

WSRSG 19/03(2)

DRAFT NO.2 (10 February 2003)

**THE REFORM OF WATER AND SEWERAGE SERVICES IN NORTHERN
IRELAND**

A Consultation Document

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Ministerial Foreword

Since assuming responsibility for the Regional Development Ministerial portfolio, I have been acutely aware of the need for massive investment in Northern Ireland's water and sewerage infrastructure. £3 billion must be invested over the next 20 years if we are to obtain the public health, economic and environmental benefits of higher water quality and more effective wastewater treatment.

Given the nature of the water industry, it must be able to plan with certainty over the long term. Self-financing arrangements will provide the secure and reliable revenue stream, which is so essential to water and sewerage services, and will remove the uncertainty which exists within the current financing arrangements.

In principle, self-financing arrangements will require the introduction of domestic water charges. Domestic customers are charged for the water and sewerage services they receive in all other parts of the UK, and in many other countries. **[DN: need for reference to low levels of local taxation in NI?]** In the present context, the only realistic alternative to domestic water charges would be substantial cuts in public services, well in excess of what could be secured from improved efficiency in the management of public services. At a time when both the Government, and the Executive when it was in place, regard the development of public services as a key priority, it is very clear that such cutbacks would be unacceptable. However, as this paper demonstrates, we are also taking forward the Executive's commitment to reform public services and hence ensure that people will not be asked to pay more than is absolutely necessary.

I want to ensure that water and sewerage services are delivered as effectively and efficiently as possible, so that the water charges borne by households in the future

will be reasonable and offer value for money. To achieve this, we will have to reform the structures we currently use for the delivery of water and sewerage services. In December of last year, I travelled to Scotland and Wales to learn more about the operation of the water industry in both regions. The clear lesson from both regions is that reform of the arrangements for water and sewerage delivery is essential if the charges borne by customers are to be fair and affordable.

I have been greatly impressed by the professionalism and dedication of Water Service staff, who continue to deliver services to over 1.7 million people across Northern Ireland against a backdrop of historic under investment and ageing water and sewerage infrastructure. These staff must be given the tools to continue to perform this important public role. Investment is key to this. The challenges facing Water Service are immense. We must now create the right framework, both in terms of organisation and financing, to ensure that these challenges can be addressed.

This paper demonstrates my commitment to full and inclusive consultation, through which I believe we can arrive at a new future for the provision of water and sewerage services tailored to the specific needs and circumstances of the Northern Ireland community. This paper gives you the chance to convey your views on our proposals for the reform of the water industry in Northern Ireland. There will be further consultation on the detailed implementation proposals for reform in the autumn. These will be subject to a full assessment of their equality, health and regulatory impacts, as well as any implications for the rural community, and the contribution of Water Reform to the policy of targeting social need (New TSN).

It remains the Government's aim that Devolution will be returned to Northern Ireland again soon. That carries with it the implication that the complex and difficult issues and choices, which are raised in this Consultation paper, will need to be addressed by a local Executive and Assembly. But, the need for investment and reform is so pressing and clear that I am convinced that it is right, indeed essential, that the issues and hard choices be set out now.

CHAPTER 1

INTRODUCTION: THE NEED FOR CHANGE

Delivery of Water and Sewerage Services in Northern Ireland

This chapter explains why we need to reform the way the Water Service is funded and structured in Northern Ireland and describes how you can contribute to the consultation process.

- 1.1 Clean drinking water and effective sewerage services are fundamental aspects of modern life. They are critical to public health, they underpin a vibrant and sustainable economy, and they contribute to the maintenance of a clean and safe environment. The services provided by the water industry depend on very expensive infrastructure in the form of water mains, sewers, reservoirs, and treatment works to ensure that the water supply is drinkable and that waste water is dealt with without leading to unacceptable levels of pollution. Hence the service operates on the basis of long-term investment decisions for the design and construction of long-life assets. The nature of the water industry means that it is reliant on reliable and sustainable levels of funding, year on year.
- 1.2 Since 1973, water and sewerage services in Northern Ireland have been delivered by Central Government. Following the devolution of powers to the Northern Ireland Assembly in 1999, statutory responsibility for water and sewerage services has resided with the Department for Regional Development, with service delivery being the responsibility of its executive agency, Water Service.
- 1.3 Water Service serves a population of 1.7 million people and provides water and sewerage services to over 720,000 domestic, agricultural, commercial and

business customers across Northern Ireland. The agency employs 2,130 staff, has gross annual expenditure of £255 million, and fixed assets valued at £4.9 billion. **[DN: Water Service - can we say a bit more, perhaps in an annex, about what the Water Service actually does and delivers - using lay terms, graphs, maps etc?]**

