Public Services International Research Unit (PSIRU)

UK Water privatisation – a briefing

February 2001

by
Emanuele Lobina,
Research fellow, PSIRU, University of Greenwich; and Consultant in Globalisation, Water Supply and Sanitation, Arezzo, Italy

And
David Hall, Senior Research Fellow, PSIRU, University of Greenwich

This report was partly financed by the Canadian Union of Public Employees (CUPE)

Public Services International Research Unit (PSIRU)
School of Computing and Mathematical Sciences, University of Greenwich
30 Park Row London SE10 9LS U.K.
Email: psiru@psiru.org *Tel*: +44-(0)208-331-9933 *Fax*: +44 (0)208-331-7781 www.psiru.org

Emanuele Lobina *via Kennedy 101, 52100 Arezzo, Italy Tel/Fax: +39 0575 908460 Email: lobina@technet.it*

Director: David Hall Researchers: Kate Bayliss, Steve Davies, Emanuele Lobina, Sam Weinstein

The PSIRU was set up in 1998 to carry out empirical research into privatisation, public services, and globalisation. It is part of the School of Computing and Mathematics in the University of Greenwich, London. PSIRU's research is centered around the maintenance of an extensive and regularly updated database of information on the economic, political, financial, social and technical experience with privatisation and restructuring of public services worldwide.

This core database is finananced by Public Services International (PSI), the worldwide confederation of public service trade unions. www.world-psi.org

1. Background and structure of privatisation in 1989

1.1. The history of the water industry in the UK

Water services in England and Wales followed a pattern similar to most European countries. Services were taken over by local authorities from the late nineteenth century onwards, and a mixed pattern developed with some individual authorities running water companies, some large inter-municipal operators, and a surviving handful of private water-supply only companies, which were strictly regulated by a simple cap on their profits at a maximum rate of return of 5%.

In 1974 the service was reorganised. 10 unitary regional water authorities (RWAs) were created, each covering a river basin area, each responsible for water quality, water supply and sanitation throughout the area. The authorities were appointed by the government, not by municipalities, and so were not accountable to local government any more. However, the board meetings remained open to the public, until they were made secret by the Thatcher government in 1983. The RWAs made considerable efficiency gains: between 1974 and 1989 the number of employees was reduced from 80,000 to 50,000. [1]

1.2. The background to the Thatcher privatisation

Various arguments were used in favour of privatisation, including claims that

- the private sector would be more efficient;
- private companies would be better able to finance the large investments needed; and
- privatisation would create competition.

These claims were not supported by evidence from comparative studies or international reviews of the actual performance of public and private sector water companies.

The more fundamental motive was the Thatcher government's neo-liberal economic policies, which meant reducing the role of the state, and reducing public sector borrowing as low as possible. The RWAs were finding their ability to raise finance for investment curtailed by these policies – and this was used as a further justification for privatisation.

The government originally proposed water privatisation in 1984, but there was a very strong public campaign against the proposals, and so they were abandoned before the issue could influence the 1987 election. Once this was won, the privatisation plan was resurrected and implemented rapidly.

In Scotland and Northern Ireland however water remains controlled and operated by public authorities. Since devolution, the new Scottish parliament has discussed the water industry, but privatisation has been ruled out except for some BOT-financed treatment plants.

1.3. Private regional monopolies

Under the Water Act 1988, the newly floated companies became owners of the entire water system and properties of the RWAs. The Act gave them 25-year concessions for sanitation and water supply (except for the 25% covered by the existing small private companies), protected against any possibility of competition. It was the simple creation of private monopolies.[2]

The RWAs were sold by issuing shares on the stock market, with special discounts being offered to the public to ensure a political success. This form of privatisation was possible because the industry had been concentrated into the hands of the RWAs.

Privatisation did not create any competition. The companies were given monopolies in their regions for 25 years, without having to compete even once for the business.

♦ **Table 1: Regional water and sewerage companies created in 1989**

Name
Anglian Water
Dwr Cymru (Welsh Water)
North West Water
Northumbrian Water
Severn Trent Water
Southern Water
South West Water
Thames Water
Wessex Water
Yorkshire Water

1.4. Government subsidies

The Thatcher government took a number of steps which were all calculated to boost the profitability of the privatised water companies, at the expense of either the taxpayer or the consumer.

- The government wrote off all the debts of the water companies before privatisation, worth over £5 billion pounds (about 8 billion Euros/US dollars). In addition, it gave the companies a 'green dowry' of £1.6 billion pounds (about 2.6 billion Euros/US dollars).

The government also offered the companies for sale at a substantial discount, which has been assessed as equal to 22% of the undertakings' market value, measured as the difference between the issue price of the water companies' shares and the share price after the first week of trading.[3]

The initial price regime, set as a political act before OFWAT was established, was also extremely generous. As a result the pre-tax profits of the ten sewerage and water companies rose by 147% between 1990/91 to 1997/98 with sewerage and water prices rising respectively by 42% and 36%. [4].

The companies were given special exemption from paying profits taxes.

1.5. Regulation

The privatisation process created three regulators: the Drinking Water Inspectorate (DWI) monitoring water quality; the National Rivers Authority (now the Environment Agency (EA)) for monitoring river and environmental pollution; and OFWAT, to set the price regime that companies follow.

OFWAT is statutorily responsible for ensuring that the companies were profitable, a task which it performed very well, and for encouraging efficiency. As there is no competition, OFWAT compares the companies' performance with each other.

OFWAT's regulatory mechanism is by price-cap, carried out every 5 years according to a formula RPI + k. RPI represents general retail price inflation , and k adjusts this by reference to performance standards, efficiency and service and levels.

1.6. Image and reputation

Within a few years of privatisation the privatised water companies were unpopular, with a bad reputation for excessive pricing, excessive profits, and poor performance. As summarised by the parliamentary committee: *"After privatisation profits started to soar in real terms—between 1990/91 and 1997/8 the pre-tax profits of the ten water and sewerage companies increased by 147% at a time when customers faced continual price rises. Water and sewerage prices rose respectively by 36% and 42% from 1988-1998 (in real terms) with the bulk of the increase occurring in the period up to 1994-1995. The industry faced a public outcry in relation to high levels of directors' pay and profits…"*[5]

This view was not confined to a particular political perspective: one of the most consistent critics of the industry was the Daily Mail, a staunch supporter of the Conservative party. In 1994 the paper ran a feature entitled 'The Great Water Robbery', which slated the companies on all counts: *"In recent weeks the penny has been dropping that something has gone horrendously wrong with the privatisation of Britain's water industry. When it was privatised in 1989 the water industry was hailed as the jewel in the crown of the Thatcherite privatisation programme….In reality, as a string of reports have confirmed - including the latest today from the National Consumer Council - the water industry has become the biggest rip-off in Britain. Water bills, both to households and industry, have soared.* And the directors and shareholders of Britain's top ten water companies have been able to use their position as monopoly suppliers to pull off the greatest act of licensed robbery in our history ". [6]

2. Economic performance

2.1. Price increases

2.1. A. Price changes

The universal experience of water privatisation in the UK was a sharp increase in the cost of water. On average, prices rose by over 50% in the first 4 years. The first 9 years produced an increase of 46% in real terms, adjusted for inflation. The details are shown in the table below.

- **Table: Average annual water bills, by company**

Water and sewerage companies, England and Wales. Total all households, measured and unmeasured water and sewerage bills. £ 1998/999

			1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	% rise 89/90-98/99
Anglian	cash		157	178	205	226	244	259	272	279	282	288	84%
	real	terms	217	224	247	264	280	289	294	294	288	288	33%
DwrCymru	cash		149	169	197	218	237	255	263	272	281	294	98%
	real	terms	206	214	237	255	272	285	284	287	287	294	43%
NorthWest	cash		111	125	143	156	170	182	194	208	221	234	111%
	real	terms	153	157	172	182	195	204	210	219	226	234	53%
Northumbrian	cash		108	123	148	160	177	188	197	207	216	229	112%
	real	terms	149	155	178	186	203	210	213	218	221	229	53%
SevernTrent	cash		107	122	139	153	166	181	189	200	208	222	108%
	real	terms	148	153	168	178	190	203	205	211	213	222	50%
SouthWest	cash		147	165	194	231	268	304	318	329	339	354	142%
	real	terms	203	208	234	270	308	340	344	347	347	354	75%
Southern	cash		124	138	161	173	183	197	214	229	244	257	107%

