



**REGULATING FOR SUSTAINABILITY**

**RESPONDING TO GOVERNMENT POLICY  
AND THE PLACE FOR SUSTAINABILITY FOR THE  
NEXT PERIODIC REVIEW AND AMP4**

**PHILIP FLETCHER  
DIRECTOR GENERAL OF WATER SERVICES  
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Three quotations:

'The last month has reinforced an important lesson: that we need to work together to solve common challenges, to address the common good. It has reminded us that there are challenges so great that they are beyond the capacity, not just of an individual or of a family or even a country, but almost beyond our capacity as a world to solve not only unless we work together but unless we find new ways of working together.' (The Rt Hon Margaret Beckett MP, 24 October 2001, speech to the Green Alliance.)

'Water is essential for natural life and for human use. We use it in our homes and gardens, in industry and commerce, and in agriculture. The way we use water has a direct impact on the natural environment. This means it is essential to have a secure framework for the management of water that protects the long term future of the water environment while encouraging sustainable development.' (Environment Agency, August 2001, A Scenario Approach to Water Demand Forecasting.)

'Water privatisation so far has often been bad news for vulnerable communities and the environment.' (FOE press notice, last week.)

Agree unreservedly with first two quotations. Disagree unreservedly with third. Disappointing that FOE, which gained a high reputation for careful research, should seem to stray so far from the facts, at least for England and Wales.

What facts?

- Bills up in real terms by 24.8% since privatisation in 1989, including a 12½% cut in 2000. Special measures (regulations) to protect vulnerable customers.
- Bills have gone up notwithstanding very large efficiency gains, because of the need for huge capital investment (£3 billion pa since 1989, double the previous public sector rate). Results clear cut: drinking water quality up from 99% of tests meeting standards in 1990 to 99.83% in 2000 (1 in 100 to less than 1 in 500).
- 83% of rivers of good or fair chemical quality and 86% biological quality in England in 1990 to 94% for both in 2000.
- Leakage down by 37% since the drought in 1995.
- Sewage treatment works compliance up from 90% (1990) to 98.6%(2000).
- Fylde beaches finally meet European standards. (98% compliance with EC directive for bathing water quality in 2001).

Plea number one for working groups at this conference: address the facts.

Ofwat itself has been accused of prejudice, more strictly of 'appearing to demonise the environment'. (EAC report on the 1999 periodic review and an earlier 1998 report claiming that Ofwat had seen its role 'in terms only of protecting the customer from rising bills'.) If that had been the case, £50 billion to be invested in capital improvements to the water system between 1989 and 2005 would be seen by Ofwat as a 'defeat'. Far from it. We take as much pride as the industry and as my fellow quality regulators, the Environment Agency and Drinking Water Inspectorate, in what has been achieved. I do not believe that it would have been possible either in the public sector or by leaving unregulated companies to exploit their monopoly position.

Ofwat prepared to play its full part in helping develop an approach which will promote long term sustainability and will foster sustainable development.

To help reassure, I have supported the EAC recommendation that, when a new Water Bill is passed, Ofwat should be given a specific duty 'to have regard to sustainable development'. This recommendation appears to be at odds with a more recent report from the Better Regulation Task Force (Lord Haskins) on clarity and consistency of regulatory objectives and legislation. (A key part of my job is to keep regulatory uncertainty to the necessary minimum to avoid unnecessary costs for the companies and thus for their customers by ensuring that the risk to be borne by investors and lenders are clearly circumscribed.)

However, a sustainable development duty should in my view produce clarity and reassurance, not confusion. Government objectives for sustainable development are:

- social progress which recognises the needs of everyone;
- effective protection of the environment;
- prudent use of natural resources; and
- maintenance of high and stable levels of economic growth.

What economic regulator could fail to endorse such objectives? I am equally happy to sign up to the seven guiding principles outlined by Government:

- taking account of costs and benefits;
- creating an open and supportive economic system;
- respecting environmental limits;
- the precautionary principle;
- using scientific knowledge;
- transparency, information participation; and
- making the polluter pay.

But these are not new to Ofwat. From its foundation 12 years ago, we have emphasised and endorsed the long term nature of the industry. Its infrastructure lasts a long time, sometimes very long. All those involved in considering future investment need a horizon that stretches many years ahead. Five yearly price reviews are, I believe, a sensible compromise between the need for stability and the need to take account of developments over time (whether on capital requirements or on efficiency gains or on market developments). But that need not mean that we take a blinkered short term view. At AMP4, for example, we shall no doubt be looking ahead to the implementation of the water framework directive by the end of the AMP5 period, and maybe beyond.

