paper states that "*the Commission services will undertake a review of the legal and administrative situation in the water and waste-water sector. This will include an analysis of the competition aspects, in full respect of Treaty guarantees for services of general economic interest and environmental provisions*". If so, this will be extremely wasteful: DG Competition commissioned just last year: 'A Study on the Application of the Competition rules to the water sector in the European Community', published in December 2002.<sup>4</sup> It has serious weaknesses – notably a failure to address empirical evidence on the prospects and problems with private sector involvement in water -<sup>5</sup> but a repeat commissioned by DG Markt is unlikely to overcome those weaknesses.

The politician at the head of DG Markt, Commissioner Bolkestein, had previously signalled his intention to open up water for private enterprise, and to expand the role of so-called 'public private partnerships' (PPPs) in public services, in two speeches in November 2002. On 7<sup>th</sup> November, a speech<sup>6</sup> headed 'Nuclear Energy' included a section on water which warned that liberalisation was a good thing and an inexorable trend, even in water, although some countries such as the Netherlands were not following that trend, and

“Worse still, some people want to have nothing whatsoever to do with it.” . However, Commissioner Bolkestein was certain about the future: “The market presses on, also in the water sector... The current trend will also take on a European dimension one day...As soon as [the Water Framework Directive (WFD) is implemented], we shall be better placed to look at water as a cross-border product. The Framework Directive provides for cross-border trade in water if certain ecological standards are observed.”. However, the WFD can surely not be used as a reason for treating water as an issue of cross-border trade, and therefore within the scope of the internal market rules. There is no significant international trade in water, and the WFD itself is not concerned with trade issues, but with environmental management.

## 2.2 Trade before health services

The PR urges countries to comply with ECJ decisions on health services allowing patients to get treatment across borders paid for by their national public health scheme: “The Strategy emphasises the need for Member States to comply with recent court judgements, in particular allowing patients to seek treatment outside their own Member State. This can help alleviate the problems faced by national health care systems by allowing the most efficient possible use of resources across the EU.” (PR) This fails to acknowledge that these decisions have been widely criticised for undermining universal provision of public health care – the trade rules must be followed, whatever the cost.

The FAQ repeat this position more emphatically, with a simplistic suggestion that “The Internal Market has the potential to help both providers and patients by allowing for the most rational and efficient possible use of resources across the Union”, and finally a call on true believers to promote the neo-liberal faith: “The Strategy calls for the development of a shared vision to maximise this potential”. These statements are supporting politically controversial policies, and insisting on a solution that makes the internal market rules supreme. This is not the way to develop responsible or accountable public services in the EU.

The paper bases its comments on court cases which have been heard by the ECJ, which are based on EU competition and internal market law. Some decisions have supported existing health systems, some not;<sup>7</sup> but in all cases the health system has to justify its departure from competition and market rules. However, DG Markt should note that even these cases set out clear conditions when healthcare systems need to be respected, rather than market rules, and when not.

## 2.3 PPPs: state aid and exemption from competition for the private sector

The PR notes that “The Commission will also clarify how competition and state aid rules apply to private/public partnerships and publish a Green Paper on ensuring that such partnerships are compatible with public procurement rules.” The concern is that EC grants should be available to support the use of private companies without being “anti-competitive subsidies”. This commitment had also been pre-announced by Commissioner Bolkestein, in a speech on PPPs<sup>8</sup> in November 2002, in which he stated that EU legislation needed to be reviewed to facilitate the greater role of the private sector in public services.