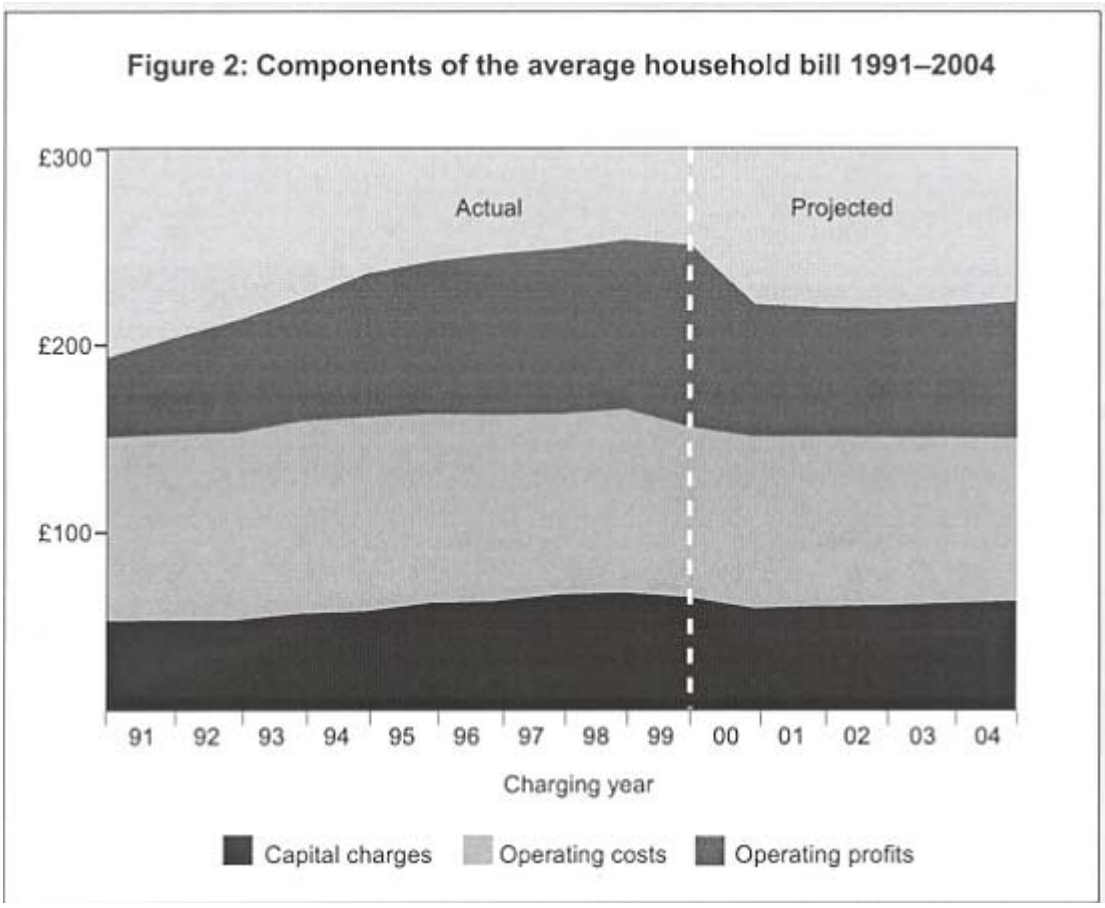
	real	terms	172	174	194	202	210	220	231	241	249	257	49%
Thames	cash		101	114	130	141	153	163	174	182	190	201	99%
	real	terms	140	144	156	164	176	182	188	192	194	201	44%
Wessex	cash		139	155	178	193	210	223	234	243	252	265	91%
	real	terms	192	196	215	225	241	249	253	257	258	265	38%
Yorkshire	cash		123	136	155	166	179	192	204	213	216	226	84%
	real	terms	170	172	187	194	206	215	221	225	221	226	33%
England&Wales	**cash**		**120**	**135**	**156**	**171**	**186**	**199**	**210**	**221**	**229**	**242**	**102%**
	real	**terms**	**166**	**170**	**188**	**199**	**213**	**223**	**228**	**233**	**234**	**242**	**46%**

Real terms = adjusted to 1998/99 prices using RPI deflator . E & W totals include water only companies
Source: OFWAT Memorandum 18 March 1998, in House of Commons Research paper 98/117 December 1998

2.1. B. Profits as fastest growing component

OFWAT identifies three main components of customers' bills: operating costs, capital charges (for investment and renewals), and operating profits. A graphic presentation of these elements over the period since privatisation shows that operating expenditure as a proportion of bills has shrunk; the capital charges have risen; but operating profits, which have more than doubled, account for virtually the entire increase in customers' bills. [7]

♦ **Figure 2: Components of the average household bill 1991–2004**

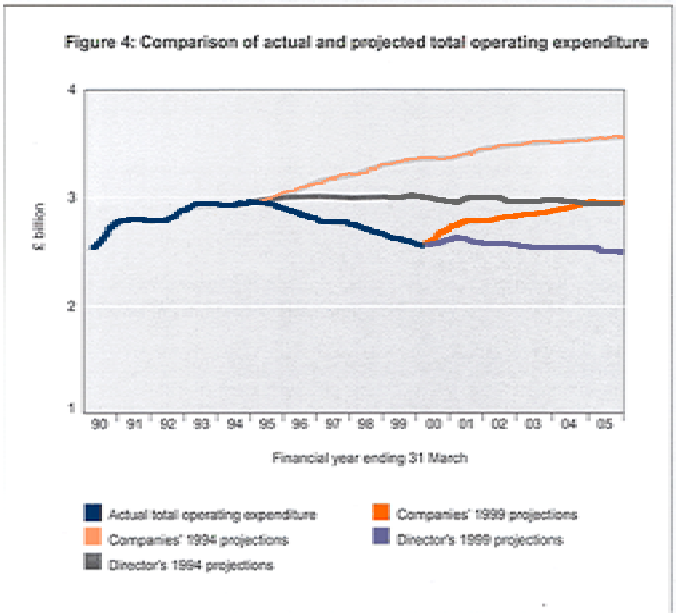


These three elements are related.

2.1. C. Operating costs: unexpected savings?

On operating costs, OFWAT comments that "Since the 1994 price review, the companies have significantly outperformed the Director's expectations about how efficient they could become." This raises the question – why were OFWAT's projections so wrong? One possible explanation is that the regulator was misled by the companies' own submissions. This is supported by the fact that the companies have made far more cuts than they themselves forecast: "They have also consistently outperformed their own estimates at both the 1989 and 1994 price reviews". The result of this would have been to persuade the regulator to allow price increases on the grounds that they were needed to cover operating expenditure, and for the revenue to be used to boost profits instead.

- **Figure 4: Comparison of actual and projected total operating expenditure**



2.1. D. Capital expenditure: overestimated

It is in the water companies interests for the forecasts of capital expenditure, which are used to calculate the allowed price rises, to be higher than actual expenditure. In that case the companies could use the shortfall in expenditure to boost profits.

This is in fact what happened. Capital expenditure started accelerating before privatisation, rose to a peak in 1991-92, and then levelled off and even fell, although the companies had projected that it would continue to rise at the same rate. This pattern of underspend has been highlighted as unusual in such major works projects: *"So, unlike most major capital expenditure programmes, the level of investment even at the height of the investment programme turned out to be less expensive than expected. Expenditure had been expected to peak in 1994-95 and then fall back to the levels of 1992-93 and below. In fact it peaked in 1991-92."* [8]

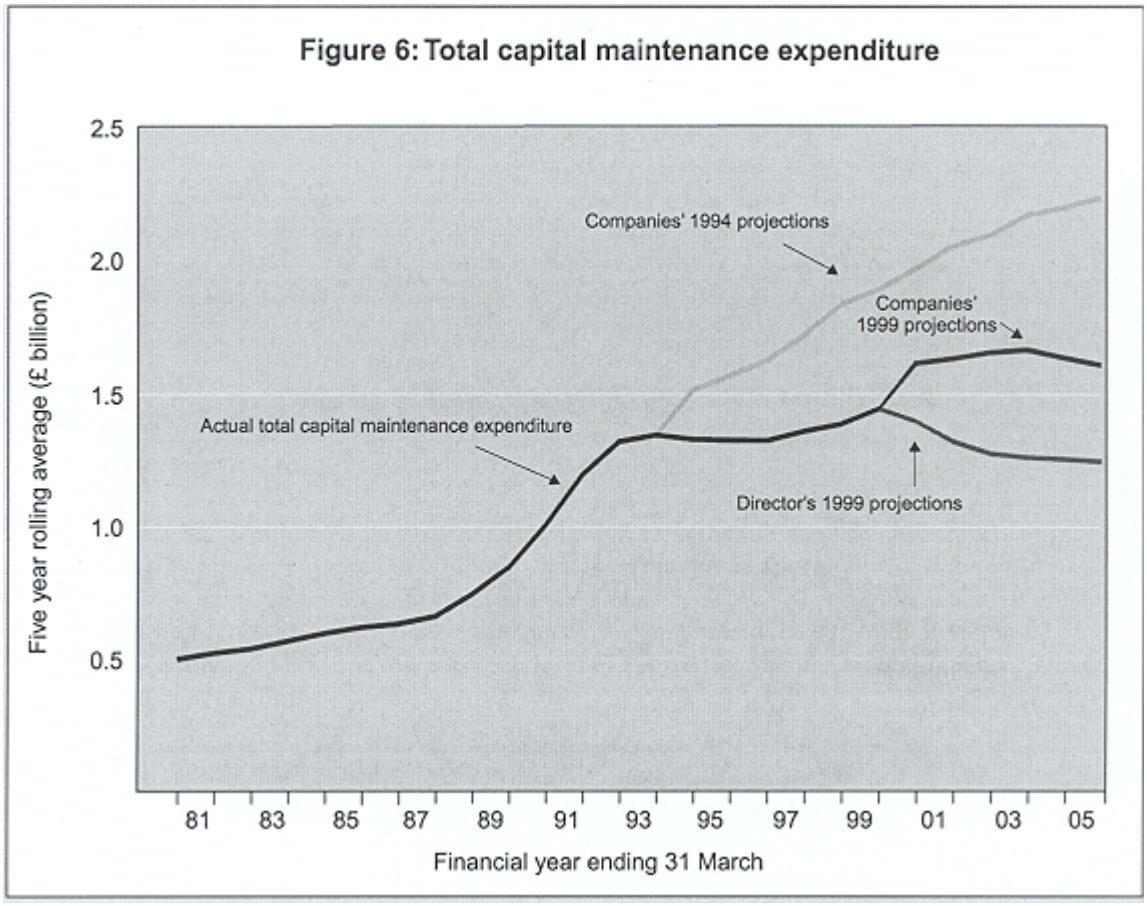
OFWAT was certainly asked to set price formula to allow for investment that was never made. One example of this included Southern water submitting plans for a series of sewage treatment plants which were not installed. [9] Another example was Yorkshire Water expecting to avoid £50m expenditure on sewage treatment because the

Conservative government promised to redefine coastal waters near the city of Hull as sea - where untreated sewage could be dumped - instead of estuary - where sewage would have to have been treated.[10]

Shortly after the 1994 price review was finalised, a number of companies discovered that they did not need to spend so much on capital expenditure after all. The companies then made use of this 'capital efficiency' to boost dividends, not to cut prices (see next section).

