Italy's experience in reforming the water sector

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First objective of the reform: institutional reorganization and sector regulation

In the ’90s there were a number of political-institutional and regulatory goals to be met:

- To separate (public) asset and resource ownership and control from (private or public) management of the service
- To institute, and regularly update, a national observatory for monitoring the sector and enabling yardstick competition among water service companies
- To establish a single, national, “normalized”, tariff-setting system
- To reduce and gradually eliminate the role of taxpayers’ money in supporting investments and covering service management costs

The reform's second objective: to create an industry

From an industrial point of view the goals in the '90s were:

- To overcome fragmentation in water services management, whether directly handled by municipalities or through municipally-owned companies
- To optimize economies of scale
- To attract private capital for financing investments

Obstacles to be overcome

Right from the start of the early reconnaissance and planning phases there emerged a number of significant obstacles:

- Very extensive investments in new works were required, especially as regards sewage collection and treatment (in order to comply with European standards)

- Large quantities of pipelines and plants, dating back to the ’60s and ’70s, had to be renovated or replaced

- Very significant water services management costs were “hidden” in municipalities’ general accounts and not covered by existing tariff systems

- Enormous differences in tariffs applied by different municipalities

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The new regulatory framework

Prior to the reform: absence of regulation and control where water services are managed by publicly-owned companies or directly by municipalities

After the reform:
three levels of control

Optimal Basin Authority (Autorità di Ambito Territoriale Ottimale or AATO)

- Investment planning
- Award of management concessions based on a service contract (concession) with the water services company