This concern to facilitate PPPs extends to other parts of the Commission. A paper on PPPs has already been produced, by DG Regio, relating to PPPs in the accession countries in water and transport.<sup>9</sup> It is ill-informed about actual experience in the accession countries, and assumes throughout that public sector provision has been ruled out as an option.<sup>10</sup>

The DG Markt strategy paper and FAQ claim neutrality on the issue of public private provision and ownership: “The Commission’s position on this issue [greater private sector involvement] is entirely neutral. The Strategy simply says that public-private partnerships are becoming more common as public sector budgets are coming under pressure, and that they raise certain legal issues which must now be clarified.”(FAQ). However, these legal issues are two central parts of the treaty: one is the issue of state aid, which the treaty denounces as a distortion when given to the public sector; the other issue is competition, a central principle of the treaty, to which DG Comp and DG Markt are very keen to subject public sector providers. The paper’s approach to these issues in relation to PPPs, however, is quite different, and implies that private provision is viewed as desirable in a way that public provision is not.

For the paper is concerned to make it **easier** to provide state aid for PPPs – and so to the **private** sector; and in relation to competition, the DG is ready to amend the procurement directives so that, for example, contracts can be renegotiated after award without having to be re-tendered<sup>11</sup> – with the openly stated objective “*to facilitate public-private partnerships*”. (DG Markt also wants to give companies “*the right to bring complaints before a court empowered to penalise contracting authorities*” – it does not specify what for).

## 2.4 Unsupported assumptions

### 2.4.1 Rail – market opening and passenger safety

The DG’s paper talks of how network industries – including railways - are “vitaly important” for our quality of life and the well being of our citizens. The following paragraph (3 (b), Actions) continues enthusiastically that “*The Council and Parliament should rapidly adopt the “second railway package”....The Commission will rapidly bring forward proposals for passenger transport market opening in order to complete the Internal Market in the railway sector.*” Rail commuters in the UK, who have suffered unreliable services and dangerous neglect of track maintenance since the UK’s rail services were opened to private operators, are unlikely to share that view. The DG Markt paper was published three days before the anniversary of the Potters Bar train crash, in which 12 people were killed, while a year later the private company supposedly responsible for the track is still denying responsibility.<sup>12</sup>

### 2.4.2 Energy – households do not benefit from retail competition

The paper makes the sweeping and contentious claim that the liberalisation of these sectors has ‘*brought considerable benefits for both business and consumers*’, supported only a box which offers a few selective facts such as “*Domestic consumers are paying 15% less for their electricity in liberalised markets than in closed markets*”. The same week that this paper appeared, a report by the National Audit Office in the UK pointed out that large business consumers had experienced a fall of 19% in their prices, most domestic consumers had failed to obtain any benefit at all if they had not switched suppliers<sup>13</sup>.

### 2.4.3 Fiscal constraints – inefficient distortion, not modernising

The paper notes the fiscal constraints on public authorities, faced with high investment requirements, which should be regarded as a problem because they constrain the choice of the most effective way of funding infrastructure investment. Instead the paper makes the assumption, unsupported by any empirical evidence, that this enforced dependency on long term private sector concessions will produce better results: “*The private sector will play an increasingly important role in financing infrastructure and in modernising our vital services and ensuring that they are affordable and of the highest possible quality.*” Modernisation, affordability and quality are automatically associated with the private sector

But DG Markt should be aware that borrowing through the private sector **increases** capital costs of infrastructure projects by 10% or more, because governments get the lowest interest rates.<sup>14</sup> In capital-intensive industries, such as water or energy, operating costs would have to be reduced by a huge percentage to compensate for this. Fiscal constraints cause inefficient distortions in the choice of mechanisms for raising debt finance for public services.

## 3 Comments

### 3.1 A biased neutrality

The neutrality on public/private provision that is defensively proclaimed by the EC operates only within the model of competing businesses. Publicly owned companies are given equal status with privately owned companies when they are doing the same thing as private companies – pursuing profit maximisation through competing for customers.

But this ‘neutrality’ is trivial: successful competition for business is rarely, if ever, the main purpose of public enterprises. Their main purpose is to provide a structure which guarantees the provision of public

services, shares the benefits of efficiency and productivity gains with all, excludes the damaging effects of cherry-picking, etc. These core features, however, conflict with the principle of maximising the opening of the internal market, and on this the EC is not neutral. DG Markt quite openly prefers an EU-wide market in water services ahead of locally accountable municipal provision; insists that trade rules take precedence over health; and wants to actively facilitate private sector participation through softening rules on state aid and competition.