In their submissions to the regulator in 1999, the companies projected a significant rise in investment to 2005 – but this time OFWAT has been more sceptical, implying that the regulator does not believe that these forecasts are an accurate reflection of what is necessary or likely. [11]

♦ **Figure 6: Total capital maintenance expenditure**



2.2. Investment

2.2. A. Inadequate investment and regulation

The companies and OFWAT have argued that investment has been adequate and matched forecasts and expectations. But the parliamentary committee report in November 2000 was not convinced, and contrasted the reality of worsening conditions in water mains with OFWAT's claims that nothing had got worse:: *" For the period 1993-1998 water mains in poor condition (grades 4 and 5) increased from 9% to 11%, equating to £0.78bn worth of pipes moving into these categories. As of March 1998 (the latest assessments) 10% of critical*

sewers were also in a poor condition. However, Ofwat maintains that there has not been a measurable increase in the amount of assets in poor condition over the last five years" [12]

In a statement the committee blamed the regulator as well as the companies, comparing the post-privatisation system in water with the practices of the railways. *"The current Ofwat method for assessing the investment companies need to make to maintain our water pipes and sewers is seriously flawed. This means that current levels of investment may be insufficient to ensure that the basic levels of service which customers presently expect can be met in the future. Like the railways—it would be better to invest in infrastructure to prevent problems rather than in reaction to them - why wait for failure?"*

The committee's report concluded that: *" The Committee is not satisfied that Ofwat's "no deterioration" approach to the maintenance and renewal of underground assets (sewers and water mains) is a logical or acceptable means of assessing the amount of investment which water companies need to meet these requirements.* The Committee believes that this approach has amounted to intellectual neglect of this important problem."[13]

Two years earlier a critical academic study of the accounting data has similarly concluded that *"Far from maintaining the infrastructure, the underground network is deteriorating faster than it is being renovated. This has very serious implications for the future delivery of services as well as public health and the environment"* [14]

Evidence to the parliamentary committee in 2000 suggested that technical advances made it easier to cover up the consequences of under-investment: *" … in recent years, the improved management of asset failure incidents, and the introduction of automatic control has delivered improved levels of service to customers without an improvement in the asset condition. This is because the impact of individual failures on the customer has been reduced"* [15]

2.2. B. Cut investment to maintain dividends

A number of companies deliberately cut their investment programmes and used the 'savings to maintain or increase their dividends. The companies which did this include Thames Water, North west water, and Yorkshire Water.

"Britain's biggest water company is to cut its investment programme by £350 million - but it will not be passing on the savings to its 7 million customers. Thames Water has no plans for early price reductions or rebates. Instead consumers - whose bills have increased by 50 per cent since privatisation in 1989 - face yet another rise in April, by inflation plus 0.5 per cent. The latest price rise was decided by the industry regulator, Ofwat, during the five-yearly price review last year. It was based on a £2.1 billion capital investment plan agreed with the company. But now, six months after the review, Thames says its investment target is only £1.75bn - down £350m, or £70m a year - equivalent to £10 off every domestic bill." [16]

OFWAT suggested in 1996 that Yorkshire Water PLC's serious failures to ensure a reliable and continuous supply, as well as to control leakage and flooding from sewers had to be related to the company's dividend policy. [17]

Similarly, in 1995 North West Water appeared to favour increasing dividends to shareholders and overheads' remuneration rather than investing on the necessary infrastructure developments.[18]

2.2. C. Sewers maintenance

The capital expenditure and maintenance of sewers has been a particular cause for concern.

The low level of investment is such that sewers are expected by the companies to last for, on average, 280 years, and in some cases as long as 1,000 years. The table below *"reveals the implied asset life of these sewers (critical sewers) given the rate of investment from recent years. It should be noted that these represent less than a quarter of the whole public sewerage network. At best the implied average asset life of these sewers is nearly 280 years and on one calculation could be nearly a thousand years. Few if any sewers ever built have had to last that long. Even Water UK argued last autumn that it was unreasonable to expect an asset-life of more than 100 years"* [19]

The companies are said to subordinate the needs of the system to their business objectives: *"It is apparent that expenditure on sewers is largely driven by companies' operational and business requirements. Most of the work relating to the sewerage system is seen by Ofwat as activities not outputs and is therefore not reported despite the obvious importance for public health. It is quite conceivable that companies have submitted plans for investment in some sewers that have been included in previous rounds. For instance in setting the prices for Yorkshire Water at privatisation they were expected to improve 380km of sewers, 82km immediately, according to the prospectus, but between 1990-91 and 1994-95 only 17km were renovated. By 1999 only 65km had been renovated or replaced. On this basis it is clear that environmental improvements could have been achieved under the 1999-2005 price round without an increase in price"* [20]

- **Table: Sewers and investment**

Company	Total length of critical sewers,[1] km	Critical sewers renovated 1990-97,[2] km	Critical sewers renovated 1997-98,[2] km	Critical sewers renovated 1998-99, km	Critical sewers replaced 1990-97,[2] km	Critical sewers replaced 1997-98,[2] km	Critical sewers replaced 1998-99,[2] km	Total critical sewers renovated or replaced 1990-99, km	Total critical sewers renovated or replaced 1997-99, km	Average p/a sewers renovated/replaced 1990-99, km	Average p/a sewers renovated/replaced 1997-99, km	Implied asset life on 9 year view—years	Implied asset life on 2 year view—years
Anglia	8,191	34	29	13	36	16	3	131	61	14.56	30.5	562	268
Dwr Cymru	4,321	32	8	5	70	8	13	136	34	15.11	17	285	254
North West	10,674	127	23	27	120	24	17	338	91	37.56	45.5	284	234
Northumbrian	5,982	137	49	57	17	1	1	262	108	29.11	54	205	110
Severn Trent	7,471	95	5	2	265	21	23	411	51	45.67	25.5	163	292
South West	1,815	32	1	0	17	0	0	50	1	5.56	0.5	326	3,630
Southern	6,460	21	3	1	16	0	0	41	4	4.56	2	1,416	3,230
Thames	18,936	195	35	70	90	14	13	417	132	46.33	66	408	286
Wessex	2,841	63	6	8	17	1	2	97	17	10.78	8.5	263	334
Yorkshire	6,846	23	17	1	11	9	4	65	31	7.22	15.5	948	441
Total/All	73,537	759	176	184	659	94	76	1,948	530	21.65	26.5	486	908

Source: CROSS

2.3. Profits

UK water company profits have been extremely high, both by UK and by international standards. The tables below show how pre-tax profits doubled in the first year of privatisation, and rose by 142% in real terms in 8 years.

♦ Pre-tax profits of water and sewerage companies in England and Wales:

£ millions, cash

	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1989/90-1997/8
Anglian	78	153	171	185	132	216	239	208	274	250%
DwrCymru	34	128	138	155	144	120	113	208	209	510%
NorthWest	39	215	230	247	269	273	348	383	394	921%
Northumbrian	10	47	61	69	63	90	92	125	135	1250%
SevernTrent	130	249	265	270	281	268	373	361	351	170%
Southern	60	97	115	119	128	143	166	na	na	176%
SouthWest	45	88	90	93	93	63	109	114	106	133%
Thames	161	213	236	251	242	304	229	372	419	160%
Wessex	23	66	77	86	103	117	134	145	139	510%
Yorkshire	101	114	124	139	144	142	162	216	206	103%
Total	682	1,370	1,508	1,615	1,599	1,736	1,964	2,132	2,232	227%

£ millions, real terms (1997/98 prices)

	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1989/90-1997/8
Anglian	106	188	202	212	148	236	252	215	274	158%
DwrCymru	46	158	163	177	162	132	119	215	209	351%
NorthWest	52	265	271	282	302	298	368	396	394	658%
Northumbrian	14	58	72	79	70	99	97	129	135	898%
SevernTrent	176	307	313	308	316	292	395	373	351	100%
Southern	81	120	136	136	143	157	175	na	na	115%
SouthWest	61	109	106	106	104	69	115	118	106	72%
Thames	218	263	278	287	271	332	242	384	419	92%
Wessex	31	81	91	98	116	128	142	150	139	351%
Yorkshire	137	141	146	158	161	155	172	223	206	50%
Total	922	1,690	1,776	1,844	1,794	1,898	2,077	2,203	2,232	142%

