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Summary

1. This submission is a response to the Minister for the Environment, Community and Local Government's consultation on the reform of the water sector. We welcome the fact that one of the key tasks of PwC was to *"Recommend the most effective assignment of functions and structural arrangements for delivering high quality competitively priced water services to customers (domestic and non-domestic) and for infrastructure provision"* (emphasis added),¹ and believe that competition can play a key role in meeting this objective.
2. The model recommended by PwC is the establishment of a public water utility monopoly, Irish Water. They recommend that the introduction of competition should not be regarded as a priority at this time, but that once Irish Water is well established as a self-funding utility, international experience of the role of competition in water and sewerage services should be examined to see whether Ireland could benefit from competitive markets at a later date.² They state that *"when undertaking the detailed design of the new organisational structure for Irish Water, the possibility of future retail competition should be taken into account"*.³
3. From a competition perspective, this is not an ideal outcome. However, given the particular characteristics of the water supply chain and the challenges facing the water sector in Ireland, we agree with PwC's analysis that this is the most feasible model in the short term. A public utility is likely to be the best way to put in place all that is required so that a functioning water market exists, (i.e. installing water meters, transfer of staff from local authorities, investment in water infrastructure). Once this new structure is in place, we believe the introduction of competition where possible could further improve the delivery and efficiency of our water services.
4. It is thus important that the new monopoly water company is not created with expectations that such a model may continue indefinitely. Setting out medium and long-term goals involving increased competition would help to manage any such expectations. Such a roadmap would also reassure households and businesses that when they are charged the full cost of

¹ *Irish Water Phase 1 Report* (2012), Introduction and Overview, pg 20, PwC.

² *Irish Water Phase 1 Report* (2012), The Role of Competition in the Provision of Water Services pg 119 PwC

³ Ibid

water services - as they must be under EU Directives - the price charged will be competitive.

What competition can bring to the Irish water sector

5. Competition has the potential to bring many benefits to the Irish water sector including:
 - the efficient use of water;
 - value for money;
 - effective regulation;
 - the avoidance of over-spending and inappropriate assets, and;
 - cost competitiveness for all businesses in Ireland.
6. International experience and independent studies⁴ suggest that there are ways of introducing competition which could prove helpful in meeting the Government's objective of delivering high quality, competitively priced water services to customers. Given the relatively short time period of experience of competition being introduced in this area, and the different models of organisation of the water sector worldwide, conclusive evidence that introducing competition in water services is a proven success is not available. However the influence of competition on other traditional monopoly sectors such as energy and telecommunications has helped to make those sectors more efficient and dynamic over time, and customers have in general benefited from lower prices. These sectors have also seen increases in innovation, research and development, and higher quality services resulting. Although there are differences in the characteristics of these sectors, we believe that similar benefits can be brought to the water sector in the long run.
7. These benefits could play a crucial role in ensuring the sustained growth and development of industries that have significant demand for water services - such as pharmaceuticals, food production, and agriculture - as well as attracting more water-intensive industries to Ireland. Competitive influences also support fair regulation of prices to consumers, and will help

⁴ *Competition and Regulation in the Water Sector 2004*, OECD Competition Committee Roundtable Report, and *Study on the Application of the Competition Rules to the Water Sector in the European Community*, Prepared by WRc and Ecologic for the European Commission - Competition Directorate General, December 2002.

to ensure that pressure is put on Irish Water to be efficient and innovative in how it provides services to customers.

How this fits with the proposed public monopoly water utility

8. The model recommended by PwC is the establishment of a public water utility monopoly, Irish Water. The model envisages the use of competition solely by means of outsourcing and competitive tendering for the design, build and operation of new water facilities, as already currently occurs in Ireland. We agree that introducing competing water companies is not feasible or desirable at this early stage. Thus PwC's recommended model is the most feasible model in the short term.
9. However, we believe that there is potential for further competition to take place in the future. There are areas of the water allocation, supply and retail chain in which efficiency could be improved through the introduction of competition. Once Irish Water is well established as a self-funding utility, the Department and the CER should assess where and how these forms of competition can be introduced.
10. In the meantime, it is important that when setting up Irish Water the Department avoids putting in place anything that could prevent the emergence of competition in the future. The initial structure of Irish Water will be important in facilitating future competition in the Irish water sector. For example, tying the pensions of Irish Water employees to the assets of the company could make it excessively costly to separate out more contestable assets in the future. It is also important that the new state-owned water monopoly is not created with expectations that this model will continue forever. Setting out medium and long term goals involving increased competition would manage expectations and reassure households and businesses that the price of water services will be competitive.
11. The remainder of this submission goes into more detail regarding the role and scope for competition in water services, and how it differs from privatisation and PwC's recommendations regarding the future use of competition in the Irish water sector.