### **3.2 Free market laws and exemptions for public services**

The paper's demand that health systems should open up to an internal market highlights the imbalance in community law and the proliferation of cases where public service systems are required to justify themselves against EU law on competition and the internal market. There are a number of cases concerning the permissibility of health system regulations in the context of competition law and internal market law (see above), and also cases on the question whether state aid need not be notified to the EC under the competition laws: in one such pending case the Advocate-General is suggesting that any public finance for a service which is an 'economic activity' must be reported to and approved by the Commission before being implemented.<sup>15</sup> Whatever the outcome in actual cases – and the health judgments have varied – the requirement that public service practices must justify any departure from competition and internal market law is seriously imbalanced, both politically and in terms of decision-making in the public interest.

### **3.3 Political agendas and administration of EC law**

It is not easy to distinguish in the publications of DG Markt (and DG Competition) between advocacy of political policies and administration of EC law. Commissioner Bolkestein's speeches in November make clear commitments to opening up the water sector, and supporting the development of PPPs, both areas which are the subject of public, political controversy. These policies are advanced as though there was only one right solution, and any opposition is unreasonable: e.g. *“Worse still, some people want to have nothing whatsoever to do with [liberalisation in water]”* (from Bolkestein's speech on nuclear energy and water), or *“Some players, needless to say, are opposed to a legislative initiative on PPPs at the European level.”* (Bolkestein's speech on PPPs).



**Annexe: Commissioner Bolkestein on water, 7 November 2002**

(from [http://europa.eu.int/comm/internal\\_market/en/speeches/spch-02-543\\_en.htm](http://europa.eu.int/comm/internal_market/en/speeches/spch-02-543_en.htm) )

“...But one segment of the utility market is permanently omitted: the water sector. We should also look at market forces here. In The Netherlands the water sector is not following the trend towards liberalisation. Worse still, some people want to have nothing whatsoever to do with it. We have to bear in mind that liberalisation is not a dogma; it is a practical instrument for establishing the correct relationship between price, quality and the standard of the service provided. Water will be a scarce commodity in the future. The demand for water is rising as a result of an increase in population and economic growth, while the amounts of relatively clean and cheap groundwater are decreasing. And there is the problem of desiccation, resulting particularly from the large amounts of water used in agriculture. This is already serious in Spain. Drinking water is used for everything nowadays, including washing cars and flushing toilets. From an ecological point of view one may wonder whether the water sector does not need to be more subjected to market forces if supply and demand are to be better matched. The question is logical and legitimate.

Some may say that the British experience in the water sector has not been very positive. But here there is a lesson to be learned. In 1989, Britain started to privatise the water companies but not to liberalise the market. That was putting the cart before the horse. One should begin by opening up the market and giving consumers a choice, only then letting government and companies decide on the structure they wish to adopt for operating on this market. In a nutshell: first liberalise and then, if you want, privatise. The privatisation of the British water sector did not come out of the blue; the sector was in a state of severe neglect - and in government hands. The people of Britain had long assumed that water supplies and water purification were not a problem. It turned out that they were wrong.

During the privatisation process, a major investment project was launched with a view to improving the quality of drinking water and the purification facilities. Many British water companies both produce drinking water and treat waste. The price of water in the United Kingdom went up because the country had to meet the EU's environmental standards. The high costs of treating waste were taken up in the price of drinking water. Privatisation was seen as a way of restoring the strength of the entire sector. The market had to make up for the Government's negligence. But market forces had no influence at that time. When presenting the budget in 1999, the British government proposed greater competition in the water sector. It was thinking in particular of competition between regional networks. On the Continent one often hears the argument that the water sector in Britain is in a bad state because of privatisation, this being a danger for public health or the environment. This is tub-thumping. The sector was neglected when it was in government hands!

