

DEMOCRATISING THE REGULATION AND GOVERNANCE OF WATER IN THE US

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In the United States, the term “public utility” refers to a class of industries that, because of their essential nature and their tendency toward monopoly provision, have historically been subject to more direct and pervasive governmental control than is common in other industries. Public control over utilities has been effected through (1) direct government ownership of utilities, or (2) government-appointed or elected regulatory commissions that oversee the rates and services of private utilities. In each area, popular movements have been instrumental in shaping the nature and structure of the government’s role, including the role of citizen representation within public processes.

EARLY HISTORY

“By the late nineteenth century there was a strong feeling among municipal leaders that any respectable community needed a citywide waterworks.”

- Martin V. Melosi, *The Sanitary Idea: Urban Infrastructure in America from Colonial Times to the Present*, 116 (2000)

In the 1800s, as American cities increased in size and density, the provision of municipal water systems emerged as a vital public interest. Health was a primary concern as increasing congestion in the urban environment heightened pollution of local sources and the spread of typhoid, cholera and other water-borne disease.¹ Additionally, the provision of a city-wide water supply was important to many businesses and industries; providing a water system became one of the most important ways that a city could demonstrate its commitment to economic growth.²

Initially, private ownership and operation of water services predominated. All but one of the 16 water systems in existence before 1800 were privately owned and, in 1870, 52% of the 244 water systems in the US

were privately owned. But over the next 50 years, coinciding with the growth of the power and importance of municipalities, the tide dramatically turned toward public provision. By 1896, the number of water systems in the US had exploded to over 3,000 with the majority owned and operated by municipal governments. In 1924, 70% of all water systems were municipally owned and controlled.

The shift of most cities, especially large ones, to public ownership of water systems by the close of the 19th century was motivated in part by negative experiences with private water suppliers. Private water companies “were notorious for choosing a water source that would minimise the initial investment outlay, and for ignoring the concomitant shortcomings in water quantity and quality.”³ Lacking incentives to complete ostensibly unprofitable projects, companies “preferred to lay their distributing pipes through the wealthier sections of the city and to hold back from carrying water into the poorer districts.”⁴ The Baltimore Water Company, for example, provided water to only about 30% of Baltimore’s citizenry, even after significant infrastructure additions between 1835 and 1852.⁵ At its peak, the privately operated Manhattan Water Company served only one third of the city and was the subject of constant criticism for deteriorating water quality.⁶ Private water companies were also more expensive than most municipal suppliers – by as much as 40% by the close of the century.

In many cities, including New York, these experiences fueled political movements that pushed city legislatures to pass resolutions in favour of municipalising water suppliers. In other cities, municipalisation was promoted by chambers of commerce and boards of trade seeking to compete with rival communities in attracting development.⁷ Finally, it was often the case that the private sector did not have sufficient capacity to meet rapidly rising demand.

Municipalisation did not automatically correct inequities in service provision. Hierarchical relationships existed in the governing structures of many cities that favoured moneyed interests. In Detroit, for example, the public system prioritised extending service to uninhabited land for development over servicing working class areas of the inner-city.⁸ On the whole, however, most municipal systems were favoured for their greater capacity to meet the rapidly increasing demand for water at a lower price than their private counterparts.

THE BIRTH OF REGULATION

“Regulation is a peculiarly American institution.”

- Roger G. Noll and Bruce M. Owen, *What Makes Reform Happen*, 7 Regulation 19 (1983)

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Although direct municipal provision of water and sewerage was the dominant mode of supply by the early 1900s, there remained a significant number of private water utilities serving towns and cities of various sizes. With the advent of the Progressive Era, these entities were identified as “natural monopolies” and subjected to control by state regulatory agencies.

The concept of a natural monopoly had its genesis in analysis of the railroad industry. There, it was observed that unbridled competition led to highly inefficient outcomes, including multiple companies laying parallel lines of track to serve the same locations at great cost.