- 1.4 Though the Agency has a long history of providing service to the community in difficult circumstances there are a number of reasons why the present arrangements for financing and delivering water and sewerage services are in urgent need of reform.

What are the challenges facing the water industry in Northern Ireland?

Investment Need

- 1.5 An Asset Management Plan recently completed by Water Service shows a backlog of water and sewerage investment of [£x] million and a need for investment of [£x] billion over the next 20 years **[Water Service – please provide data]**. Investment of this scale is necessary to:

- replace the ageing water and sewerage infrastructure (which is over 100 years old in parts), and hence reduce the level of leakage and the risks from weaknesses in the infrastructure;
- ensure a sustainable long term supply of clean, healthy drinking water;
- improve significantly the treatment of waste water before it is returned to the environment;
- safeguard public health,
- respond to increasing demand arising from housing growth and changing lifestyles.

Hence the investment will help to meet increasingly rigorous European Directives on water quality, which are designed to promote these essential standards for the public interest.

Public Health

1.6 **[DN: Water Service to suggest line]**

Ageing Infrastructure

- 1.7 **[DN: Water Service to input to this section]** Water Service currently maintains [x,000] kilometres of mains across Northern Ireland. [X%] of this network is over [x] years old, and needs to be replaced. Large parts of the network are cast iron, and vulnerable to bursts after severe cold spells. Currently, 37% of all treated water is lost through leaking pipes. Large parts of the Belfast sewerage network rely on Victorian brick sewers, which are vulnerable to collapse and can give rise to major traffic disruption. **[DN: Water service to supply some stats on level (cost?) of maintenance required due to age of network]**

European Imperative

Water Quality Directives

- 1.8 **[DN: Water Service to provide brief description of relevant EU Directives on water quality, and Water Service's current stage of compliance with these directives]**
- 1.9 Failure to comply with the European Directives could result in costly infraction proceedings against the United Kingdom (UK) Government. These infraction proceedings take the form of fines, which can amount to tens of thousands of pounds per day, and which divert public resources away from key services and spending priorities. **[DN: Water Service - can we say what current levels of compliance are and compare with elsewhere in the UK and Ireland?]**

Water Framework Directive

- 1.10 The central aim of the European Water Framework Directive is the sustainable management of water resources across Europe. Article 9 of the Directive

requires Member States to have water pricing policies in place by 2010, which:

- Provide adequate incentives for users to use water resources efficiently; and
- Ensure an adequate contribution to the recovery of the costs of water services from industry, households and agriculture.

Increasing Demand

1.11 Northern Ireland's housing growth is forecast to expand by an estimated 10,000 units each year. Increasing housing growth places additional pressure on existing water and sewerage networks, and wastewater treatment works. As the planning difficulties that emerged in 2002 illustrated, some of these works are now reaching capacity, which in turn gives rise to planning constraints for new housing developments.

1.8 Changing lifestyles have resulted in higher levels of household demand for water and sewerage services, as water intensive appliances such as dishwashers, washing machines, and electric showers become more widely used. **[DN: Water Service to provide some statistics/trends]**

Why do we need to reform the arrangements for the future financing and delivery of water and sewerage services?

1.12 The reasons for the need for fundamental change in the organisation and financing of water and sewerage services are set out fully in the sections that follow. In brief the main points are:

- the present arrangements do not provide a clear source for the sustained investment programme that is needed over the medium to long term. Experience in the rest of the UK shows clearly that such an investment programme is not deliverable through a structure based in central government;

RESTRICTED – POLICY

- there is no possibility of securing additional resources from the UK Treasury while payments of local taxation and charges by the domestic sector are as far below those paid in England as at present (see paragraph 1.20); and,
- a self-financing arrangement, which will require the introduction of direct domestic water charges, is needed to ensure that the water and sewerage investment programme can be delivered without compromising the necessary levels of public expenditure in fundamental services such as health and education.

