

C7.1 Pricing of water and water services

Characteristics

The purpose of water pricing is:

- *Cost reflectivity*: charges signal to users the true scarcity value of water (eg through abstraction charges) and the cost of providing the service; they providing incentives for more efficient water use and give investors information on the real demand for any needed service extension. Pricing also helps to identify the most cost effective means of meeting both demands and revenue needs.
- *Environmental protection*: encouraging conservation and efficient use; recognising environmental benefits from leaving water in its natural state *Cost recovery*: generation of revenues for the efficient operation (and debt service) of the present system and its future maintenance, modernisation and expansion. The operation of the sector.

As well as ensuring recovery of costs, an effective tariff should be:

- *Affordable*: recognising the vital role of water, the special needs of socially deserving cases, and the importance of safe water and sanitation for public health. Mechanisms to protect the poorest from high charges while avoiding subsidies to the better off are necessary. The urban poor often pay more (per unit) for water via the informal private sector than the better off pay to the official water utility.
- *Acceptable to the public*: tariffs should be clear, comprehensible and fair
- *Administratively feasible*: levying and collection of charges should be within the capacity of the water undertaking (links with institutional capacity).

Volumetric tariffs, which charge according to the amount used, are more versatile than fixed charges and can provide incentive for careful use. Tariffs typically combine a fixed and variable element to cover overhead and operating costs respectively. Cost recovery charges for sanitation services are often levied on households and/or industry, typically as a surcharge on the water tariff, but are less easy to set and administer than water consumption charges. Charges are sometimes levied for the cost of connections to public systems, or for the provision of facilities, such as low cost latrines.

Pricing or cost recovery for irrigation systems are beginning to be used, although irrigation water is often heavily subsidised. Volumetric pricing is still the exception, and proxies are used, such as acreage, type of crop, size of harvest; however, with modernisation of irrigation systems, improved charging is feasible. Direct cost recovery for environmental services or resource management is also rare but has been applied. Charges may be linked to environmental management (e.g. charges for abstraction licenses, or discharge permits).

Lessons learned

Water pricing is applicable under almost all circumstances, but there are several preconditions for a successful cost recovery policy:

- Public acceptance of the need for cost recovery; people may need a public information campaign to persuade them, if they are used to regarding water as a gift of nature
- Higher charges are easier to implement when there is an associated service improvement
- Strong political backing, and the avoidance of extravagant and unaffordable promises before elections.
- Thorough demand surveys and consultation with consumers are essential. In poorer communities with underdeveloped services, willingness-to-pay surveys can be a useful pointer to setting appropriate tariffs, provided that the people who actually pay (often women) are actually consulted
- Careful provision for poor or disadvantaged consumers. Direct support may be more effective, since subsidies often benefit the rich more.
- Financial transparency including independent auditing and regular and automatic price adjustments (based e.g. on inflation)
- Firm and clear public regulation of tariffs set by the private sector see . [Because of lack of competition and the high social sensitivity of water, governments usually regulate prices whether charged by public utilities, municipalities or private concessionaires.]
- Consumers tend to respond to price increases by greater care in water use
- The structure of tariffs is just as important as the level of charges in achieving equity and cost recovery aims
- Private companies find it easier to levy and raise charges than their public counterparts