The concept of natural monopolies provided a classical economic justification for strong government intervention in a finite class of “public utilities”, since without competition there would be no incentive to keep prices low or to serve less profitable areas of the community. To reach economically and socially optimal solutions, either the government had to provide the goods or service directly, or it had to establish regulatory institutions that would “replace the invisible hand of Adam Smith in order to protect consumers against extortionate charges, restrictions of output, deterioration of service, and unfair discrimination”.⁹

Although economic academics provided the theoretical justification for government control of public utilities, it was popular organising, beginning with the Granger movement of small farmer collectives, that drove the first action by governments. In the 1870s the Granger movement grew rapidly to over 850,000 members that placed growing emphasis on the extent to which farmers were being victimised by abusive pricing and commercial practices of railroads, merchants and banks.

The Granger movement succeeded in pressuring state governments to create scores of state regulatory commissions with the power to investigate (but often not to set) the rates of railroads. The development of regulatory institutions was strengthened during the period of popular political agitation known as the Progressive Era, lasting roughly from 1896 through World War I. Drawing on the lessons of natural monopoly theory, the Progressives called for strong government regulation of a number of powerful industries of the day, including private electricity and water utilities.

By the 1920s, every state in the US had a regulatory commission with authority to oversee the rates and services of privately owned public utilities. The commissions were generally under an obligation to promote adequate services at reasonable rates while protecting a fair rate of return to the utility on its investments to reward shareholders and attract further infusions of capital from private markets.

By design and effect, regulation by state commissions shifted authority over regulated service priorities from local to state governmental bodies, thus diminishing the power of municipalities. Municipalities could escape this loss of power by establishing their own utilities, which were not regulated by most state commissions. This provided an additional incentive for enterprising cities to build and maintain their own water systems and other utilities. Today, about 85% of the US population is served by public water systems and there are approximately 4,000 municipally-owned electricity systems.

DEMOCRATISATION OF THE REGULATORY PROCESS

“A prime characteristic of the American consumer movement over the past decade has been its concentration on the investigation and reform of administrative agencies lax in protecting citizens’ interests.”

- Robert B. Leflar & Martin H. Rogol, *Consumer Participation in the Regulation of Public Utilities: A model Act*. 13 Harvard Journal on Legislation 235 (1976).

Between the 1920s and 1960s, the main task of commissions was to distribute to consumers cost savings from technological advances and economies of scale in the form of rate decreases. Although the commissions had their detractors,¹⁰ it was not until the rise of the consumer movement in the late 1960s and early 1970s that serious reform was implemented. In

those years, increased interest rates, a world fuel crisis and rising inflation reversed the steady course of declining utility rates, pushing prices, especially for electricity, far higher. In this context, critiques of industry capture of regulatory agencies grew louder and proposals for regulatory reform gained a serious audience.¹¹

Many states responded to the growing legitimacy crisis in regulatory commissions by transforming the selection of commissioners to an elected process. Another common series of reforms was designed to broaden the degree of participation in the regulatory process, particularly that of residential consumers who, because of lack of resources and high transaction costs of forming associations, commonly lacked any representation within the process.

Reforms enacted to increase consumer representation ranged from government or utility payment of fees to public interest interveners to the establishment of special “consumer counsel” offices staffed with lawyers, accountants, economists and community organisers to engage the regulatory process and organise and educate community groups about utility issues. One especially innovative and effective institution established in many states is referred to as a Citizen Utility Board (CUB), sometimes called a Residential Utility Consumer Action Group.

CUBs are voluntary organisations funded through contributions from their members. The model laws creating CUBs permit them to recruit members through bill inserts, through which a consumer could check off a contribution to the organisation that would be added to the regular utility bill and transferred by the utility to the CUB.¹² All members who make a minimum contribution receive the right to vote for the CUB’s board of directors on a one-person one-vote basis. The board oversees a staff of organisers, lawyers and other experts needed to represent residential consumers in proceedings in regulatory agencies, legislative bodies and other public processes that impact utility rates or services. The model act for establishment of CUBs also gives them authority to conduct and support research, investigations and public information activities regarding utility matters and to participate in initiative and referendum campaigns.¹³

Many CUBs have been very successful in their advocacy of consumer interests. One of the most successful, the Illinois CUB, has saved consumers more than \$5 billion in two decades by blocking rate hikes and winning consumer refunds. The CUB promotes tougher consumer protection laws in the state legislature, publishes consumer education materials and operates a Consumer Hotline that fields more than

6,000 calls a year providing assistance to consumers who have complaints against their utility companies.