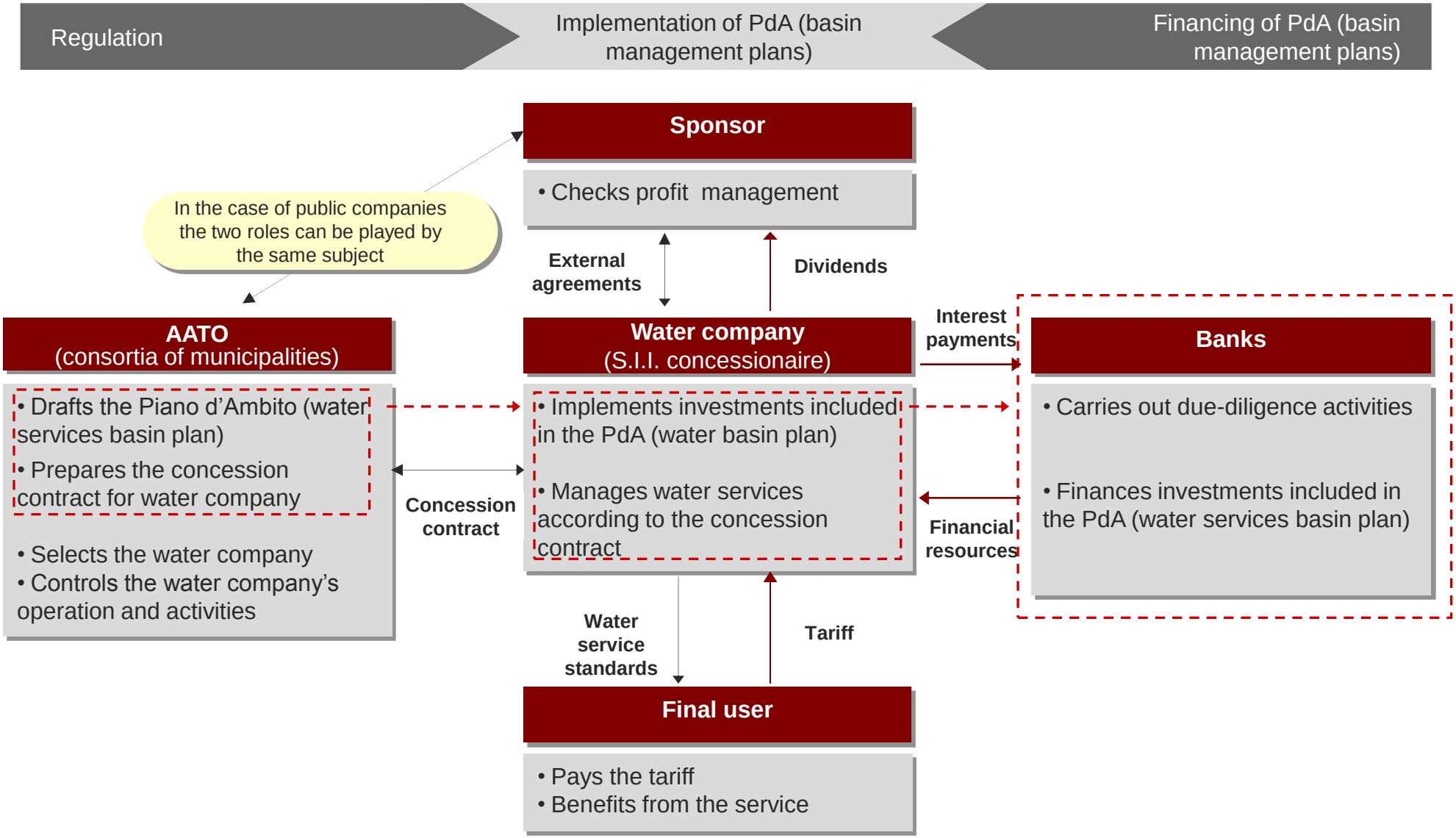
REGIONAL GOVERNMENT

- Coordination of the various ATO
- Planning of water resources use

National Control Committee (Comitato di Vigilanza Nazionale or COVIRI)

- Collection and processing of water sector data
- Design of the tariff system
- Monitoring and control of ATOs' activities

The parties involved



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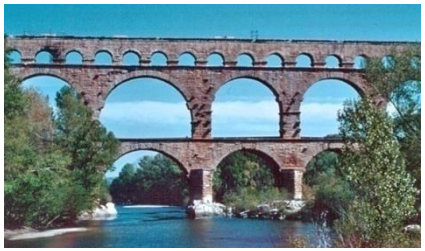
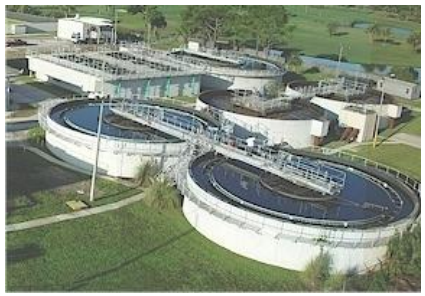
Investment needs for the Servizio Idrico Integrato (S.I.I, Integrated Water Services)





Estimated investments for the S.I.I	Measured values				Projected values	
	S.I.I. Investments	Average annual investments	Investments per capita	Annual investments per capita	Average annual investments projected for the whole of Italy	Total investments projected fo the whole population
units	(mln €)	(mln €)	(€)	(€)	(mln €)	(mln €)
Committee (2007)	28 826	1 390	773	37	2 204	45 714
Blue Book (2007)			925	37	2 056	61 668

Source: Comitato,elaborazioni indagini 2007 and data from the Blue Book (ANEA - Utlitatis, 2007)

- **<u>Investments per capita (for the whole duration of the plan):</u>**
  - Average value: 773 €
  - Maximum: 3.511 €
  - Minimum: 77 €
- **<u>Annual investments per capita:</u>**
  - Average value: 37 €
  - Maximum : 117 €
  - Minimum: 19 €