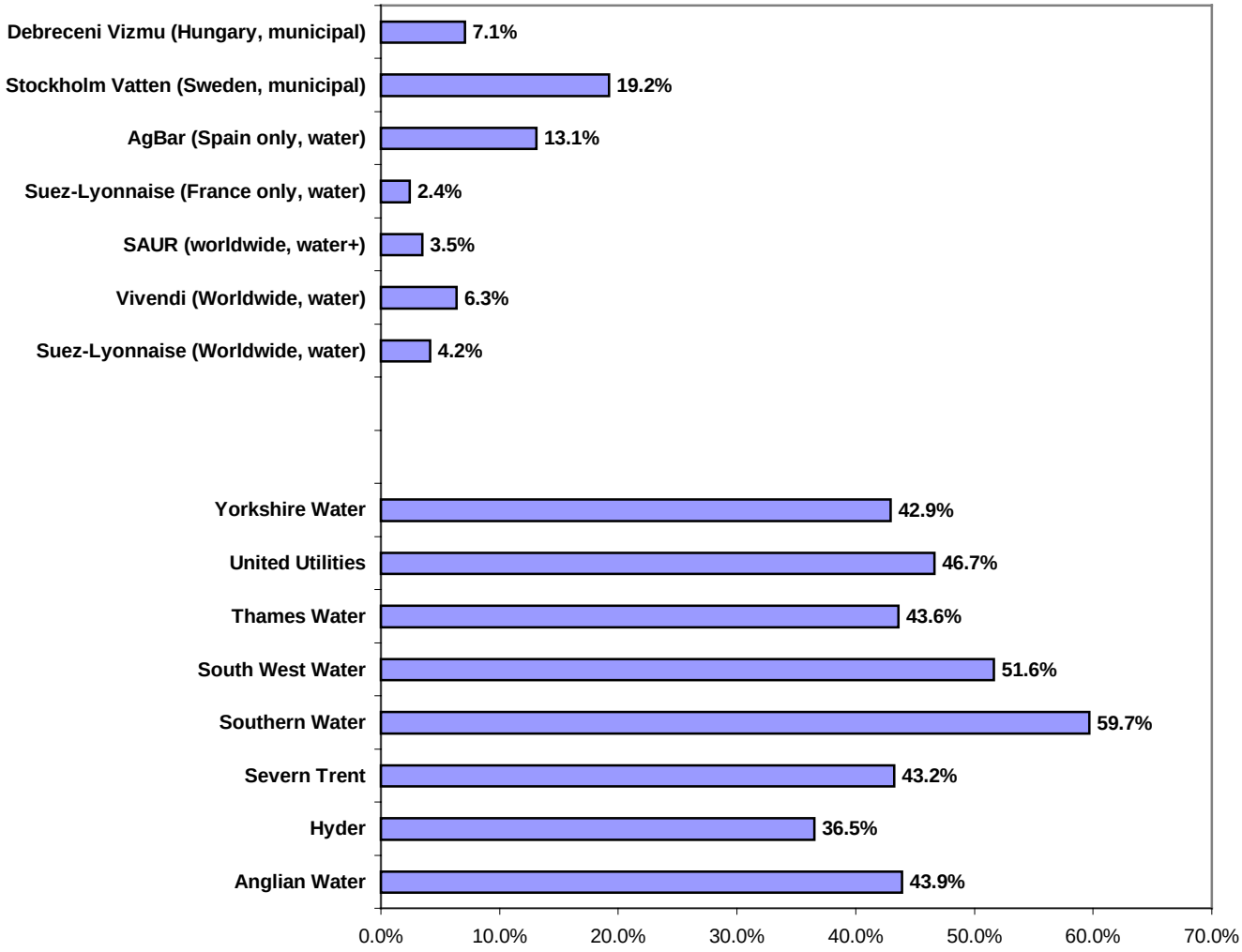
Source (both tables): *Company Annual Reports, presented in House of Commons Research paper 98/117 December 1998*

2.3. B. Excessive profit margins by international standards

Chart 3 shows comparisons between the UK water companies and some other water companies' profit margins.[21] In all cases, the data refers to profits from water and sewerage activities. The results are remarkable: profit margins in the UK are typically three or even four times as great as the margins of water companies, private and public, in France, Spain, Sweden, or Hungary. The profit margins of the greatest water multinationals – Suez-Lyonnaise and Vivendi - worldwide, also show a much lower return than that enjoyed by the UK companies.

♦ **Table: Comparative profit margins**

CHART 3: COMPARATIVE PROFIT MARGINS, WATER AND SEWERAGE COMPANIES, 1998



Source: PSIRU database and company annual reports and accounts

2.4. Excess management remuneration

Another source of anger against the water companies has been the large fees , salaries and bonuses paid to directors of the companies. In a 7-year period the real value of the highest paid director's pay increased by between 50% and 200% in most of the water companies.

♦ **Table: Remuneration of the Highest Paid Director: £ thousands, cash**

	1990/91	1991/92	1992/93	1993/94	1994/95gd	1995/96	1996/97	1997/98	1990/1-1997/8
Anglian	na	107	163	187	219	199	216	378	253%
DwrCymru	143	141	156	156	137	195	325	345	141%
NorthWest	144	189	284	361	361	380	326	444	208%
Northumbrian	82	110	129	150	189	164	158	152	85%
SevernTrent	159	148	195	302	315	231	240	293	84%
SouthWest	89	124	136	150	217	162	172	109	22%
Southern	142	169	170	215	233	203	Na	na	82%
Thames	209	199	306	317	408	106	247	277	33%
Wessex	128	160	208	224	231	184	202	206	61%
Yorkshire	119	143	156	181	190	170	176	298	150%

♦ **Table: Remuneration of the Highest Paid Director: £ thousands, real (adjusted to 1997/98 prices)**

	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1990/1-1997/8
Anglian	na	126	186	210	239	211	223	378	200%
DwrCymru	176	166	178	175	150	206	336	345	96%
NorthWest	178	223	324	405	395	402	337	444	150%
Northumbrian	101	130	147	168	207	173	163	152	50%
SevernTrent	196	174	223	339	344	244	248	293	49%
SouthWest	110	146	155	168	237	171	178	109	-1%
Southern	175	199	194	241	255a	215	na	na	23%
Thames	258	234	349	356	446	112	255	277	7%
Wessex	158	188	237	251	252	195	209	206	30%
Yorkshire	147	168	178	203	208	180	182	298	103%

Source: Company Annual Reports, presented in House of Commons Research paper 98/117 December 1998

2.5. International efficiency comparisons

OFWAT only compares English and Welsh companies with each other, it does not make international comparisons. However, a 1995 study carried out by the consultancy ITT compared the costs of water provision between Swedish and UK cities of comparable size. As shown by table 2, the study revealed that Swedish POEs enjoyed considerably lower costs than their private British counterparts. Furthermore, the average return on the capital invested by Swedish companies was positive allowing for full cost recovery, but accounted for nearly a third of that noticed in England [22]

♦ **Table: Water costs comparison between Swedish and English cities, 1995**

(Source: ITT, presented in Hall 1998) M = municipally owned; P = privately owned; Cost per cubic metre of water delivered, purchasing power parities, US$.

Water company	Ownership	Cost to customer	Cost of operation	Capital maintenance	Return on capital
Stockholm	M	0.28	0.17	0.03	0.09
Manchester	P	0.91	0.40	0.20	0.31
Bristol	P	0.83	0.48	0.19	0.15
Gothenburg	M	0.38	0.11	0.05	0.21
Kirklees	P	0.99	0.52	0.31	0.15
Hartlepool	P	0.73	0.35	0.08	0.29
Helsingborg	M	0.42	0.42	0.05	-0.05
Waverley	P	0.82	0.48	0.22	0.12
Wrexam	P	1.25	0.57	0.35	0.32
Swedish average		0.36	0.23	0.04	0.08
British average		0.93	0.48	0.20	0.23

A comparison closer to home, shows that the privatised companies of England and Wales charge roughly twice as much as the public sector water authorities of Scotland.

♦ **Table: Public sector Scotland and privatised England and Wales**

Average annual water and sewerage bills, £ real

	1994/95	1995/96	1996/97	1997/98
East	-	-	125	118
North	-	-	129	134
West	-	-	110	112
Scotland	110	113	-	-
EnglandandWales	223	228	233	234

Sources: CIPFA The UK Water Industry Charges for Water Services various years

2.6. The costs of diversification: write-offs in UK and overseas

The UK water companies have consistently sought to diversify their activities, by expanding internationally and into other sectors. These have for the most part been unsuccessful, unprofitable, and so supported, subsidised and financed by the excess surpluses on the UK monopoly water and sewerage business. In the process, the companies have raised loans to finance their investments, thus transforming the debt-free bounty that they inherited at privatisation into indebted groups with ever lower credit ratings.