More general, on the European level, steps towards market opening of the water sector are feasible.

1. Diversification is an important factor, since consumers - and particularly businesses - increasingly want given amounts of a given quality. Major consumers in new sectors of industry are starting to install double pipelines in order to differentiate between water products. They simply want to be more economical with water because prices go up. After all, there is a big difference between drinking water, rinsing water and cooling water. You can use rainwater for watering plants. Nowadays high-quality drinking water is used for too many purposes and the groundwater level is falling as a result.
2. Another possibility is competition between networks. Supplies of drinking water are at present regional, so companies depend on a regional supplier. It is possible, however, for a water company to connect a pipeline to a neighbouring distribution network in order to supply a given customer or group of customers. This means the consumer has a choice. It also means that an inefficient water-supplier would run the risk of losing customers to another regional distributor. This would be an incentive for providing good service. The British government is particularly keen on stepping up regional cross-border competition with a view to improving the performance of privatised water companies. I am pleased to note that the UK government's paper on its future water policy released this week ('Directing the Flow') states that it intends: to introduce greater competition in the supply of water for larger users, to encourage further innovation, greater efficiencies and keener prices".

3. We must also consider technological developments. Time does not stand still. In telecommunications, technology did much to open up markets. In the water sector, membrane technology is making decentralised and small-scale water production possible. With the aid of a fairly simple installation, a company can purify and use water itself, thus reducing dependence on water companies. The water sector is not stagnant, therefore, and it will become better if it makes preparations for new developments rather than entirely depending on government support.
4. Another possibility would be a form of competition based on concessions along French lines. With this approach, the government issues a public invitation to tender for the production and distribution of water and the company offering the best terms gets the contract for a given period. All the essential agreements are made within a legal context and the private concession-holder has access to the capital market and may form partnerships. The World Bank vigorously promotes the concession model.

The market presses on, also in the water sector. The water sector has been 77% privatised in France and 87% in Great Britain. In Spain, privatisation is well under way and Portugal and Italy are moving in that direction. It is also interesting that in Germany, which has a large number of water companies, the government is dismantling the drinking-water monopoly. The water company serving the capital, Berliner Wasserwerke, has been privatised to a considerable extent. The City of Berlin holds 51% of the shares and market operators 49%. The Ministry of Economic Affairs considers that German water companies are inadequately prepared to act as international operators and that the water sector is too fragmented. Liberalisation should provide German water companies with an incentive to modernise and increase the scale of their operations. We can therefore expect a wave of mergers and alliances between German and foreign water companies. The current trend will also take on a European dimension one day. As far as water is concerned, the Commission has hitherto concentrated on quality. In September 2000, the European Parliament and the Council of Ministers adopted the Framework Directive on Water, which should be implemented in national legislation within three years. As soon as this has been done, we shall be better placed to look at water as a cross-border product. The Framework Directive provides for cross-border trade in water if certain ecological standards are observed.”

<sup>1</sup> Internal Market Strategy Priorities 2003 – 2006 . Communication From The Commission May 2003

[http://www.europa.eu.int/comm/internal\\_market/en/update/strategy/index.htm](http://www.europa.eu.int/comm/internal_market/en/update/strategy/index.htm)

<sup>2</sup> Internal Market: Commission presents ten-point plan for making Europe better off IP/03/645 Brussels, 7<sup>th</sup> May 2003

[http://www.europa.eu.int/rapid/start/cgi/guesten.ksh?p\\_action.gettxt=gt&doc=IP/03/645/0/RAPID&lg=EN&display=](http://www.europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=IP/03/645/0/RAPID&lg=EN&display=)

<sup>3</sup> FAQ: Internal Market Strategy 2003-2006 Frequently Asked Questions. DN: MEMO/03/100 Date: 07/05/2003

