

# Are differences in water prices economically justified?

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# PRESS RELEASES

## Are differences in water prices economically justified?

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**A parliamentary procedure is currently underway for the [Report on the work of the State Audit Office for 2013](#)<sup>1</sup> which includes a special report: „Economic justification of differences in public utility prices“, relating to the prices of water services in 2012. The Report is the result of the audit of the operations of 123 companies owned by local government units (cities and municipalities) which provide public water supply and drainage services. The audit results reveal significant problems in the supply system, particularly as concerns the water pricing methodology.**

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Macroeconomic discussions, especially those on budget deficit and public debt, have overshadowed issues that deeply affect the living standards of households. Among them are the price of water and its calculation, as well the operations of companies providing water supply and drainage services. Water prices are expected to go up in 2014, due to the need to cover the rising costs of water suppliers but also the announced increase in water charges. In Croatia, there is no complete information available on water prices broken down by supplier and consumer, and relevant expert and research analyses into the companies' financial operations are scarce. The State Audit Office is warning of the economically unjustified differences in the prices of water services and of the uneven water pricing criteria applied by the suppliers. Only 5 of the 123 companies determine their water service prices correctly (the companies in Makarska, Split, Sinj, Čakovec and Đurđevac), while the remaining 118 do that in an incorrect manner.

There are two main determinants of the supply and pricing of waters. Firstly, according to the Water Act (Official Gazette 153/09, 63/11, 130/11 and 56/13)<sup>2</sup>, all the water suppliers are obliged to be organised as companies or public institutions exclusively engaged in drinking water supply and/or wastewater disposal. They can be founded and owned only by cities and municipalities. The suppliers were obliged to exclude all other activities from their operations within three years from the entry into force of the Act, i.e. by 31 December 2012. As most of the companies failed to adjust their operations during 2012, Amendments to the Water Act were adopted (on 26 April 2013), extending the deadline for compliance until 31 December 2013. Secondly, under the Water Act, water service pricing is based on the principles of full cost recovery, social acceptability and protection against monopolies, and water service providers must comply with the prescribed. At the proposal of the Water Services Council, the Government issued a Decree on the minimum water service price and on the types of costs covered by the water service price (Official Gazette 112/10) and a Decree on the operational efficiency standards for water service providers (Official Gazette 112/10). These decrees were supposed to ensure economic prices of water services that should cover the actual costs of their provision.

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<sup>1</sup> The Croatian version available.

<sup>2</sup> Articles 202 and 258.

## MAIN PROBLEMS IN THE CALCULATION OF WATER PRICES

**Organisation of the water supply companies.** There is a problem with cost calculation for water services, because, in addition to public water supply, these companies also provide other utility services (municipal waste collection and disposal, funeral and related services, the design and maintenance of public spaces, unclassified roads, cemeteries and markets, passenger transport, etc.). Given such organisational deficiencies, it is difficult to establish the portion of costs arising from water distribution services and to properly determine their prices.

**Indefinite decree regulating water pricing.** Due to imprecise provisions of the Decree on the minimum water service price and on the types of costs covered by the water service price, water service providers apply uneven criteria for the determination of costs covered by the minimum basic water price. Although it is prescribed that the water service tariff should be set in accordance with the planned costs, the portion of costs at the chart of accounts level to be involved in the calculation of fixed and variable costs, is not clearly determined, which results in different fixed-to-variable cost ratios applied by particular suppliers. For example, the utility company Ponikve d.o.o., Krk has the highest fixed part of the price for households (48 kuna per cubic metre) and the highest total price of 52.15 kuna per cubic metre. The lowest fixed part of the price for households is found in Vodovod Dubrovnik d.o.o. (4.05 kuna per cubic metre). This utility company also reports the lowest total water price, 7.48 kuna per metre. Zagrebački holding d.o.o. - Water Supply and Drainage d.o.o. has charged the highest (10.36 kuna per metre) and VG Vodoopskrba d.o.o., Velika Gorica the lowest (2.28 kuna per metre) variable portion of the water price for households.