One example is Yorkshire water (now part of Kelda Group): *"The problem for these mature, capital-intensive industries is that their new owners require a rate of return commensurate with the (high) amount of capital employed, and income growth. YW's parent company distributed £350m of the £954m dividends received from the core water business between 1990 and 1999 to its shareholders. A further £275m was spent on acquiring new companies in the search for growth from non-regulated businesses. Initially unsuccessful, they have now begun to make a small profit. As a result of remitting so much to the parent company, YW had a negative cashflow that could only be offset by short- and long-term debt, thereby mortgaging the future. Some of the dividends were recycled back to the regulated business in the form of interest-bearing debt to make up the shortfall between the amount needed for capital expenditure and cash available after paying dividends to the parent company.* ***So, despite the debt write-off at privatisation, the water companies have increasingly come to resemble their debt-ridden publicly owned counterparts*** *– and YW, with a gearing ratio of 34%, is one of the least indebted of the companies"* [23]

The cost of these failures has been extremely high. The table shows some major write-offs by the water companies of ventures which have failed to be profitable. The largest and most frequent write-offs have come in failed international ventures.

♦ **Table: Write-offs by UK water companies**

Company	Year	Amount written off	Activities
Anglian Water	1999	£5.4m	Water (International) Operating losses before interest
	1998	£4.7m	Water (International) Operating losses before interest
	1999	£17.5m	Group Restructuring "This is part of an expected total of £50.0m which includes the cost of up to 400 redundancies in the regulated business during the next 2 years
	1999	£0.8m	Group Disposal of tangible fixed assets
Hyder /Welsh Water	1999	£9m	Regulated utilities Restructuring
	1999	£20m	Water (UK) Bad debt following ban on disconnections
	1999	£43.5m	IT New billing system inadequate
Severn Trent	1996	£4.5m	Water (UK) Failed take-over bid for South West water
	1999	£9.1m	Group Interest costs, including to finance the Windfall tax
	1999	£1.1m	Waste Charge for depreciation (due to new methodology)
	1999	£1.1m	Severn Trent Services Loss from software solutions
South West Water	1999	£0.3m	Viridor Instrumentation Integration costs on the Orbisphere acquisition
	1999	£1.9m	Waste Accounting changes and end of NFFO 1 and 2 contracts
Thames Water	1994	£35m	Selling off and closing unsuccessful businesses in water (£25m in Egypt) and other companies (UK, US, Germany and Asia)
	1996	£95m	Selling off and closing unsuccessful overseas contracts and businesses; MD resigned
	1998	£8.3m	Property Disposal of fixed assets
	1999	£3m	Group higher interest charges largely reflecting last year's balance sheet restructuring and the payment of the final windfall tax instalment
United Utilities	1996	£123.8m	Manufacturing/Construction: restructuring
	1996/97	£83m	Water - Problems with Bangkok contract
	1999	£5m	Electricity Distribution - under-recoveries
	1999	£3.2m	Gas Supply Operating losses, including marketing efforts
	1999	£3.2m	Telecommunications Investment in business development
	1999	£5.2m	Telecommunications Closure of digital powerline technology business
Yorkshire Water	1999	£30.2m	Group Returns on investment and servicing of finance

2.7. Employment falls

Since the privatisation of the water industry in England and Wales, the jobs of water workers have been eroded. The table shows the change in employment in the 10 water and sewerage companies in the UK since 1989. The data is derived from the companies' annual reports, but focuses exclusively on the numbers employed on water supply and sewerage in the UK, thus excluding the effects of the companies' diversification into other areas. Overall, there has been a fall of 21.5%, or 8,599, since 1990.

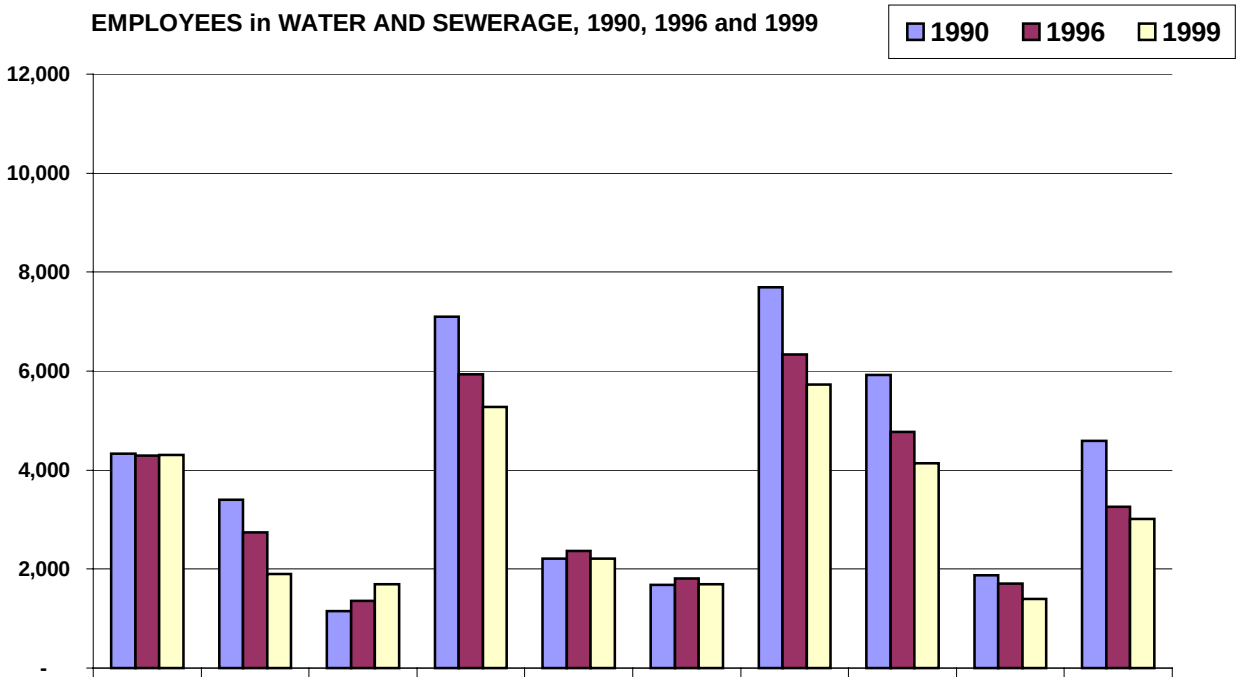
♦ **Table : Overall fall in employment, water and sewerage, 1990-1999**

	1990	1996	1999	Change in numbers, 1990-1999	Percentage change, 1990-1999
Employees in water supply and sewerage, 10 regional companies	**39,962**	**34,578**	**31,363**	**- 8,599**	**-21.5%**

Source: *Company annual reports, presented in Hall and Lobina (1999)*

These figures are reflected in most of the individual water and sewerage company accounts. There is a clear pattern of job cuts in six of the companies in the UK water and sewerage operations; at least two of the others, Northumbrian and Anglian, would show similar patterns were it not for extra employees acquired as a result of taking over smaller water companies in recent years."

CHART 1: UK WATER COMPANIES
EMPLOYEES in WATER AND SEWERAGE, 1990, 1996 and 1999



	Anglian Water	Hyder	Northumbrian Water	Severn Trent	Southern Water	South West Water	Thames Water	United Utilities	Wessex water	Yorkshire Water
1990	4,328	3,397	1,155	7,105	2,217	1,684	7,688	5,928	1,869	4,591
1996	4,287	2,744	1,352	5,930	2,371	1,815	6,338	4,770	1,708	3,263
1999	4,305	1,906	1,699	5,276	2,205	1,700	5,732	4,132	1,400	3,008

Source: Company annual reports and accounts, presented in Hall and Lobina (1999)

3. Social exclusion

3.1. Disconnections and company policies

Following privatisation there was a sharp rise in the number of households being disconnected. The rate tripled in the first 5 years, with 18,636 households disconnected in 1994.[24] But there was widespread opposition of this practice on social and health grounds.

The companies were criticised for failing to exercise restraint or social responsibility over their disconnections policies. In the House of Commons, it was reported that:
"The water companies say that they disconnect only the "won't payers"--those who can afford to pay, but refuse to do so. I shall bring to the attention of the House some recent examples of people I know who have been disconnected : in Southampton a lady with seven children, one aged three who suffers from a heart condition ; a family of five, in which the mother suffers from a medical condition which requires a constant supply of water and whose neighbours provided that water via a hose pipe ; and a severely disabled elderly lady, whose neighbours brought her water in a variety of containers. In south Staffordshire, a single parent on unemployment benefit was threatened with disconnection for arrears of £60.73. When the local citizens advice bureau contacted the water company to say that there was a child in the house, the company said, "So what?--We'll still disconnect." A young mother with three children, aged two, five and eight, handed over £50--all her family credit for a week--when the company turned up to cut her water off. The water company got its money, but the family had nothing left for food for the following week. In mid-Kent, the water company refused to allow a family with two children under five and a baby on the way to repay £5 a week under an instalment plan and demanded the payment of more than £400 in full. I do not call those people "won't payers", but "can't payers"."[25]

3.2. Disconnections and public health

A constant and powerful strain of criticism was that cutting off water supplies endangered the health of the household and of the public. In 1992 there was a rise in the number of cases of dysentery reported, in all major conurbations other than London. The water companies were further criticised for failing to notify cutoffs to the local authority, despite their statutory duty to do so and the attendant health risks of not reporting.[26]

The policies were criticised by the medical and nursing professions, who argued that a clean water supply was essential for human life, hygiene and health: *"Both the NGOs concerned with child poverty and the medical profession had opposed the disconnection of consumers who did not pay their bill, arguing that there was no reason why the companies should have access to a remedy for non-payment of debt that was not open to other creditors seeking to recover debts"* [27].