1.14 Commercial, industrial and agricultural users in Northern Ireland pay around £40 million per year in charges to Water Service. Otherwise the service is currently funded entirely through the public expenditure system as domestic users do not pay a direct charge for water services.

1.15 The allocations for Water Service for the next three years were set out in the Budget for the Northern Ireland Departments announced on 11 December 2002. The details of these allocations are set out at Annex 3 **[DN: Finance Division – please provide]** and summarised below: these show the current cost of operating the Service.

[DN: Finance Division – insert table]

1.16 The funding arrangements in Northern Ireland are at odds with the position in the rest of the United Kingdom (UK). Northern Ireland is the only region of the UK where water and sewerage services are delivered by Central Government and where consumers do not pay directly for the costs of their water and sewerage services. (The delivery of water and sewerage services is a local authority function in the Republic of Ireland, and domestic customers are not charged for the water and sewerage services they receive.) In England and Wales there is a system of domestic water and sewerage charging based on metering or the rateable valuation of the property. In Scotland, domestic water and sewerage charges are based on the Council Tax system. Average domestic bills for water and sewerage services in Great

1.16 Britain range from [£224 a year in England and Wales to £350 in northwest Scotland]. **[Water Service – please confirm figures].**

[DN Insert table showing annual charges by region]

1.17 Water and sewerage services in England and Wales are in the private sector and are funded entirely by the charges levied on customers. They are not funded from public expenditure. As a result the Treasury makes no allowance for water and sewerage services when it calculates the budget for the Northern Ireland departments. This is normally assessed every two years in Spending Reviews through a mechanism known as the Barnett formula. This formula determines the changes to the spending allocation for the services which are the responsibility under devolution of the Northern Ireland Executive, in the form of its Departmental Expenditure Limit (DEL) often referred to as the Northern Ireland Block.

1.18 Since the privatisation of the water industry in England in 1989, there has been very substantial investment in the services there. However, because this has been private as distinct from public investment, serviced by charges paid by domestic and non-domestic consumers, Northern Ireland's public expenditure budget has not received any read across of those amounts. Hence all funding provided to Water Service has been dependent on the public finance available within Northern Ireland. While some very limited amounts have been available from the Regional Rate, this has been very much less than the amounts available in England. Thus in effect the costs of investment in water has the effect of sacrificing spending on other key services – our hospitals, schools, roads etc. This adds to the difficulty of matching English increases in spending on priority services such as health, education and transport at a time when total spending in England is already rising more quickly than here. **[DN: DFP - can we add any relevant tables/charts to show this effect or chance a line on the Barnett squeeze here?]**

But surely we pay for our water through the Rates?

1.19 There is a widespread perception that households in Northern Ireland currently pay for water and sewerage services through their rates bill. However this not the case. Water and sewerage services in Northern Ireland have been funded directly from public expenditure and are simply part of the wider cost of local public services that the Regional Rates help to finance. The Regional Rate is a local tax that forms part of the overall revenues available to the Northern Ireland Executive to fund key public spending priorities. Prior to 1999, a portion of the Regional Rate was allocated to water services, leaving much less as a contribution towards meeting the costs of other services. So while Regional Rate revenues do indirectly contribute to the financing of the Water Service, comparisons with the average levels of local taxes raised elsewhere in the United Kingdom show very clearly that people in Northern Ireland do not contribute enough towards the cost of public services, compared to citizens in the rest of the UK.

1.20 The average Council tax bill in England for 2003-03 is £804 per household. The average water tax bill is £228 per household. When these are added together the average household contribution in England, over and above national taxation, towards the cost of local authority services and the water companies is £1032. **[DN: Scottish equivalents?]** The comparable figure for Northern Ireland is the average domestic rates bill which is £445 for 2002-03, some 57% less than the average level of local taxation paid by householders in England. Even when allowance is made for comparative standards of living and higher levels of deprivation in Northern Ireland, this is a significant disparity.