**Double charging of the concession fee.** The concession fees shown on the water bills of the companies Veliki Grđevac d.o.o. and Komunalac d.o.o. (Bjelovar-Bilogora County) and Vodoopskrba d.o.o. Darda (Osijek-Baranja County) are not included in the variable part of the water price, but are reported as separate invoice items. The concession fee is covered by the price of public water supply services, as it constitutes the supplier's direct cost and should therefore not be paid by the end user. So it turns out that the consumer pays the concession fee twice, once in the form of the water service cost and again as a separate item on the water bill.

**Multiple charging of the fixed part of the water price.** The water consumption of households in residential buildings with shared pipe connections is normally charged per number of household members. Hence, all households are required to pay the full amount of the fixed portion of the price. Bearing in mind that the fixed portion is used to cover the costs that are independent of the quantity of water supplied (the costs of connecting a building to the municipal water infrastructure), all tenants are required to pay the water meter charges as if they had individual water meters. Moreover, for the users of residential buildings with separate measuring of cold and hot water consumption the fixed part of the water price is calculated and charged twice.

**Sharp differences in water prices charged to different consumers.** In some counties, the prices of water delivered to industry are even double the prices for households. Moreover, in most cases, private owners renting out tourist facilities pay the water consumption price for households, although they engage in an economic activity.

**Water losses.** Almost all water supply companies have recorded considerable water losses (measured as the difference between the quantities of water drawn and delivered). The maximum acceptable rate of water loss set by the European Union is 15% to 18%. Some of the companies greatly exceed this limit. The greatest water losses are found in Vodovod Imotske krajine d.o.o. (as great as 78.7%) and JP Komunalac d.o.o., Hrvatska Kostajnica (78%). Such huge losses are very often due to illegal use of water outlets and hydrants, worn out pipes, obsolete technology and dilapidated reservoirs and local water tanks.

**Imprudent financial management** is also reflected in the fact that certain suppliers used to sell water to other companies at a price lower than the minimum basic price, thus failing to ensure the full cost recovery. For example, Istarski vodovod d.o.o., Buzet sells water to Rižanski vodovod Koper, Slovenia, at a price lower than the price charged to households and other consumers, and even lower than the irrigation water price. The same is true for the utility company Komunalno d.o.o. in Vrgorac, which sells water to the Public Utility Ljubuški, Bosnia and Herzegovina, at a price markedly below the

household water price. There are cases (for example in Osijek-Baranja County) where the prices of public water supply are below the economically justified levels. Some of these companies also make expenditures for donations to various sports and other clubs, as well as civic associations. Despite the, probably, noble purposes of such donations, the revenues collected should be used exclusively for covering the companies' operating costs, as well as for the development and improvement of the water supply services. Furthermore, the share of employee expenses in the operating expenses of some companies is well above the average and these expenses directly affect the water service prices. While it is prescribed that water pricing should be based on the principle of full cost recovery, these prices cannot (and should not) cover the costs of the water supplier's uneconomical operation.

### **POSSIBLE SOLUTIONS TO IMPROVE THE SUPPLY OF WATER SERVICES**

**The relevant ministry and Water Services Council** should formulate more precisely the provisions of the Decree on the minimum price of water services and on the types of costs it should cover.

**Cities and municipalities should exclude other activities from the scope of activities of their respective utility companies** in order to eliminate the problems related to common cost accounting and to ensure correct water service pricing. In residential buildings with shared water network connections, the portion of costs covered by the fixed part of the price should be distributed among the households, so that each of them pays only a part of fixed costs. The ratio between the prices of water services to industry and to households should be reviewed.

**In cooperation with the cities and municipalities, the relevant ministry should** work out a plan for the gradual merging of relatively small companies into larger ones, with a view to increasing the cost-effectiveness and ensuring uniformity of water service prices.

One thing is certain: an audit of utility companies for 2013, which is yet to be carried out, should reveal how many of these companies have improved their operations and ensured the transparency of their water pricing practices and compliance with effective regulations. The practices of five companies (in Makarska, Split, Sinj, Čakovec and Đurđevac) show that this was possible as early as 2012.