



Tariff recommendations: A Panacea for the Portuguese water sector?



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ABSTRACT

In Portugal, in the early twenty first century, the water utilities industry was still quite complex displaying considerable financial shortcomings. That issue occurred, mainly, at the retail level due to faulty rate setting practices, stressing, perhaps, arbitrariness and political influence in price-setting strategies. To cope with that situation, the water sector regulator published tariff guidelines to harmonize cost analyses, tariff structures and levels, creating a basis for comparison. The suggestion of two-part tariffs with increasing block rates seems to lack enough flexibility and proper supporting material. Thus, our analysis focuses on assessing whether the recommendations issued are able to achieve the proposed objectives through the suggested procedures, reviewing the structure proposed and possible adjustments.

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1. Introduction

Water and wastewater services (WWS) are essential for the economic, territorial and social cohesion. In order to fulfill those needs, due to the complexity of WWS systems, it is paramount to highlight the “real” costs inherent to the WWS provision (Brattebø et al., 2013). Pragmatically, since higher demand for water, poor performance, low system coverage, run down infrastructure and decreasing public investments are current problems, it is imperative for utilities to generate revenue to support these costs, *i.e.*, if they are to operate adequately and continue to provide improved services (WHO and UNICEF, 2014). Thus, diversified sources of financing have been adopted, particularly by requiring a payment from users (inducing the user-pay and polluter-pay principles). This entails the setting of tariffs, which with transfers and taxes, make up the so-called 3Ts policy (OECD, 2009). Those components of the 3Ts policy are considered the ultimate financial sources. To streamline concepts, tariff is the system of procedures and elements that determines a customer’s bill. Any part of that bill is called a charge measured in money/volume units, money/time units or money units alone; and any unit price can be called a rate (OECD, 1999).

Furthermore, water tariffs are an increasingly endorsed source of water pricing due to the growing acknowledgment of water

tariffs as a conceptually simple way to promote multiple objectives, such as: revenue and economic efficiency, equity, fairness, income redistribution and resource conservation (Rogers et al., 2002). However, those objectives are difficult to reconcile, possibly producing undesirable results, as well as conflicts of interest between stakeholders, making the study of tariff structures crucial for policy guidance.

Most of the previous objectives imply that prices can change customers’ behavior. Whether this is so, is an empirical matter that certainly can vary with different circumstances. Tariffs seem to be effective or ineffective as tools for influencing behavior, depending on how they are deployed/structured.

In Portugal, in the early 21st century, despite the improvements achieved through multiple institutional and regulatory reforms, the water utilities industry was still quite complex, displaying considerable financial shortcomings. There were multiple management models linked to diversified forms of ownership that could be in charge of wholesale and/or retail activities. Yet, according to Pires (2007), the financial bottleneck occurred, mainly, at the retail level (not disregarding the role of structural factors such as scale and population density, see Carvalho and Marques, 2014). The main reasons were that retail utilities were undermining the achievement of multiple objectives due to faulty rate setting practices, stressing, perhaps, arbitrariness and political influence in price-setting strategies. By keeping tariffs at harmful low levels, the recovery of financial costs alone stood as a difficult milestone (particularly for wastewater, see ERSAR, 2013), disregarding the recovery of

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environmental and social costs. Hence, there was no compliance with the EU-Water Framework Directive (WFD) which requires full cost recovery. However, the WFD also states that price should be used as an incentive to achieve an efficient use of water and never as a compensation mechanism for situations of inefficiency on the supply side.

The problem of those inappropriately low tariffs was identified to be the heterogeneity of retail tariffs (in both structure and level) applied throughout the country. That daunting “lack of political power” to transpose to the final users the real cost of the service led the customers to misunderstand tariffs, driving the tariff review processes to be carried from a lengthy and politicized point of view, with little buy-in from the population and a hindered willingness-to-pay (Pires, 2007). To counter such predicament, new legislation was introduced in 2009 to clarify decision-making prerogatives endowing the water sector regulator with extended powers in price regulation, as well as with the role to issue non-binding recommendations on tariff features. The objective lies in the dissemination of adequate principles to all operators and related authorities.

Other associated aspects covered include the content of invoices sent to customers, the relationship between rate setting and the utility costs, along with the possibility to adapt tariffs (level and structure) to local requirements (e.g. by including household, hereafter HH, size adjustments).