CONSOLIDATION, PRIVATISATION AND RESISTANCE

“Europe’s leading water companies saw the United States as the last great bastion of water (and wastewater) still under public control.”

- Steve Maxwell, *Musical Chairs in the Water Industry: Consolidation or Fragmentation?* Journal of the American Water Works Association 28 (November 2003).

The cost of providing water in the US is increasing dramatically due to the need to replace aging infrastructure and to comply with heightening security and environmental regulations. At the same time, national government support for local infrastructure development projects has been decreasing, forcing municipalities and their citizens to bear the increased costs.

Small systems are perceived by many to be in a particularly poor position to meet the increasing investment obligations. In the private sector, there has been a wave of consolidations that, according to the large water companies, increase the capacity of the companies to meet investment obligations. The largest water companies in the US have, in turn, been targeted for acquisition by far larger European water companies, including RWE/Thames, Veolia (formerly Vivendi) and Suez.

Powerful political forces have risen up against privatisation in the US, derailing several large projects. Coalitions of citizen organisations and public sector unions pressured the city of Atlanta to cancel a \$428 million operation and maintenance contract after the Suez/United Water contractor drastically cut employees, hiked rates 17%, slowed service delivery times and failed to adequately respond to consumer complaints of brown water coming from their taps. In New Orleans, the city spent \$5 million assessing private contracting offers before ending the process of privatisation in April of 2004 in response to a groundswell of popular and union organised opposition.¹⁴ In Stockton, California, a plan to turn over operation and maintenance of the water system to RWE/Thames was overturned by a court upon application by community groups alleging that the plan failed to comply with environmental planning laws.

The privatisation focus is now shifting toward small towns, where communities are often less organised and the financial pressures may be more severe. However,

as small-town citizens learn more about the ramifications of privatising, opposition appears to be gaining a foothold. In September, the town representatives of Lee, Massachusetts, voted 41-10 to reject a 20-year monopoly contract with Veolia. Their decision to forgo privatisation was influenced by a grassroots campaign that raised concerns about Veolia's past project history, articulated the risks of privatisation and warned that current employees might not receive fair treatment.¹⁵

Where private systems are in place, consumers in some areas have pressured their governments to municipalise them. In Lexington, Kentucky, a grass roots group successfully lobbied the city council to vote to take over the private company that had served the town since the 1880s, but which was recently purchased by the German conglomerate RWE.¹⁶ Municipalisation is also being pursued by communities in Felton, California, and Nashua, New Hampshire.¹⁷ In Pekin, Illinois, voters used the Progressive Era referendum process (allowing citizens to pass legislation directly through popular vote) to demand public ownership of its water system.

TOWARD DEMOCRATISATION OF UTILITIES

Democratisation of public utilities need not stop at the simple distinction between public and private ownership. Democracy is a process not an ownership structure. Participatory institutions, including CUBs, municipal utility districts and co-operatives, may assist the democratisation of publicly-owned utilities by better empowering citizens to hold their leaders accountable.

For many communities, the pressure to consolidate resources to meet their funding and operational challenges is real. Often, these needs can be met through inter-local joint action with other municipalities. For example, several suburbs surrounding Manassas, Virginia, outside of Washington D.C., were facing rapid population growth prompting the need for a new wastewater treatment facility. Rather than privatising, the region defrayed the cost and benefits from economies of scale by creating a new public authority, known as a joint action agency, to build and operate a new treatment plant.

Access to necessary expertise can be accomplished through public mechanisms. The public supplier in Cincinnati, for example, extends technical assistance services to smaller public systems surrounding it.