It is important that the various stakeholders in the water industry, the companies, Government, the quality regulators, customers, the environmental and development interest groups and Ofwat itself, should not spend the next four years fighting battles over the next periodic review. There is a danger that we distract ourselves from the delivery of the challenging programmes and efficiency gains required of the companies through the last review. That is one reason why, in the Ofwat draft Forward Programme, published for consultation this week, we indicate our intention to launch the review proper in October 2002, which will set us a tight timetable for reaching conclusions on final determinations in November 2004.

At this stage, my plea is for each stakeholder, whether approaching the issues of sustainability, sustainable development, the periodic review, the AMP programme or any other particular element to recognise that simplistic slogans and point scoring will not do. Back to the Secretary of State's point on working together on common challenges.

I should like to suggest a few key points for you to consider in your workshops:

1. We are working in a market economy and within a context established in law of private sector monopolies delivering essential services. It is simply a distraction to say, from one perspective or another, that we should not start from here.
2. A private sector company which needs to finance a significant programme of works without reference to the taxpayer must be able to finance that programme. Efficiency gains have been very considerable. So companies depend not just on the customer but on the markets – equity, bonds and bank lending. The investors and lenders (often our pension funds) will choose to go elsewhere if they can see a better or less risky alternative.
3. Water bills matter. It is good news that nearly 90% of customers are fully or fairly satisfied with their water company on the basis of Ofwat/ONCC research published today. It is also good news that 75% think that they get good value for money. That would change very quickly if bills were increasing rapidly. Part of the reassurance for customers is that their water bills are subject to scrutiny by an independent regulator.

4. It is equally important that the capital programmes which have required £50 billion of expenditure from 1989 to 2005 should be subject to proper appraisal in terms of costs and benefits. Proper appraisal includes, of course, taking account of environmental benefits which are hard to measure. But the difficulty of measurement is no excuse for failure to appraise.

We need to look in a broad perspective: what does society lose or gain from investment proposals, or from changing the current use made of water to alternative uses in the future? What does it gain from preserving or enhancing the quantity and quality of its water resources and environment? Thus, it is good news that salmon are back in the Mersey. But if that had been the objective of the clean-up campaign, they would have been the most extravagantly costly fish ever. Of course, the campaign was not just about making the Mersey clean enough for breeding salmon, it is about the social, economic and environmental regeneration and future of Merseyside and the Irish Sea. All these factors need to be taken into account in appraising the policy options and outcomes.

And sustainability will not always be identical with maximising apparent environmental goods. For example, where is the balance to be drawn between using more energy to treat effluent to produce ever higher standards of treatment as against less energy intensive solutions?

The sponsors of this conference, Wessex Water, have an interesting test case in their own backyard. The issue of alleviation of low flows in important chalk rivers, including the Hampshire Avon, was a project deferred for further examination by the Minister in the discussions around AMP3. There are:

- 1 Environmental aspects – abstraction of water from the aquifer for the Hampshire Avon leading to this winterbourne drying up earlier, possibly by 3-4 weeks in a normal year, than it would otherwise do. This affects vegetation and the survival of juvenile trout. But there are also:
- 2 Social aspects: water bills are likely to rise permanently if the company undertakes major capital works to alleviate the problem. Is it relevant to take account of the benefits, or lack of them, that customers themselves derive from the work? If there is no access to the water for other than landowners or the holders of fishing rights, how far should the generality of customers be expected to meet the bills? Further, what about the effects on those with below average income, who will often coincide with those who have least access to the areas of water concerned?
- 3 Economic aspects – how far should the proposed scheme offer value for money? Is this a case of absolutes – it will cost whatever it takes – or of weighing benefits alongside costs? What other investment will be displaced if a very costly scheme goes ahead?
- 4 What are the implications for natural resources generally, including the energy use required to alleviate the low flow?

A number of us are engaged in thinking through these issues. They are not easy.

I have no doubt that as we go further, we shall find ever more difficult issues in looking to the next capital programme, including the implementation of the water framework directive which may offer a variety of options to achieve its overall goals. I suggest it is important that the full principles of the directive are followed rather than simply identifying projects to meet the periodic review timetable. The directive requires integrated river basin management, looking at all pressures on the river basin, not just the easy-to-identify specific point emissions often the responsibility of water and sewerage companies. Thus I welcome the increasing emphasis being placed by Ministers and others on the need to address diffuse pollution, often far more difficult to resolve than point emissions.

Finally, what about the implications of climate change? This will be a major challenge. We are staying closely in touch with the debate. How could it affect the water industry? Will there be less rainfall, or could it become wetter at least locally, or at particular seasons? In the interests of sustainability it is essential that we tread the fine line between doing nothing in the hope that nothing is required, and seeking to anticipate and find ourselves investing wastefully in infrastructure that may at best not be required or at worse exacerbate problems. I think it is reasonable to say that at this time, we do not yet know, but the regulatory regime that develops through the next 20 years must take into account the need to take action, as and when the appropriate action is identified.