Distribution of investments over time: crucial issues

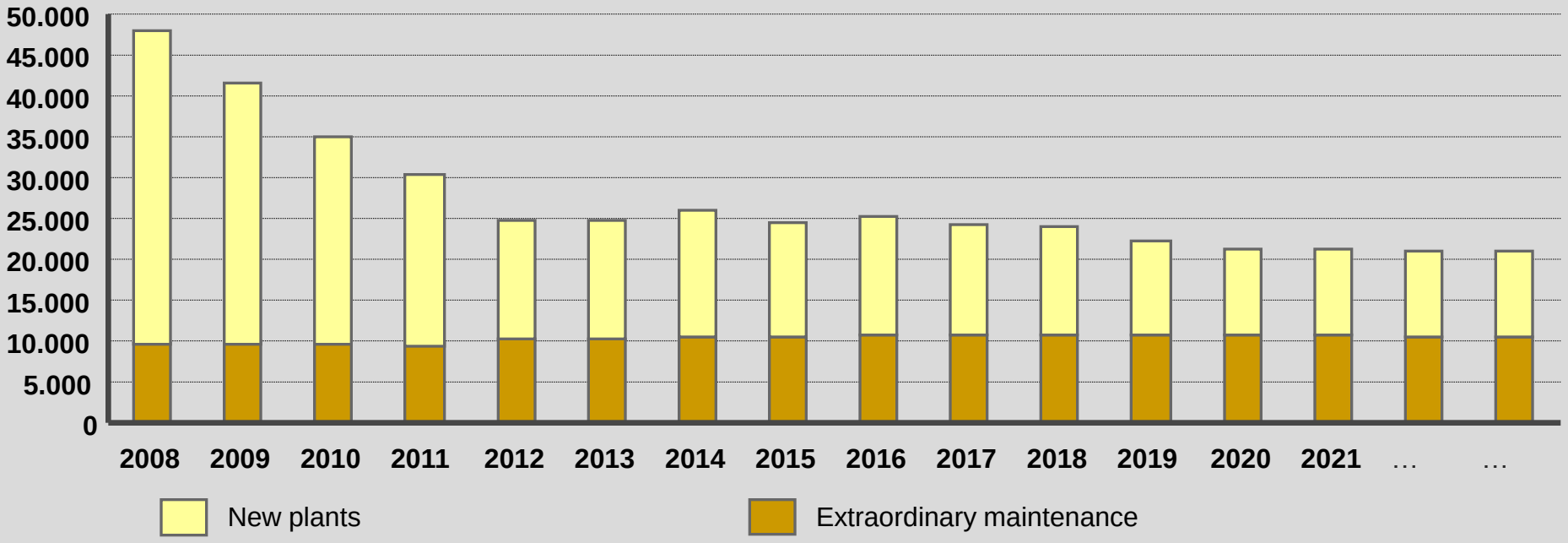
Early years

Compliance with legal standards regarding:

- Infrastructural requirements
- Service quantity and quality

Latter years

- High capital intensity is maintained
- Largely divergent aging of plants needs to be addressed
- Pipelines and plants need to be replaced and maintained in good working order



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Integrated water services critical issues

	Critical issues	Observable consequences
Regulatory issues	Legal framework : uncertain and incomplete (especially as regards concession award) Normalized tariff : incomplete and obsolete (dates back to 1996) Municipalities : conflict of interest when they are present both as regulator and as water company Control of water companies : Concession contracts are vague and incomplete Basin plans : need updating and are not bankable	• Uneven application of the tariff system • Difficulty in applying penalties to underperforming water companies • Delays in reaching established service standard levels • Difficulties in financing investments
Industrial issues	Unification of service management : incomplete within the single management basins Market : ➢ Not considered strategic by large water companies (multi-utilities in Northern Italy) ➢ "In house" management prevails among smaller companies (North and Central Italy) ➢ Highly fragmented or direct municipal management in large parts of Southern Italy	• Lack of private water companies (national and foreign) • Structural weakness of industrial sector • Lack of managerial know-how • Scarcely efficient and oversized company structures
Technical characteristics	Investment requirement : very significant, both as regards extraordinary maintenance and new works Service levels : far removed from European standards	• High levels of structural and management inefficiency • Supply problems or continuity of service problems • Quality of discharges and rivers not compliant with European regulations (infraction procedures underway)

