NewStatesman

Charting the future of Britain's water supply

Exploring the politics of public and private ownership

BY THE NUMBERS

How is the UK's water industry performing?

£150bn

Water companies in England and Wales have spent around £150bn improving pipes, pumping stations, sewers and treatment centres, and the industry continues to spend around £8bn a year to keep on improving.

1/3

Water companies have reduced leakage by a third since the 1990s, and it continues to be a top priority.

£1 a day

Water bills are currently just over £1 a day on average – currently £405 a year on average across England and Wales.

86%

Recent research shows that 86 per cent of customers trust their water company.

99%

Overall compliance levels for discharge at wastewater treatment works were 99 per cent in 2016 according to the Environment Agency.

90%

Customer satisfaction levels for water and sewerage services have been rated around 90 per cent.

5%

Bills are going down by 5 per cent in real terms between 2015 and 2020.

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Why the UK needs fresh ideas to keep the taps on

The water industry should be reformed rather than renationalised, writes Angela Smith MP, chair of the all-party parliamentary group on water

After the hottest and driest summer for over 40 years questions are rightly being asked about the resilience of our water infrastructure. In this country we tend to take access to clean, safe water for granted, assuming as we do that the UK endures too much wet weather to ever be seriously at risk of water shortage. But the statistics say otherwise. The National Infrastructure Commission has established that by 2050 England alone will require an additional capacity of 2,700 to 3,000 litres a day, just to maintain resilience at today's levels.

Forecast population growth and climate change are the forces driving this challenge. A 25 per cent increase in the population of the south-east of England is predicted, for example, by 2050, and at the same time we expect changing weather patterns to create a greater risk of flood and drought. It is in this context that we need to place the current debate about the future of the water industry. Quite understandably, there has been a focus on the corporate behaviour of the nine regional water companies, and in particular on the financial engineering by some which has in recent years done so much to damage their reputation. But in an era of populist politics this has led to siren calls for renationalisation, which in themselves risk taking us back to the stale old arguments of the 1970s.

The old, tribal lines of left and right do nothing to contribute to the serious thinking needed if we are to meet the challenges facing the country as far as water is concerned. If it is accurate to say that the water companies haven't always covered themselves in glory, then it is also true to say that under the old nationalised model the water industry suffered a chronic lack of investment, in a period when public borrowing limits were growing ever stricter and strengthened environmental and water quality regulation was forcing up standards.

A progressive way forward recognises the potential for using the regulatory mechanism to ensure that the industry is focused firmly on delivering the investment needed if we are to secure water resilience; the National Infrastructure Commission has developed clear recommendations based on a mix of new supply infrastructure, transfer capacity and measures to reduce demand, including increased metering and reductions in leakage.

Reviewing Ofwat, as recommended by the Chartered Institution for Environmental and Water Management, would identify whether or not it has the powers and resources necessary to do this. One good example of where change is needed is the current rule under which Ofwat is barred from varying the licensing conditions for water companies unless it has agreement from all of them to do so; giving it more control over this key regulatory mechanism would be an important step in the process of rebuilding confidence in the industry.

There is, though, another forceful argument for looking in more detail at how Ofwat works. A key role of the regulator is to protect consumers from the absence of competition, which quite obviously characterises the water industry. But the need for new infrastructure, both in terms of supply and transfer capacity, creates opportunities for bringing new operators into play. New transfer capacity in particular offers the prospect of innovation in both ownership and delivery of services; it also highlights the need for robust regulation and transparency in procurement. If Ofwat gets this right, we can look forward to a more challenging and potentially more competitive environment for water services.

Private companies are still acting in the public's interest

Private ownership of the water industry has helped to deliver better outcomes for customers, writes Michael Roberts, chief executive at Water UK

Two things are not in doubt in the current debate about the future of water. Water companies need constantly to improve, to meet the challenges posed by climate change and a growing population; and they must meet the highest standards of behaviour rightly expected of such companies.

More questionable as a response to these challenges, however, is the proposal recently published by the Labour Party leadership to put English companies into public ownership. There are three reasons why this needs to be handled with extreme care. First, contrary to Labour's assertions, England's private companies are actually doing many things well. On the back of £150bn of investment in improvements since 1989, around 90 per cent of customers are satisfied with the service they get and 86 per cent of the public say they trust their water company.

Further improvements are being proposed up to 2025, including the most ambitious leakage reduction programme in 20 years, £50bn of further investment and bills falling on average by more than 4 per cent in real terms – made possible through further efficiency gains and lower returns, in some cases, to investors and shareholders.

Second, the proposals leave unanswered some big questions. Where will the long-term investment needed to support the economy and improve the environment, which successive governments failed to make sufficiently available before 1989, be found? Given the funding pressures in healthcare and education, there has to be a concern that under public ownership, water would not be a high enough priority for government investment.