[http://europa.eu.int/rapid/start/cgi/guesten.ksh?p\\_action.gettxt=gt&doc=MEMO/03/100/0/RAPID&lg=EN&display](http://europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=MEMO/03/100/0/RAPID&lg=EN&display)

<sup>4</sup> [Study On The Application Of The Competition Rules To The Water Sector. COMP/2002/E3/SI2.334052](#)

<sup>5</sup> See PSIRU paper

<sup>6</sup> Speech by Commissioner Frits Bolkestein Member of the European Commission in charge of the Internal Market and Taxation, to Institute of Economic Affairs, London, 7 November 2002 "Nuclear energy needed more than ever"

[http://europa.eu.int/comm/internal\\_market/en/speeches/spch-02-543\\_en.htm](http://europa.eu.int/comm/internal_market/en/speeches/spch-02-543_en.htm)

<sup>7</sup> See most recently the decision concerning the Netherlands health system's restriction on use of foreign providers, at N° 36/2003 : 13 May 2003 Judgment of the Court of Justice in Case C-385/99 Müller-Fauré et van Riet

<http://curia.eu.int/en/actu/communiqués/cp03/aff/cp0336en.htm> ; the opinion on the German health system's fixing of

prices for drugs at N° 44/2003 : 22 May 2003 Opinions of the Advocate General in joined cases C-264/01 and others

AOK-Bundesverband and others at <http://curia.eu.int/en/actu/communiqués/cp03/aff/cp0344en.htm>; the opinion on imports of drugs into Germany restricted to pharmacy sales: 16/2003 : 11 March 2003 Opinion of the Advocate General

in the case C-322/01 Deutscher Apothekerverband <http://curia.eu.int/en/actu/communiqués/cp03/aff/cp0316en.htm>

<sup>8</sup> Speech by Commissioner Frits Bolkestein Member of the European Commission in charge of the Internal Market and Taxation , at the 3d annual Public-Private Partnership Global Summit Holland, Noordijk, 08 November 2002:

“European Commission's current policy on public-private partnerships and its future projects”

[http://europa.eu.int/comm/internal\\_market/en/speeches/021108-bolkestein\\_en.htm](http://europa.eu.int/comm/internal_market/en/speeches/021108-bolkestein_en.htm)

<sup>9</sup> European Commission, Directorate-General Regional Policy, “Guidelines for Successful Public – Private

Partnerships”, March 2003, [http://europa.eu.int/comm/regional\\_policy/sources/docgener/guides/ppp/ppp\\_en.pdf](http://europa.eu.int/comm/regional_policy/sources/docgener/guides/ppp/ppp_en.pdf)

<sup>10</sup> See PSIRU critique: The European Commission's *Guide to Successful Public-Private Partnerships* - a critique By *Robin de la Motte and David Hall* March 2003.

<sup>11</sup> Speech by Commissioner Frits Bolkestein Member of the European Commission in charge of the Internal Market and Taxation , at the 3d annual Public-Private Partnership Global Summit Holland, Noordijk, 08 November 2002:

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<sup>12</sup> Press Association May 28, 2003 Potters Bar: 'No Evidence Of Sabotage Or Vandalism'

<sup>13</sup> NAO press release “The New Electricity Trading Arrangements in England and Wales”

<http://www.nao.gov.uk/pn/02-03/0203624.htm>

<sup>14</sup> The Business **October** 6, 2002 It Has Been A Bad Week For The Private Finance Initiative

<sup>15</sup> PRESS RELEASE No 01/03 14 January 2003 Opinion of Advocate General Léger in Case C-280/00 *Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH*: Advocate General Léger Takes The View That The Financing Of Public Services Constitutes State Aid For The Purposes Of Community Law *In the Advocate General's view, Member States must in principle notify their financing plans to the Commission and may not implement them without prior authorisation from the Commission. The Advocate General states that this review machinery is not liable to disrupt the functioning of public services in the Member States.*

<http://curia.eu.int/en/actu/communiques/cp03/aff/cp0301en.htm>