

## **Our water ways for UK**

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*Victoria's water management has lessons for Britain as physical conditions change, write **Martin Cave and Bruce Cohen**.*

TOGETHER with population growth, environmental change is imposing new challenges on the water sector.

In Australia, the impact is already clear. In England, the effects are still largely based on forecasts, such as that of the Environment Agency that the level of summer flows in rivers in the south of the country will halve in the next decades. In both countries, innovative thinking is needed to deal with the new problems - in the form of new technologies, such as desalination and recycling, enhanced investment in pipelines and new industry structures and methods of work.

The water sector in England and Wales consists of about 20 regional monopolies that source water, treat it and deliver and sell it to customers. They are largely self-sufficient in resource terms. As highly geared investor-owned companies, they finance their huge annual environmental investments mainly by accessing bond markets. This system works adequately in normal times. However, it is not well adapted to changes that require different forms of investment and more integrated planning of resources capable of bringing water from the wetter north of the country to the drier south.

So the new government of the United Kingdom will have on its desk an independent report, commissioned by the previous Cave review, outlining possible new ways of organising the water sector, progressively involving greater use of competition to deliver a better service to customers and to bring more innovation to the sector. This can be combined with better focused regulation to make the sector more responsive to change.

For business customers, this would involve, in the first place, the right to choose which of several retailers supplies them with water and also with advice over how to reduce consumption. Scotland already has such a scheme, and it seems to work well and be popular.

Second, setting higher prices for abstracting water in regions where there are water shortages is an obvious way of promoting conservation where it is needed by reducing leakage and encouraging customers to reduce consumption. It would also supply signals to firms to move treated or untreated water about the country. In the United Kingdom, it seems that this can be done by a fairly cheap combination of investment in short pipelines and use of the river system. As the companies are investor-owned the process would be driven by private investment decisions rather than by government decisions.

These initiatives are all part of a move towards making investment in water assets more contestable - by allowing different firms to propose different ideas as to how to meet customers' preferences for the price and reliability of water service, rather than rely on one firm to make all the decisions.

Many of these ideas have already been put into effect in different parts of Australia, whose harsh experience of drought has turned it into a laboratory of models of change. Melbourne is particularly interesting. Its retailers have long been separated from their wholesale supplier, even though they do not compete with one another. Significant new pipeline capacity has been constructed, which links the city with points to the north where a market for abstraction rights already exists. A large desalination plant is under construction. Other possibilities are the development of new water supply sources, such as recycling by private or government-owned firms and stormwater capture by local government.

These options create the potential for one model of competition well known in the energy sector and evaluated in the UK report - a single buyer acquiring treated water from multiple sources, which is

then handed over to competing retailers to sell to end customers. There is also the possibility of even more flexible arrangements, where retailers or large customers contract directly for new supply.

Is any one of these alternatives clearly better than another or than current methods employed in either country? Which approach to take depends on where you start from, and even then we do not yet clearly know. It also depends on who owns the sector. The freedom of policy manoeuvre available to a government that owns the suppliers is much greater than that of a government dealing with investor-owned firms.

In Victoria, the combination of impressive conservation efforts by the community, the construction of new infrastructure and helpful recent rains means the immediate problems of water shortages are now abating. However, there is a clear task to ensure that Victoria's new supply sources are utilised efficiently, and that processes are put in place to deliver new supplies to meet future demand.

In the UK, there is widespread agreement that change to the regulation and structure of the water sector is urgently needed. A new government can accomplish this task.

We will now see what happens.

*Martin Cave, author of the UK report mentioned above, was until recently a professor at Warwick Business School; Bruce Cohen is an honorary fellow with Grattan Institute.*