Nor is it clear how removing senior management experience and replacing independent regulation with government intervention is going to work in the best interests of customers, the environment and the nation as a whole.

Third, supporters of renationalisation in England fail to credit how far the private sector model has not only changed, but continues to adapt.

For example, companies have sought the views of over five million customers in preparing the latest round of business plans – believed to be one of the biggest such exercise ever undertaken by an industry. And individual companies are bringing forward innovative ideas about how they give customers an even bigger say in how they are run.

The sector has also seen increased competition with the opening up of the non-household market for water, and new companies are able to compete to supply housing developments. Competition will soon grow further with changes to the markets for sewage sludge and water resources.

Where the scope for competition is limited, there has been a move towards smarter oversight of companies. Ofwat has developed a more incentives-based approach to regulation, to encourage companies to strive harder in delivering for customers and communities.

The recent business plan responses to direction from Ofwat on issues such as dividend payments and executive pay, and proposals to introduce a public interest condition into company licences, are further examples of how the model is evolving in light of recent challenges.

And yet more is still possible, as private companies strive to do more in the public interest, whether by working with farmers through catchment management schemes or through public policy (such as better building regulations) to deliver better water and environmental outcomes.

In short, the English private sector model has achieved much, but it has plenty more to offer. Let's focus on realising that potential.

Is a pledge to the past the best policy for the future?

Re-nationalisation of the water industry may not represent the panacea that some people want it to be, warns John Earwaker, director of First Economics

The Labour Party's 2017 manifesto pledge to renationalise water companies in England and Wales has garnered commentary, criticism or praise along mostly political and ideological lines. Yet a full appreciation of the costs and benefits that private-sector provision brings has often been missing from the public debate.

A proper economic analysis has to start with a recognition that shareholder ownership and private-sector financing have a cost. As at 2018, with £70bn of capital to lenders and shareholders outstanding, at an annual cost that Ofwat estimates to be approximately four percentage points above the cost of government gilts, the amount paid by customers to support private-sector capital can be put at close to £3bn a year – not an insignificant figure.

Looking back over a period of 30 years, it is, however, quite easy to show how the benefits of privatisation have up until now been more than sufficient to offset this expense. Under public ownership, the old water authorities were operating well short of achievable levels of efficiency, but a combination of new management teams, shareholder pressure for returns, and cleverly designed economic regulation led to a step change in productivity.

This is evidenced most clearly in benchmarking of companies from across the United Kingdom, which showed that companies in Scotland and Northern Ireland that had not been privatised were spending, by the early 2000s, at least 80 per cent more than equity-owned companies in England and Wales. In a sector that spends close to £10bn a year, there should really be no dispute that the benefits of efficiency improvement more than offset the higher cost of capital and made privatisation a success.

This is a lesson in history, though. The question is, does it still make sense to go on paying private-sector financing costs now that the industry is performing at or near to the efficiency frontier?

It is impossible to know for sure what would happen if companies were to be taken back under public control. But it is perfectly reasonable, given the experience of the past, to worry that a return to public ownership could lead to an erosion in standards of performance and cost control. Policymakers only have to look across to the recently renationalised Network Rail – a company that is spending more and delivering less, and whose regulator has recently said is around 10 per cent less efficient than it was five years ago – for a case study in the pitfalls of public-sector provision. When one also factors in the execution challenges that there would be in swapping billions of pounds of private capital for government borrowing, it is hard not to conclude that renationalisation would be a considerable gamble.

Does that mean that current industry ownership and financing arrangements should continue unaltered for the next 30 years? Maybe not. The challenge coming from the Labour Party is a reminder that government, Ofwat and companies need to be vigilant about industry financing costs and take all steps that are available to them to minimise this expense. Similarly, complaints about a lack of democratic control over companies seem to resonate with the public, and could perhaps point towards a move in the future to some sort of "third way", equity-based alternative to the standard plc or company limited by shares structure.

Key industry figures assess the economic, legal, environmental and customer service aspects of the UK's water supply

What water needs to succeed

Scott Corfe, chief economist at the Social Market Foundation

Research by the Social Market Foundation, published earlier this year, estimated that it would cost the government about £90bn to purchase all of the water companies in England. However, in return for these costs, the government would run a series of currently profitable industries from which it could make a financial return. Given this, those in favour of nationalisation argue that in fact there are no long-term costs from bringing the entire UK water industry into public ownership.

The counter-argument to this view, which we highlighted in our research, is that there are multiple question marks over the government's ability to run the water industry well. The current profitability of the sector is no guarantee of future profitability under public ownership.

Once in public hands, water pricing could become an increasingly politicised issue. One could imagine pressure on government to cap water prices in the run up to an election, undermining financial sustainability in the sector.