Within the US there are a variety of organisational structures that afford more direct participation in the governance of utilities than mere government

ownership with directors appointed by an elected council or other official. The Sacramento Municipal Utility District (SMUD), for example, is governed by a board of directors that are directly elected. Each of the seven directors represents a different geographic area, or ward, within SMUD's service area, with seats allocated based on a one-person one-vote methodology. This structure allows citizens to express different political preferences for governance of their utility than they might choose to do with respect to governance of the rest of the city. It also ensures that all areas have representation equal to their population, providing a bulwark against utility decisions that favour investment in one region to the disadvantage of others. Another example of a more directly accountable utility structure is a co-operative, where the consumers of the utility have the sole right to elect the governance of the utility. There are over a hundred million customers of co-operative utilities in the US, including water, electricity and telephone co-operatives.

Where utilities are privately owned, advocates for democratisation need not end their advocacy with calls for municipalisation. Establishing institutions that link citizen interests with access to financial and knowledge resources, such as CUBs, can increase popular power to control utilities through regulatory processes and increase their sway with government leaders. And regulators themselves can be subject to direct election to improve their responsiveness to consumer concerns.

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END NOTES

¹ Comm. on Privatisation of Water Services in the US, National Research Council, *Privatisation of Water Services in the United States: An Assessment of Issues and Experience*, 30 (2002).

² Martin V. Melosi, *The Sanitary Idea: Urban Infrastructure in America from Colonial times to the Present*, 119 (2000)

³ Peter H. Gleick et al., *The New Economy of Water: The Risks and Benefits of Globalisation and Privatisation of Fresh Water*, 23 (2002), quoting L.

Anderson, "Water and the Canadian City," *Water and the City* (1991).

⁴ Id., quoting N.P. Blake, "Water and the City: Lessons from History," *Water and the City* (1991).

⁵ *Privatisation of Water Services in the United States*, 31.

⁶ Melosi, 37.

⁷ Melosi, 119-121.

⁸ Melosi, 123.

⁹ Walter Adams, "The Role of Competition in the Regulated Industries," *53 American Economic Review* 40 (1963).

¹⁰ Horace M. Gray, "The Passing of the Public Utility Concept," *Journal of Land & Public Utility Economics* 16, 8-20 (1940) ("It originated as a system of social restraint designed primarily, or at least ostensibly, to protect consumers from the aggressions of monopolists; it has ended as a device to protect the property, ie, the capitalised expectancy, of these monopolists from the just demands of society, and to obstruct the development of socially superior institutions.").

¹¹ See Stephen Breyer, *Regulation and Its Reform*, 351 (1982) ("If agency decisions are not controlled by Congress, if they are not scientifically determined, if agency decision makers are not elected, what right does the agency have to make its policies? What makes the agency's decision legitimate?"); Robert B. Leflar & Martin H. Rogol, *Consumer Participation in the Regulation of Public Utilities: A model Act*, 13 *Harvard Journal on Legislation* 235, 242 (1976) ("[commission] staffs frequently exhibit a tendency to subject the carefully prepared analyses of the data submitted by the utility company to less than critical scrutiny, particularly if there is a lack of pressure from consumer interests to do so".).

¹² A much criticised US Supreme Court decision held that states could force a private corporation to "speak" in this way, after which CUB laws were changed to provide member recruitment in other ways, such as through inserts in government agency mailings.

¹³ See Leflar & Rogol, *supra*.

¹⁴ Public Citizen, "U.S. Privatisation Update: State of Play and Recent Developments" (Boston Social Forum, July 2004).

¹⁵ Public Citizen, *Currents: Public Citizen's Water For All Campaign Newsletter* (October, 2004).

¹⁶ The group's website may be viewed at <http://www.bluegrassflow.org>; see John Stamper, "Mayor appoints task force to study how city could run water company," *Lexington Herald-Leader* (Mar. 10, 2004).

¹⁷ US Privatisation Update.