Critical issues: incomplete and uncertain regulatory and legal framework

Incomplete and uncertain regulatory and legal framework

Vague concession contracts with issues left open or not completely dealt with

Unreliable basin plans (Piani di Ambito)

Recently-launched concessions or concessions still in a start-up phase

Legal framework : uncertain and incomplete (especially as regards concession awards)

Normalized method : incomplete and obsolete (dates back to 1996)

Municipalities : conflict of interest when they are present both as regulator and as water company

Lack of a real national Authority

Critical issues: vague and incomplete concession contracts

Incomplete and uncertain regulatory and legal framework

Vague concession contracts with issues left open or not completely dealt with

Unreliable basin plans (Piani di Ambito)

Recently-launched concessions or concessions still in a start-up phase

- Highly divergent concession management contracts
- Lack of regulation on a number of crucial issues, such as:
  - Economic and financial sustainability of the concession
  - Incentives for efficiency improvement on the part of the water company
  - Control procedures and information flows between ATO and water company
  - Penalties for contractual breaches
  - Concession termination clauses (withdrawal, redemption, early termination, compensation)

Critical issues: unreliable basin plans (Piani di Ambito)

Incomplete and uncertain regulatory and legal framework

Vague concession contracts with issues left open or not completely dealt with

Unreliable basin plans (Piani di Ambito)

Recently-launched concessions or concessions still in a start-up phase

The unreliability of the Piani d'Ambito stems from:

1. Mistakes in the planning phase:
   - Unreliability and obsolescence of surveys of services and plants conditions
   - Unreliability of estimates (often for "political" reasons) regarding:
     - Water sales volumes
     - Necessary investments, particularly in the first years
     - Personnel and other operating costs
   - Failure to provide for a start-up period for concessions
2. Water sector structural problems :
   - Investments distributed during the whole length of the concession
   - Investments with long period of technical depreciation
   - Lack of incentives for efficiency improvements
   - Insufficient remuneration of invested capital

Critical issues: concessions still not fully up to speed

Incomplete and uncertain regulatory and legal framework

Vague concession contracts with issues left open or not completely dealt with

Unreliable basin plans (Piani di Ambito)

Recently-launched concessions or concessions still in a start-up phase

Concessions still in a start-up phase, especially as regards:

- governance e management structures
- Reconnaissance of critical issues concerning the service and the area
- Ability to operate throughout the area covered by the ATO
- Planning and implementation of investments
- Efficient management of “exogenous” costs (water purchased from third parties and electricity)

The sector's current situation

- Regulatory authorities are still very weak, both at the local level (ATO) and at the national level (COVIRI)
- The industry is not yet fully developed:
  - Multi-utility companies in Northern Italy, which do not regard the water sector as strategic
  - "In house" management is prevalent among small companies (Northern and Central Italy)
  - Highly fragmented management or direct in-house management by municipalities in Southern Italy
  - Lack of large private water companies (both national and foreign)
- Insufficient consumer protection and level of investments still low

A half-baked reform

- A strong commitment towards market liberalization is lacking, in other words towards:
  - Strong (public) regulation and consumer protection
  - Industrialized (private) management of the service
- There remains strong political and social resistance to significant increases in tariffs to finance investments and raise service standard levels

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- Alessandro is Managing Director of a consortium of municipalities charged with the strategic planning and control of water services in a Tuscan water management area (ATO).
- He is also one of AREA group's (www.area-group.it) founding partners, with extensive expertise in the field of economic development and financial planning and regulation of local public services; he consults for many of the main utilities players in Italy as well as for a number of local government bodies.
- He supports banks and concession managers in setting up structured finance operations in the local public services sector.
- As regards the water sector, he has advised the Ministry of the Economy and the Supervisory Committee for water resources, and is a member of the "Water Resources Group" within the Ministry of Agriculture and Forestry.