The new Labour government adopted the same position – that disconnection is a health risk: *"The Government believes that access to water is essential to the maintenance of general good health and well being. Some of the greatest improvements in general public health have stemmed from every household having access to a constant supply of potable water. Good hygiene and effective sanitation are key elements to the maintenance of good health and each depends on having constant access to water. Where the water supply is disconnected, the maintenance of good health and hygiene can only be put at risk. In the light of this, and having considered the available evidence, the Government believes that disconnection does not have to be an integral part of the process of collecting arrears of charges for water supplied to domestic premises"* [28]

3.3. Pre-payment meters

When their powers to disconnect were curtailed, the companies started using the 'pre-payment meter' for customers unable to pay their bills. This supplied water when charged with a card: otherwise the household would get no water. They thus operated as self-disconnecting meters. By 1996 over 16,000 had been installed, according to OFWAT, which led to "a startling increase in the number of hidden disconnections associated with these meters".

Birmingham city council challenged the legality of the meters, to the installation of such meters. The council estimates that**,** in Birmingham alone, there have been no fewer than 2,489 disconnections associated with pre-payment meters. Those were the disconnections that had taken place by April. As it is estimated that only about 1,500 pre-payment meters have been installed in the Birmingham area, there is clearly a pretty staggering disconnection rate.

> *"Those figures do not sit easily with Ofwat's press release yesterday, in which it applauded the fact, as it saw it, that there had been a 42 per cent. reduction in domestic disconnections in one year. Ofwat stated that only three out of every 10,000 households are having their water supply disconnected"* [29]

"In the Severn Trent area, each installation of a pre-payment meter costs the customer about £26. That could be about 10 to 15 per cent. of someone's water bill for a year. For the privilege of having a pre-payment meter, the customer is charged £26. There is another catch in the operation of the vast majority of such meters. I said at the beginning of my speech that they differed in one significant respect from traditional gas and electricity meters. The difference is that the vast majority of water pre-payment meters are not volumetric. Normally, when the customer charges up his water key or other pre-payment device, that does not involve his buying a certain quantity of water; he is buying a certain amount of time during which he is connected to the water supply. His annual water charge is divided by the amount charged up on his card or key. The catch is this. If the customer does not keep the card or key charged up, that will not alter his liability to pay his annual water bill. That means that, even if the customer is cut off, he will be charged for water that he is not receiving. That is a very strange aid to budgeting--a very strange easy payment scheme. The customer is told that the device will be helpful, but if he cannot keep up the payments, he is charged for water that he is not allowed to receive" [30]

3.4. Disconnections and pre-payment meters made illegal

The 1998 Water Act made it illegal for water companies to disconnect customers' water supply, or to install pre-payment meters or 'trickle valves'. This confirmed a UK court ruling that prepayment meters were illegal, after a challenge from municipalities .

4. Service delivery

4.1. Market failure: no incentive to improve efficiency or reduce leakage

Under the UK post-privatisation structure there are little effective incentives for the companies either to improve their efficiency or to reduce leakage. In November 2000, 11 years after privatisation a parliamentary committee concluded that:

" We believe that companies do not have significant incentives to promote water efficiency and that there would be merit in investigating the feasibility of setting company-specific targets for domestic water use, once a robust methodology for efficiency measurement has been agreed. This would help to focus efficiency efforts and drive the markets for water efficiency and innovation" [31]
and

"As with water efficiency measures overall, companies have little financial incentive over the next five years to reach their own economic levels of leakage. The benefits which companies see from reducing their leakage are often very small, largely savings in power and chemicals only. They do not receive any immediate benefits themselves from deferring the construction of a new reservoir etc and thus in effect there is market failure"

4.2. Droughts

The drought of 1995 exposed the privatised companies' weaknesses in maintaining a service. The two key features which made the situation worse than it would have been without privatisation were:

- The companies had chosen to under-invest, in order to maintain dividends. As a result, water shortages – especially in Yorkshire – were more acute
- The companies were not trusted by the public, and were perceived as greedy. As a result, the public were less willing to make sacrifices to conserve water, when the companies had clearly made no sacrifice at all.

OFWAT suggested in 1996 that Yorkshire Water PLC's serious failures to ensure a reliable and continuous supply, as well as to control leakage and flooding from sewers, had to be related to the company's dividend policy. [32] The shortage of water was so acute that the company had to hire fleets of trucks to collect water from the reservoirs of a neighbouring authority, on a daily basis. This operation was so large that it absorbed nearly all the available food-grade trucks in the north of England. Even at Christmas, long after the drought had ended, some consumers in Halifax were still having to collect water from standpipes.

The company failed to mobilise public support. The loss of confidence in the private companies is indicated by a comparison with the previous drought in Britain, in 1976, when the publicly owned water authorities appealed for restraint in the use of water – and consumption fell by about 25% as the public responded. In 1996 similar appeals in Yorkshire produced almost no reduction at all in consumption.[33]

4.3. Leakage, low pressure and interruptions

After the 1995 drought OFWAT set leakage targets for the companies, for the first time. There has since been arguments over the correct methods for measuring leakage, the desirable objectives – whether leakage should be reduced only down to the 'economic leakage level' (ELL), or lower.

Leakage has fallen in England and Wales, as shown in the table from 31% of the 16,598 Ml/d put into supply in 1994-95 to 22% of the 15,058 Ml/d put into supply in 1999-2000 . The National Audit Office said that the better performing companies are regarded as amongst the best companies in the world and average leakage figures are comparable with international figures, but these are based on uncertain data and methodology. OFWAT has expressed reservations about some companies' estimates of the average consumption by domestic consumers, including Thames Water. [34]

♦ **Table: Leakage rates**

Company	Total leakage (Ml/d)		Total leakage (l/property/day		Total leakage (m3/km/d)	
	1994-95	1999-2000	1994-95	1999-2000	1994-95	1999-2000
Anglian	236	190	136	103	7	5
Dwr Cymru	390	288	315	223	16	11
North West	874	487	290	157	22	12
Northumbrian	187	168	171	149	12	10
Severn Trent	665	340	213	106	16	8
South West	145	84	215	118	10	6
Southern	133	93	139	94	10	7
Thames	1,078	662	324	193	35	21
Wessex	140	88	283	171	13	8
Yorkshire	546	317	271	152	19	10

4.4. Sewer flooding

The extent of sewer flooding in many homes is another failure of the privatised system. In the first half of the decade *"More properties were found to be at risk of sewer flooding as company information improved. There was little improvement in industry performance and five companies had not reached their target performance in 1995."* [35]

The situation remains unresolved: *"In October 2000, local consumer watchdog for North West Water area defined raw sewage flooding into homes a misery. The North West Customer Service Committee (CSC) stressed how several cases of sewer flooding had recently occurred due to "sewers unable to cope with a sudden increase in water volume during heavy storms….CSC also blamed the government for not making elimination of sewer flooding a statutory obligation of the water companies. It said consumers were ready to pay for North West Water's investments in order to tackle the issue. North West Water would be required to invest £3bn from 2000 to 2005, mainly on enhancing the environment and water quality. The investment programme should reduce the number of flooding incidents by a quarter in the same period. In October 2000, around 2,000 properties in the North West region were estimated as being at risk of sewer flooding at least once every 10 years"* [36] (North West water is part of United Utilities)

The companies manage to risk both ground pollution and sewage flooding because of lax standards in *"the allowed rate of ex-filtration from sewers to the ground (and hence potentially to groundwater). Conversely, infiltration from groundwater to the sewers increases flows in sewers and the load on treatment, and, potentially, increases the risk of flooding from sewers. Whether the direction of flow is from a sewer to groundwater depends upon the relative depth of the sewer and the water table. Another area of controversy is the use of reinforced plastic pipes for sewers and the risk of failure in such sewers when they are jetted with high pressure water to clear blockages"*. [37]

4.5. Water quality

A review of the Drinking water Inspectorate (DWI) reports in 1998 concluded that there were still weaknesses in companies' performance and in the ability of the DWI to enforce standards by taking action. On five key parameters: nitrite, iron, lead, PAH and other pesticides, less than 80% of zones complied. Some of this may be

due to failure to maintain the network. The number of 'serious incidents' did not decline in the first 6 years of privatisation. North West, Severn Trent, Welsh and Yorkshire were the worst offenders. [38]

There was a serious outbreak of cryptosporidiosis in North London in March 1997, during which people were poisoned. The company had to pay compensation to affected households as a result, but the DWI was unable to prosecute Three Valleys Water over the outbreak.

4.6. Environment and pollution

"In 1993, we prepared a list of some 20 Sites of Special Scientific Interest, where we were seeking removal of phosphate by water companies at sewage treatment works. The total cost of this programme was estimated to be less than £10 million. Despite meetings with the Director General of Water Services and with the National Rivers Authority, we were unsuccessful in getting these improvements included in the discretionary programme of some £500 million" (EnglishNatureAppendix.htm/AMP2, 6.).