[DN: insert tables/charts showing the comparison]

Why hasn't something been done about this before?

1.21 When it launched the Review of Rating Policy in May 2002, the Northern Ireland Executive took the view that there was no realistic prospect that the funding required for the water industry could be met from the Executive's routine public expenditure budget, because that would imply unacceptable

constraints on the funding of other essential public services. The Executive also concluded that it would be unrealistic to expect the Treasury to provide additional public expenditure on this scale, as that would in effect mean that this large bill would be falling on taxpayers in other parts of the UK at a time when households here are contributing much less than those in similar circumstances in England, Scotland and Wales.

- 1.21 In addition, the introduction of new public sector accounting arrangements brought out much more clearly the full costs of providing water and sewerage services. Given the very extensive network of assets owned and managed by Water Service, under new accounting and budgeting rules the Executive's total budget for public services faced substantial new costs associated with the depreciation of Water Service's assets, and the associated capital charges from 2004.
- 1.22 Increases in these costs would have to be met at the expense of other services to the public. However recognising the importance of moving the industry to self-financing status in Northern Ireland, the Treasury exceptionally offered a concession whereby it agreed to an effective waiver of these charges¹, providing the necessary commitment was given that the Service would be reformed so that it would pay for itself.
- 1.23 Ministers have considered carefully the arguments in relation to this issue and the responses to the Rating Policy Review. On 11 December 2002, Ian Pearson MP, on behalf of the Secretary of State, gave the commitment sought by the Treasury to achieve radical reform in the organisation and funding of Water Service, so that it can become a self-financing organisation, as soon as possible. This has since been confirmed to the Treasury, with an explanation that it is not likely to be possible to achieve the necessary efficiency gains, and administrative changes by 1 April 2006, but that action will be taken forward as a key priority. It is also recognised that the changes will depend

¹ Technically this will be achieved by reclassifying the depreciation and capital charges as Annually Managed Expenditure (AME) rather than a call on the Northern Ireland DFI.

on the passage of the necessary legislation through the Assembly in due course.

What impact will self-financing status have for local people?

- 1.24 Self-financing status will require major reforms in Water Service: it also means that Northern Ireland households will have to contribute directly toward the cost of water and sewerage services in the form of a separate domestic water charge. The option of financing Water Service by devoting a proportion of the domestic rates to its costs (as was the case for most of the 1990s) would not secure self financing status, because the rates are determined by the Executive (or direct rule Ministers at present) as part of general taxation, whereas a separate charge would be set specifically and solely to recover the costs of water and sewerage services
- 1.25 Any water charges must be as fair and as affordable as possible. This means that water and sewerage services must be delivered as efficiently and effectively as possible which in turn will require reform of the current arrangements for the delivery of water and sewerage services and the introduction of independent economic and consumer regulation to oversee the price setting process.
- 1.26 Self-financing arrangements will provide the reliable and sustainable revenue stream needed to fund investment in water and sewerage services. Indirectly, this commitment will also provide a new opportunity to borrow money that may be invested in key infrastructure projects. Under the Reinvestment and Reform Initiative, any revenue raised which closes the gap between average payments here and in England can be used to service borrowing.
- 1.27 The introduction of self-financing arrangements for water and sewerage services will also give much greater flexibility to allocate additional resources to other important public spending priorities. This will lead to improvements in Water Service and increased spending in other services. A water pricing policy, which requires a contribution toward the cost of water and sewerage services from domestic consumers, is also consistent with the water pricing

objectives of the European Water Framework Directive and would bring Northern Ireland in line with established practice in the remainder of the United Kingdom.

This is the background to the reform process. This paper seeks your views on:

- ***how water and sewerage charges for domestic consumers should be determined;***
- ***how customers' needs should be addressed and their rights protected within the new water-charging regime,***
- ***how the interests of those on low incomes might be protected; and***
- ***on the most appropriate structures for delivering water and sewerage services in the future.***

Chapter 8 provides details of how you can respond to this consultation paper.