In addition, with substantial pressure on the government to invest more in health, education and elsewhere, there is a risk that the long-term investment needs of the water industry will be overlooked. Critically, it is very unclear what could be achieved through water nationalisation that could not be achieved through better regulation of the existing private enterprises. Better regulation, ultimately, carries fewer risks than nationalisation.

Dan Neidle, partner at Clifford Chance LLP

Any nationalisation of the UK water industry will certainly be unprecedented in scale and complexity.

There have been many nationalisations in the last 50 years. They've generally been of struggling sectors, such as aerospace and shipbuilding in the 1970s, or failing businesses, such as Northern Rock in 2008. Nationalising large and profitable sectors such as water, however,

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will face two significant challenges that previous nationalisations have not faced.

First, nationalisation in the modern world must realistically be for market value. Otherwise lengthy legal challenges would be inevitable – and not just in the UK courts. Many international investors would claim market value compensation under the UK's bilateral investment treaties. The way BITs work means that even parliament can't override them.

Second, the sophistication of these businesses means nationalisation isn't quite as simple as acquiring the shares in the water companies. There are other stakeholders to consider, including pensioners, lenders, bondholders and hedge counter parties. This makes nationalisation more legally complex. It also makes it more expensive: once debt and swap liabilities are factored in, the cost of nationalisation will at least double.

It is a political question whether the benefits of nationalisation justify the cost. But it would be a mistake to make a political decision based on a misapprehension of what that cost will actually be.

Dustin Benton, policy director at Green Alliance

In its first decade after privatisation, the water industry cut the proportion of beaches failing to meet water quality standards from around 25 per cent to 5 per cent. Since 2000, continued investment in end-of-pipe solutions lowered breaches to below 0.5 per cent. However, the condition of England's surface and groundwaters are generally poor and in some cases declining.

The UK is reaching the limits of cost-effective improvement in water quality from end-of-pipe solutions. Agriculture is now the principal cause of poor water quality, being responsible for nearly one third of failures to meet regulatory standards. The sector's traditional approach will not meet the government's ambition for an accelerated improvement in water quality and both marine and freshwater habitats, as set out in the 25-year plan for nature.

The sector must change. Catchment management schemes, which both avoid the need to build expensive hard infrastructure and also deliver significant habitat improvement, are much better value for money. The sector has begun to reorient: there has been a 40-fold increase in catchment management schemes in the past decade, but they still represent just 6 per cent of water company spending. Moving quickly could avoid significant cost: a large water company will need to spend more than £80m over 25 years upgrading nitrate treatment plants just to meet existing legal targets. But much of this cost could be deferred or avoided altogether by preventing agricultural pollution at source.

Government, too, must change: between 1995 and 2015, it spent £37bn on farm subsidy, some of which increased water pollution and flooding. During the same period, water companies spent £20bn on clean up and flood prevention. Removing these conflicting incentives will cut bills and deliver the healthy environment that people want.

Heidi Mottram, chief executive officer at Northumbrian Water

Our vision is to provide an inclusive, unrivalled service for all of our customers. We recognise that many of our customers can struggle with their household bills, and we want to try and make their lives that bit easier by providing a range of solutions to make things more affordable for them.

Therefore Northumbrian Water has made an ambitious commitment which will see 300,000 customers lifted from water poverty by 2025 and 400,000 by 2030 – completely eradicating water poverty from the communities we serve.

Building on the excellent progress made on fuel poverty, we are funding research and "on-the-ground" programmes led by our partners in this important initiative – National Energy Action – within a newly launched Water Poverty Unit.

Additionally, recognising that for many customers having a water meter could save them money, we will be investing in educating customers on this. We will also train employees and educate customers on schemes such as WaterSure which can cap metered bills. We hope that our aim for zero water poverty will galvanise the water industry and our partners, allowing for greater collaboration between the water and energy sectors to help *all* of our customers.

That's why we've published a *Manifesto for Water*, after talking to over 5 million customers. It's a new vision for water from 2020 to 2025, and puts customers at the heart of everything we do.

Over the last 30 years we've invested £150 billion to improve the industry. We've cut leakage by a third, and bills are falling in real terms. Research shows around 90% of customers are satisfied with the service they get. But we want to go even further – and that's what the *Manifesto for Water* proposes.

Water and Sewerage Bills
Domestic bills to fall on average by more than **4%** in real terms

Investment
Over **£50bn** to be spent across 5 years. A **13%** increase from the current period

Leakage
Technology and innovation to reduce leakage by **16%**

Customers Receiving Help
By 2025, companies plan to help **1.4m** customers each year with their water bills

The Environment
8000km of river improvements, benefitting people and wildlife

Supply Interruptions
By 2025, a **36%** decrease in the time that supplies are interrupted

Water UK represents and works with the major water companies in the United Kingdom. Our mission is to provide customers and communities with world-class services, enhancing the UK's quality of life.

For further information, please contact comms@water.org.uk

WATER UK
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