The wastewater and water companies are responsible for 1 in 5 of pollution incidents[39]

- **Table: Pollution incidents involving the wastewater companies**

Company	Pollution incidents in 1999	Prosecutions in 1999	Reduction in pollution incidents from 1998 (%)
Dwr Cymru	213	7	49
Severn Trent	494		35
Anglian	283	8	27
Southern	155	6	2
Thames	233	8	1
Northumbrian		3	
North West		2	
South West		2	

Source: *Environment Agency*

Vivendi, Suez-Lyonnaise, and Enron subsidiaries are ranked as the second, third and fourth worst polluters in the UK in 1998, in a list published by the Environment Agency (where offenders are classified according to the fines levied by the courts). Wessex Water, Enron's UK water subsidiary, had to face an overall £36,500 fine in the year and was fined only £5,000 with £500 costs for discharging 1m gallons of raw sewage into a Dorset marina on August bank holiday (when the marina was obviously crowded).

Vivendi subsidiary Tydeseley Waste Disposal is second in the list, and Suez- Lyonnaise subsidiary London Waste is third. Both of these companies are waste-to-energy incinerators. The other water company in the top ten is Anglian Water, but most of the other UK water companies are also regularly prosecuted for polluting the country's rivers.

Moreover, all water companies appear to be serial offenders of the environment and "as profits, dividends and bills go up, so do the pollution incidents". Between 1997 and 1998 all ten water companies "have been found

guilty by the courts", while since 1st January 1998 the Environment Agency "has successfully prosecuted eight out of the ten water and sewerage companies in England and Wales for a total of 22 water pollution offences".

Follows a list of successful water company prosecutions between 1989 and 1997:

Anglian (31)
Dwr Cymru (41)
N.West (30)
Northumbrian (13)
Severn Trent (44)
S.West (10)
Southern (20)
Thames (31)
Wessex (10)
Yorkshire (30) [40]

4.6. B. OFWAT lack of responsibility

The main economic regulator has no duty to, and has paid no attention to, environmental sustainability: *" The Director of Ofwat does not have a specific duty to promote sustainable development. Indeed Ofwat believes that such a duty better rests with Government rather than the economic regulator and that Government can further the cause of sustainable development through the use of economic instruments for pollution control. Ofwat's view is that it contributes to, but is not the main party responsible for, promoting sustainable development… This attitude that sustainability is not a direct matter for Ofwat is evident in much of Ofwat's work."*[41]

5. Restructuring of the industry

5.1. Ownership and takeovers

The 10 water and sewerage companies were protected from takeover for 5 years by the government's 'golden share'. The smaller water-supply only companies were however the subject of takeovers straight away, and nearly all are now owned by multinationals, mainly the three French groups Vivendi, SAUR, and Suez-Lyonnaise.

Since then, half the water and sewerage companies have been purchased by multinational companies. Two are now owned by USA companies, I by a French company, 1 by a Scottish company – and now Thames Water, the largest, has been purchased by RWE..

Apart from the takeover by Suez-Lyonnaise of Northumbrian Water, all the other takeovers have been by energy companies who wish to expand into water – Enron, Scottish Power, Southern Company (which is also present in Berlin electricity) and RWE. In addition, one of the water-only companies, Cambridge Water, has been taken over by the Spanish electricity company Union Fenosa.

♦ **Ownership of Water and sewerage companies**

Company	%	Parent Group	Country
Anglian Water	100	Anglian Water	UK
Northumbrian Water	100	Suez-Lyonnaise	France
North West Water	100	United Utilities	UK
Severn Trent Water	100	Severn Trent	UK
Southern Water	100	Scottish Power	UK (Scotland)
South West Water	100	Pennon Group	UK
Thames Water	100	RWE	Germany
Welsh Water	100	WPD (= Southern Company, PPL)	USA
Wessex Water	100	Azurix (= Enron)	USA
Yorkshire Water	100	Kelda	UK

♦ **Ownership of Water-only companies**

Company	Per-cent	Parent Group	Country
Bournemouth water	100	Biwater	UK
Bristol Water	25.8	Vivendi	France
Cambridge Water Company	100	Union Fenosa	Spain
Essex & Suffolk	20	Suez-Lyonnaise	France
Folkestone and Dover	73.95	Vivendi	France
	25	Scottish Power	UK (Scotland)
Mid Kent Water	25	Vivendi	France
	14	SAUR	France
Mid Southern Water	100	SAUR	France
North Surrey		Vivendi	France
Portsmouth Water		Brockhampton	UK
South East Water	100	SAUR	France
South Staffordshire	28.1	Vivendi	France
Three Valleys		Vivendi	France

5.2. Recent proposals to go mutual

The water companies have been under stress since the new series of tougher measures were introduced under the new Labour government. These included: applying a windfall tax; pressuring OFWAT to impose a much more stringent price-cap in the 1999 review; and introducing legislation to increase the companies' social responsibilities e.g. by outlawing cutoffs. The combined effects of these measures have been to squeeze the profitability of the companies, and provoke them into considering ways of escaping from this new pressure.

From mid-2000 there have been a number of proposals coming from the water companies themselves to split and mutualise the assets of the water system itself. These proposals take various forms, but all involve two key elements:

- the physical infrastructure of the network itself is sold to a not-for-profit body, which then finance capital investment through borrowing
- the operation of the system is contracted out to another expert water company to run, with a long-term lease or concession on the French model

The two companies which pioneered these proposals were Kelda (Yorkshire) and Welsh Water, but a number of other companies are also reported to be interested in this kind of restructuring,
including Wessex Water (part of Azurix), Pernnon Group (owners of South West Water) and Anglian Water .

5.2. A. Kelda propose 'mutualisation' – rejected

In July 2000 Kelda, the owners of Yorkshire water, suggested handing back the water system to a consumer-owned 'mutual', not for profit, company. New price regulations meant that it would no longer be so easy to make profits from water – and Kelda had accumulated a lot of debts. Kelda proposed that the mutual should take over all the debts, and be subject to the regulator.

The company argued that the mutual would be able to charge lower prices, because equity is more expensive than debt finance. This was described as "a tacit admission that the private ownership of a capital-intensive business with limited demand is unviable". Kelda/Yorkshire Water became a bad joke in the UK in 1995 when they failed to maintain piped water supplies to whole towns for months on end.

The customers will be expected to pay £2.5 billion for this mutual company; take on all the debt of the whole Kelda group, £1.4 billion; and guarantee to bondholders that they will maintain a high credit rating. The part of Kelda remaining private would hold an operating contract to run the system. Shareholders of Kelda are expected to benefit by about £1.5billion.

As part of the argument, analysts are stating that customers can expect lower prices from mutualisation because it will be less expensive to pay for loans (debt finance0 than the dividends to shareholders (equity finance). The utilities analyst at UBS Warburg estimated that water prices could fall by a further 5 per cent if the industry financed itself more efficiently purely by debt. "The most obvious benefit will be a reduction in financing costs."

The benefits to shareholders would have been substantial. The Lex column of the Financial Times summed up the advantages of the plan: "From the shareholders' point of view, spinning the water and waste assets into a mutual, financed entirely by debt, is all gravy".[42] This was quantified in some detail by a later article: *"By way of contrast, Kelda would realise £2.4bn – more than five times the 1989 purchase price – from the sale of the water business's assets built up by generations of taxpayers and consumers. This would have enabled Kelda to pay back YW's existing debt and that of the other subsidiaries, and return up to £1bn to shareholders. This is more than twice the value of their original investment, and comes on top of the £350m paid out in dividends thus far. And this would still have left enough cash for further acquisitions. Free of the regulated business, Kelda could pursue its declared objective of 'focusing aggressively on shareholder value'"* [43]

Local reaction was hostile. Local trade union official John Kidd says: "The time has obviously come when the pigs have had their feed at the trough and there is nothing left.",(Northern Echo 15 June 2000); consumer group representative Pete Bowler, said: "They have taken the company to the point of bankruptcy, increasing debt to 83 per cent of the value of the company in order to pay unsustainable dividends to shareholders. Now the company cannot be milked any more, they want rid of it." He added that making customers buy for the second time something they owned in the first place was offensive. [44]

The local Yorkshire newspaper, the Northern Echo, said in a leader: "Yorkshire Water has amassed colossal debts, the core water supply business is struggling to make profit and the share price is depressed. The directors' answer to the mess they have created is to give the business back to the public. Having milked it dry with excessive dividends and excessive wages and share options for themselves, they are walking away. And even then they have the nerve to want to continue to run the company - no doubt at a profit - saddling the public with the pounds 1.4bn debts they have left behind. The effrontery of these directors beggars belief. As one union leader put it yesterday: "The time has obviously come when the pigs have had their feed at the trough and there

is nothing left." The Government must not allow Yorkshire Water's proposals to go ahead as outlined yesterday. While the concept of public ownership of a vital economic resource is laudable, the prospect of Yorkshire Water profiting from its catalogue of failures is not."[45]

The proposal was rejected by the regulator. Ofwat explained the decision was due to the fact that Kelda's plans failed to:

"set out clearly how customers would benefit from the change in ownership" (by contrast, shareholders would certainly gain);

"properly inform Yorkshire Water's customers about the proposals and consult with them" (eg inform customers about the financial consequences of the proposal);

"ensure that the Drinking Water Inspectorate and Environment Agency are able to enforce the required quality standards" (there would be a risk "of confusing liability for environmental damage and asset failures");

"demonstrate clear independence between the proposed mutual and Kelda" [46]

5.3. Welsh Water breakup by new owners

In 2000 the Hyder Group, including Welsh Water, was taken over by a US-multinational-owned energy group, WPD. WPD effectively wanted to get rid of the water operation, and proposed doing so by splitting the assets into a separate company, and then contracting out the operating concession to another of the water companies, United Utilities.