The development of tariff recommendations by a sector specific regulator is quite unusual due to the water sector worldwide tendency to be guided by the subsidiarity principle. Indeed, the tariff setting procedure is regularly regulated by local governments and by legislation (e.g. national, international). Besides, when such regulations are developed, they look to the overall allowed annual revenue as the final output; they do not address the issue of how that revenue should be obtained through the tariff structure, under the rationale that it depends on a large degree on specific circumstances and should be addressed locally. The case of England and Wales is noticeable, since not disregarding the discretion thereof, general guidelines towards the tariff structure were established, even though the focus is on the tariff level and cost recovery principle (Ofwat, 2013). On the other hand, there is the case of Ireland where due to the amalgamation of its water utilities into one national entity, a steady regulatory procedure has been taking place in order to set a national tariff structure (CER, 2014).

This article focuses on analyzing whether the recommendations issued in Portugal, mainly related to tariff structures, are able to achieve the proposed objectives through the suggested procedures. Therefore, this paper is organized as follows: after this brief introduction, Section 2 broadly describes the Portuguese water sector, focusing on the market structure and the regulator's role. The most widely known water tariff schemes and possible adjustments are presented in Section 3, while the Portuguese regulatory recommendations (namely the tariff guidelines) are presented and discussed, respectively, in Sections 4 and 5. Finally, Section 6 draws some concluding remarks.

2. Portuguese water sector

2.1. Institutional and regulatory framework

In Portugal, the wholesale (bulk) and retail (end-user) activities in WWS are formally split, being fashioned respectively into regional and municipal systems. The role of the state, as a significant operator through state-owned companies, and ERSAR (the Portuguese acronym for Water and Waste Services Regulation Authority), as a sector-specific regulatory agency, are key institutional features.

Owing to difficulties in answering the new challenges that followed the entry to the EU (e.g. quality standards, ensure universal access to continuous services at affordable prices and environmental concerns), the Portuguese Government reorganized the sector (Marques, 2010). The resulting reforms had important goals: one of such goals was to keep the responsibility for water distribution and wastewater collection within the municipalities, assigning to the state further investments in bulk activities through the creation of multimunicipal systems (state-owned systems, with regional – multiple municipalities – coverage) to be managed in a business-like fashion.

Currently, the system's owner is legally allowed to choose the service management form in multiple ways. In state-owned systems, the possibility relies, mainly, on concessions to state owned public companies. These companies can be either 100% owned by the central state, or a partnership with proper minor equity owners (i.e. the central state still has the majority of shares), as municipalities (Public–Public Partnerships, PuP) and private investors (institutionalized Public–Private Partnerships, iPPP), whenever adequate, under proper legal procedures. In order to steer and control those corporations, a state-owned “national champion” was created, the holding Águas de Portugal (AdP).

As for the municipal systems (municipally owned, mainly the retail segment), the number of possibilities increase. If a municipality chooses to produce the services itself, it can use a municipal department or create a structure with some degree of financial and administrative autonomy. Municipal (public) companies, or local companies, owned by local governments are also possible options. The PuP concept can also be adapted here, in this case (municipal system) designated as a state/municipalities partnership (Pinto et al., in press). Furthermore, municipalities are also able to select private partners as equity owners (iPPP), generally being the municipalities the retainers of the dominant influence. Concession arrangements with private enterprises, are also a possibility, through proper public tenders.

As those reforms took place, it became imperative to monitor and supervise such procedures (Bel et al., in press). Hence, a regulatory agency (IRAR) was set up in 1998 to regulate multimunicipal and municipal concessions. However, nowadays the regulatory model has broader regulatory competences and, since 2009, it covers a wider range of activities for all delivery models. The authority currently designated as ERSAR is a public institute

Table 1

Scope of ERSAR's economic regulation according to the provider's model (adapted from: ERSAR, 2013).

Scope	State (including shares in multimunicipal systems)	Municipal (including intermunicipal systems)		
	Concessionaire	In-house	Delegation to local or mixed companies	Concessionaire
Economic regulation	Direct tariff regulation, mainly by evaluating tariff proposals, and budgets.	Indirect tariff regulation, by a sample checking mechanism.	Tariff regulation “by contract”, supervision.	Tariff regulation “by contract”, supervision.

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