

Water pricing

A decided reluctance to address the key issue of the price of water

There can no longer be any dispute as to the urgency of China's water supply problems. Nor are there any illusions as to just how difficult it will be to solve those problems. But there remains a decided reluctance on the part of China's most senior officials to face squarely the key question about the solution: At what price?

This is a double-barreled question – China will undoubtedly have to spend massive sums, on both the supply and treatment sides, to increase the efficiency of its water infrastructure.

At what price will consumers begin to treat water as a scarce resource?

But there is another vital aspect to the question, "At what price?" Namely, the setting of the price. At what rate will consumers of water – industrial, agricultural, or residential – begin to treat the resource with an appropriate sense of scarcity? And at what point will the lifesaving medicine of rational water pricing become too bitter to swallow?

Chinese water prices always have been, and remain, far too low

It is universally acknowledged, by government officials and foreign analysts alike, that water prices are far too low. It is likewise acknowledged that this pricing anomaly has been a major contributing factor to China's water woes. Senior leaders frequently speak of their determination to raise prices to encourage conservation among residential users. Leaders stress that prices must make it economically sensible for farmers and industries to invest in technology to enhance efficiency of water use. Artificially low prices discourage private investors from taking full advantage of recent liberalisation allowing them to enter the water sector. Even after increases in recent years, average prices in water stressed China are 70 to 80 per cent below international averages – which includes nations that enjoy ample water supply. It is an obvious but unavoidable fact that prices must be raised to more rational levels before investments in water supply become attractive.

Little discussion on plans or targets

Policymakers know this, but they remain afraid to say so. Even the most careful reading of official speeches or policy papers will turn up only scant details about plans and targets for water pricing. Instead of revealing specific price points, officials prefer to describe vague and fungible sets of guidelines, such as a range of values for the percentage of disposable household income spent on water for residential users, or water's percentage of the cost of total inputs for industrial and agricultural users. But when it comes to

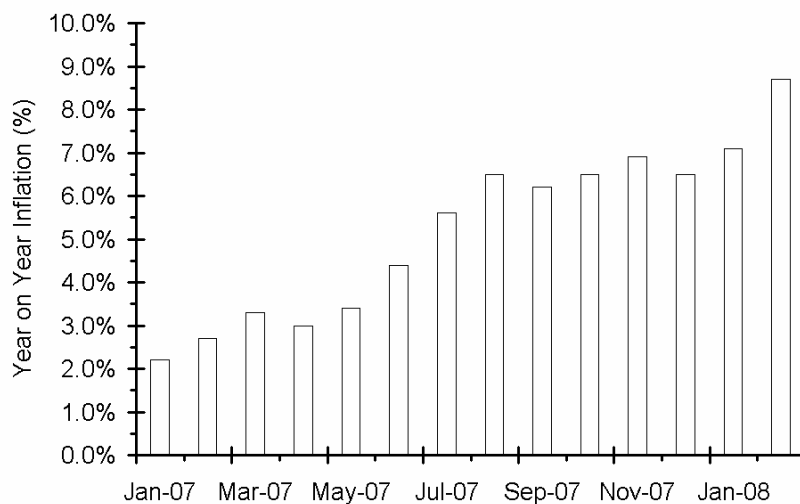
naming targets for the price per tonne, officials shy away. Pressed directly by a *Urandaline* researcher in the second half of 2007, the Minister of Water Resources, Chen Lei, refused to state how high prices might, over any time frame for any kind of user, have to rise.

The current struggle with inflation complicates the setting of a water-pricing policy

Such trepidation is understandable in light of China's current struggle against inflation (see Exhibit 5.17). Since the middle of 2007 consumer prices have jumped sharply, driven largely by food prices. By February 2008 China logged a year on year rate of 8.7 per cent, its highest in 11 years. The following month, top leaders Wen Jiabao and Hu Jintao promised to take "forceful" measures to control inflation and prevent overheating of the economy.

Exhibit 5.17 Monthly inflation

Year on year inflation exceeds 8.0 per cent



Source: China National Bureau of Statistics.

Reforms in the water sector have lagged well behind the pace of China's overall economic reform programme

Against this backdrop, it is easy to understand why the government wants to handle water price hikes cautiously. But further delay in rationalising the water market will carry costs of its own. Changes have already been too long in coming in a sector that has lagged well behind the pace of the overall economic reform programme.

Water is seen more as a social benefit or a public utility than as a business opportunity

Seen more as a social benefit or public utility than as a potential business opportunity, the water system continued to operate with high government subsidies and according to pre-reform rules. Indeed, until 1985, Chinese users did not have to pay at all for water. In that year the State Council initiated a system by which users would pay for water at cost. However, lax management and poor accounting practices left providers ill-equipped to factor in either their overhead costs or the value of the numerous subsidies they received from the state. Combined with a stubborn reluctance of users to pay for something they were accustomed to getting free of charge,

collection rates remained low, and providers continued to distribute water at rates that were well below the true cost.

Until recently Beijing had only tinkered with water tariffs

From the late 1980s until the mid 1990s Beijing tinkered with pricing models and went through several drafts of new laws and regulations governing water distribution, with trial price reforms being introduced in 14 cities in 1998. But at every step along the way, local governments have held back, fearful of imposing untenable burdens on farmers and industrial enterprises, hampering their output, or worse still, stoking public anger. Price increases that did occur seldom outpaced inflation, leaving real water prices largely unchanged. In one county in arid Hebei, for example, prices for agricultural use rose from ¥0.02 per tonne in 1985 to ¥0.045 in 1990, and then to ¥0.10 in 1997. But researchers who corrected these rates against the local retail price index found that, by 1997, the real price had increased to only ¥0.023.

The economic value of water is around ¥24 per tonne, well above market tariffs

In 1996 water prices across Hebei were still remarkably low. For residential users, prices ranged from ¥0.40 to ¥0.65 per tonne. For industrial users, the range ran from ¥0.70 to ¥1.20 per tonne, and for commercial users, the highest rates ran to only ¥2.50 per tonne. According to the World Bank, the economic value of water in this region at this time was around ¥24 per tonne.

In other locations, prices were even more absurdly low. Ningxia farmers needed pay only ¥0.006 per tonne, and when the price was doubled in 2000 to ¥0.012, usage declined by 600 million tonnes.

Ten provinces have begun differentiating their tariff rates for various types of users

While virtually every state leader and every senior MOWR official had long been on the record in support of price increases, little substantial progress was made until 2004, when a rapid-fire series of reforms finally began to have an effect. In January 2004 the NPC passed a law deregulating water prices. This move was followed within months by a State Council directive requiring governments at all levels to set prices on the basis of market mechanisms. By mid-year 2004 ten provinces had begun differentiating their tariff rates for various types of users, and half of the country's largest cities instituted significant price hikes, ranging from 50 to 200 per cent.

As an example, Exhibit 5.18 shows how Beijing priced water for various categories of users after these reforms.