So far one part of this plan has been ruled out for being uncompetitive – the proposed concession to United Utilities – but the proposed sale of the water assets to a new not-for-profit company, Glas Cymru, was approved by OFWAT.

5.3. A. Non-tendered concession contract rejected by court

In October 2000 a UK court ruled that an £800m ($1.1bn) contract awarded to United Utilities, owner of North West Water, to run Welsh Water services for up to seven years flouted EU competition rules. The contract was awarded by WPD, a US energy joint venture, following its successful £565m bid this summer for Hyder, Welsh Water's parent. The judge ruled that WPD's failure to put the contract out to open tender had breached European public procurement laws.

5.3. B. Welsh Water: OFWAT approves asset sale to non-profit company

- A proposal to sell the assets of Dwr Cymru (welsh Water) to a not-for-profit has however been approved by the regulator. OFWAT's approval was conditional on a number of points, including effective regulation by the Drinking Water Inspectorate and the Environment Agency; a commitment to reducing customers' bills, and to limiting its activities to water and sewerage services; publish "objective measures of performance" on quality and levels of customers bills; and focus on commercial success. [47]

5.4. The final contradiction

Within the very short timescale of 11 years the privatised water industry of England and Wales is voluntarily restructuring itself into an unrecognisably different form. It is doing so with almost no political input at all, no consideration of the range of options available, and in particular amidst a stunning silence about the option of public ownership which remains the norm worldwide.

The process highlights the contradictions and the failures of the UK water privatisation, which have been eloquently summarised by Jean Shaoul: *"Yet in 1989, the Conservative government did everything it could to create a viable commercial activity. The industry was restructured by means of debt write-offs and given a cash injection, tax breaks and the lion's share of the industry's pension fund, leaving insufficient for those employees*

of the water industry that were transferred to the National Rivers Authority, now the Environment Agency. It was sold at knock-down prices. All this was done to ensure that, in the short term at least, the companies could deliver a satisfactory rate of return. Regulation ensured high prices until the companies' waste and incompetence engendered uproar, making a price reduction inevitable if the ownership regime itself was not to be challenged.

But the irony is that the very price reduction designed to ensure the survival of private ownership of the industry has exposed the unviability of the project. The source of the problem is not management, regulation or the lack of competition, but an insufficient pool of value added, relative to the amount of capital invested in the business, to meet all the claims consequent upon privatisation. In this industry, it can only be significantly increased if the regulator allows prices to rise. But this in turn would generate the political outcry that regulation was supposed to prevent.

Thus the turn to mutualisation, far from representing a return to a form of public ownership, represents an exit strategy for the infrastructure industries and a mechanism for evading price regulation, at the expense of consumers. We can expect more subtle variants on the mutual theme to surface in the future. That this should happen within 11 years of privatisation is testimony to the failure of the policy" [48]

6. Select references

Green, Colin "The lessons from the privatisation of the wastewater and water industry in England and Wales" (December 2000) (paper presented to conference in Berlin on water privatisation)

Hall, D. (1998) Restructuring and privatization in the public utilities, in L. De Luca (Ed.) *Labour and social dimensions of privatisation and restructuring (public utilities: water, gas and electricity)*, pp. 109-151 (Geneva, International Labour Office).

Jenkinson, T. & Mayer, C. (1994) The Costs of Privatization in the UK and France, in Bishop, M., Kay, J. & Mayer, C. (eds.) *Privatization & Economic Performance*, pp. 290-298 (New York, Oxford University Press).

House of Commons Select Committee on the Environment Seventh Report 199-200: Water Prices and the Environment HC 597 14 November 2000 (HOCSCE7); www.parliament.the-stationery-office.co.uk/pa/cm199900/cmselect/cmenvaud/597/59702.htm

House of Commons Library Research Paper 98/117 (1998) "Water Industry Bill – Bill 1 [1998/1999]: 10 December 1998 (see Projects/UKwaterCUPE/DisconnectionReport9899.pdf).

Shaoul, Jean, (2000) Tapping into mutuals, *Public* Finance, September 8-14 2000, pp. 16-19

Shaoul, Jean, (1998) Water Clean Up and Transparency: The Accountability of the Regulatory Process in the Water Industry, *A Public Interest Report*, Dept of Accounting and Finance, Manchester University, 1998.

[1] *Bernard Barraque "les Politiques de l'Eau en Europe" 1995 p.233*
[2] *Water Act 1989 s. 11-12*
[3] *Jenkinson* et al., *1994: 294*
[4] *Green, p. 7*
[5] *House of Commons Select Committee on the Environment Seventh Report 199-200: Water Prices and the Environment HC 597 14 November 2000 (HOCSCE7); www.parliament.the-stationery-office.co.uk/pa/cm199900/cmselect/cmenvaud/597/59702.htm Introduction, para 20*
[6] *11 Jul 94 The Daily Mail: The Great Water Robbery.*

[7] *OFWAT 1999: Draft determinations - Future water and sewerage charges 2000–05: pp19-26.*
[8] *Shaoul, 1998, p. 19*
[9] *BBC water week March 1998 - http://news6.thdo.bbc.co.uk/hi/english/static/waterweek/programmes.html The information on Southern water is in The Profits Pump (shown on Tues March 24 1998), viewable at http://news.bbc.co.uk/olmedia/video/waterweek/profitspump.ram .*
[10] *Shaoul 1998 p. 20*
[11] *OFWAT 1999 Figure 6 on "Total capital maintenance expenditure", showing difference between projections and actual costs incurred, 1994-2000*
[12] *HOCSCE7, Para 186*
[13] *HOCSCE7, Para 206*
[14] *Shaoul, 1998, pp. 33-34.*
[15] *Memorandum from OXERA Environmental Ltd : PLANNING AND REGULATION OF MAINTENANCE EXPENDITURE IN THE WATER INDUSTRY (Appendix 4, evidence to Environment Committee 2000)*
[16] Observer 12 Feb 95
[17] *"UK's Ofwat says Yorkshire Water dividend policy "should not impair" business", AFX News: 20 Jun 1996*
[18] "Water firm is told to wipe out droughts", *Manchester Evening News*: 05 Jul 1995; "A scandal of water cut-offs in North West", Manchester Evening News: 12 May 1995.
[19] *CROSS appendix 7 of HOCSCE7. Implied Asset Life and Current Rate of Investment).*
[20] *Memorandum from the Campaign for the Renewal of Sewerage Systems (CROSS) appendix 7 of HOCSCE7.*
[21] *Hall and Lobina 1999*
[22] *Hall, 1998: 128*
[23] *Jean Shaoul "Tapping into Mutuals" Public Finance 8 Sept 2000, p.18*
[24] See tables on "Domestic disconnections for non-payment of bills - England and Wales" from 1989/90 to 1997/98 (DisconnectionReport9899.pdf, p. 54).
"In the UK, the number of consumers who were disconnected for failing to pay increased by 200% from 1991 to 1992" (Martin, 1993: 116-125); Stockholm Paper Formal.
"The average bill across all 10 water and sewerage companies rose by 50 per cent. between April 1989 and April 1993. Inflation rose by 23 per cent. over the same period. So on average water bills have risen by significantly more than double the rate of inflation since privatisation. Unfortunately, in the five years since privatisation disconnections have also risen. On average, the rate of disconnections has tripled. In 1991-92 the number of disconnections reached more than 21,000. Last year there was a slight reduction, but figures were still unacceptably high : 18,636 households were disconnected. Everyone accepts that water bills will continue to rise, so the number of disconnections would also rise in the future" (UKwaterCUPE/disconnections94.htm)

[25] (UKwaterCUPE/disconnections94.htm)
[26] .Official Report, 10 December 1993 ; Vol. 234, c. 395.
[27] *Green, p.14*
[28] *House of Commons RESEARCH PAPER 98/117 10 DECEMBER 1998 Water Industry Bill*
[29] *House of Commons 8 May 1996 : Column 151 Water Meters*
[30] *House of Commons 8 May 1996 : Column 151 Water Meters*
[31] *HOCSCE7, Para 225*
[32] "UK's Ofwat says Yorkshire Water dividend policy "should not impair" business", *AFX News*: 20 Jun 1996).
[33] *OFWAT, quoted in Green p.18-19*
[34] *Green p.19*
[35] *Shaoul, 1998, p. 32 and* Table 22*).*
[36] *Ofwat Web Site, Ofwat Press Notices, CSC/09/00/NW "Sewer flooding in North West Water area is misery",*
[37] *Green, pp. 20-21*
[38] *Shaoul, 1998, p. 27*
[39] Green, p. 25
[40] *Environment Agency*
[41] *HOCSCE7, Para 215*
[42] *FT 15 June 2000*
[43] *Shaoul 2000 p. 3*
[44] *Yorkshire Post 15 June 2000*

[45] *Yorkshire Post 15 June 2000*
[46] *OFWAT press release*
[47] *Ananova, 31/01/01:* Regulator conditionally approves Glas Cymru bid
[48] *Jean Shaoul "Tapping into Mutuals" Public Finance 8 Sept 2000, p.18*