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Water Regulation: The Periodic Review — A Response

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Dieter Helm and Najma Rajah let off a number of big guns, not all pointing in the same direction. May I take up three points in reply?

I. INVESTMENT

There is a whiff of ‘investment is a good thing’ in the article. Those who pay the bills to finance it may expect it to be appraised in respect of both costs and benefits. I took this up with Lord Crickhowell, Chairman of the National Rivers Authority (NRA), back in 1989 when we were first appointed. We now agree that this is the right approach. OFWAT has contributed by estimating the consequences of investment for customers’ bills and in encouraging water companies to research the views of their customers. I know the NRA is working on the assessment of environmental benefits.

Meanwhile customers’ bills continue to rise. Thirty per cent of the 15,000 complaints a year received by OFWAT are about the level of or, more often, the increase in bills. I have statutory duties to protect the interests of customers and in pursuit of this need to ensure that investment in a monopoly sector — either to improve the environment or to sustain the serviceability of water company assets — is fully justified. I am not convinced that this is always the case. Some of the standards set on quality grounds are extremely stringent and it is not obvious that all customers want to pay for them.

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II. LINKS BETWEEN REGULATORS

I agree that initially insufficient attention was paid to relations between water regulators (OFWAT, the NRA and the Drinking Water Inspectorate). We have been remedying this under the aegis of the Department of the Environment: water quality (of drinking water and waste water) is a matter to be settled by Ministers either with their colleagues in Brussels or at a national level. It is not a matter that can — or ought to — be decided by regulators, either economic regulators or quality regulators, or some combination of both. The important constitutional implication is that there should be close links between regulators and the political arm of government — relations that respect both national objectives as decided by the Government of the day and the independence of regulators to act under the law.

The quadripartite meetings are one example of how this machinery is evolving.

III. INTERVENTION

Helm and Rajah are ambivalent. Initially they are critical and then they call for more intervention to achieve the flexibility they seek. I have tried to be innovative while respecting my statutory duties.

In 1989 the water companies persuaded the Government to insert a clause in the Licence, allowing for adjustment of price limits should construction prices rise by more than was forecast. Government ensured that the facility was reciprocal. No one should have been surprised that OFWAT should adjust price limits downwards when construction prices rose by less than was forecast. This happened in 1991 and 1992. The first adjustment was voluntary (rather like an out-of-court settlement). The second was via formal process; I responded to criticisms that I had been insufficiently transparent in 1991. There were no adjustments in 1990 nor in 1993.

I have subsequently suggested to those companies that wish to do so that their Licences should be changed to delete this provision. Twenty-six have agreed to delete it; four would prefer to retain it. So we will be able to see which set of arrangements seem to work best.

I decided to have a Periodic Review in 1994 rather than let things run until 1999 because I believed that, in its absence, companies would follow South West Water by putting in applications for increases in price limits to finance the large investment necessary to implement the Urban Waste Water Treatment Directive. This Directive was agreed by the UK after price limits were set in 1989. The mechanism for Interim Determinations between price reviews (rightly) restricts the matters that can be taken into account. For example, efficiency is excluded. Given the scale of the investment involved — around £10 billion, much of it over five years — it seemed to me essential to look at the whole financial

position of the water companies and not simply to add further price increases to those set in 1989.

Having made these points, I welcome this article and would like to encourage the authors to work up their suggestions for improvement. No regime can be perfect at its inception. As Arthur Young said of the Revolutionaries in 1789, 'A constitution is not like a pudding to be made out of a recipe'. As Michael Oakeshott puts it, we need, from time to time, to 'attend to the general arrangements of a set of people whom chance or choice have brought together'.