The Role of Competition in the Provision of Water Services

Competition does not have to mean privatising key assets

12. Before we discuss the potential possibilities for opening up the water sector to competition, it is important to be clear that competition and ownership are separate concepts. Competition policy is concerned with putting in place processes, structures and regulations that support continuous improvements in efficiency, quality of service and competitive prices.

13. Competition policy is fully compatible with the public utility model. For example, if competition were introduced at retail level, as has been done in Scotland, it could involve ESB and Bord Gáis competing alongside Irish Water in the sale of water services to businesses, with Irish Water retaining 100% ownership and control of the water infrastructure.

Benefits of competition

14. Competition ensures that market participants are efficient, that market prices reflect these efficiencies and that those prices are no more than is required to facilitate an appropriate level of investment in the sector. Competition also ensures that our national resources are used in a way that creates the most value to society, with minimum wastage. Finally, competition encourages market participants to create new and better products and services in order to retain and win customers. Thus competition is a dynamic force that drives efficiency again and again over time.

15. A water sector which allows competition to play a role in the provision of the service can expect increased efficiency. This is vital in a sector that forms a key input to Ireland's industrial sector.

Where there is scope for competition in the water sector

16. The transport of water and the collection of waste water are generally considered to be natural monopolies. This is because the cost of constructing competing water distribution networks is so high that it effectively prevents potential competitors from entering and competing with the incumbent operator. As a result, the role of competition in the provision of such basic infrastructure is limited. Internationally, the sector tends to be highly regulated to protect against harm to the environment or

public health and to protect against excessive prices. However, price regulation is always a second best solution compared to competition.

17. There is increasing recognition that there are areas of water extraction, distribution and collection and of the water processing/treatment chain in which efficiency can be improved through the introduction of competition. As the PwC report outlines, competition may take two different forms, competition in the market and competition for the market.
18. Competition for the market in water services is more common internationally. In this case, utility companies compete for contracts to provide particular services to the market. The contracts are typically for the operation of an asset along the supply chain, whilst the government or municipal body retains ownership of the asset. Design and build contracts (public private partnership contracts) are already in place and operating throughout Ireland, particularly for water treatment services.
19. While the water distribution and collection network is generally considered to be a natural monopoly, market segments such as wholesale markets, and retail markets are in theory more easily contestable. However separating natural monopoly services from potentially contestable services is not an easy task. The Department and Regulator must first define and isolate the natural monopoly networks. Considerable investment will need to take place before then and the Regulator will need to be strong and independent to implement such changes. However, as can be seen from experience in Scotland, it is possible to introduce some level of competition gradually over time.
20. As noted by PwC, competition at the retail level has been introduced in Scotland for non-household customers.⁵ These retail activities include customer service, payment handling and water pricing. Customers can choose from three alternative water supply companies in addition to the public utility Scottish Water. In order to reflect the distinction between those parts of its business which are exposed to competition and those which are not, Scottish Water has separated its retail operations from the other parts of its organisation.
21. Competition of this kind is driving a more efficient industry. The new retail suppliers compete for customers by offering more competitive prices and

⁵ *Irish Water Phase 1 Report (2012) The Role of Competition in the Provision of Water Services* pg 119 PwC

seek out more cost-effective and innovative ways to serve customers. They also put pressure on Scottish Water to improve the wholesale service it provides. Retail competition was introduced in Scotland ten years after Scottish Water was established; a similar target could be set for the Irish Water Sector.

22. Competition in the market of water service provision would make a choice of water suppliers available to customers. Theoretically two primary approaches exist for facilitating such switching, namely building new infrastructure to supply the customer, or the opening of a suppliers pipes to other suppliers (common carriage). These methods for enhancing competition are largely untested, mainly because of the natural monopoly nature of the market.

PwC Recommendations

23. The model recommended by PwC is a public utility monopoly. Given the challenges facing the water and sewerage sector in Ireland at present, PwC do not consider that the introduction of competition into the market should be regarded as a priority at this time. They state that the new recommended water model will *"bring a single focus to the sector which will be regulated independently, allow for greater transparency, enable comparisons to take place with performance in other countries and also internal comparisons"*.⁶

24. PwC suggest that *"once Irish Water is well established as a self-funding utility, the Government and Regulators may wish to assess international experience of the introduction of competition in water and sewerage services to identify whether Ireland could benefit from competitive markets in the water sector at a later date. With this in mind, PwC recommend that, when undertaking the detailed design of the new organisational structure for Irish Water, the possibility of future retail competition should be taken into account"*.⁷

25. We appreciate that introducing competing water companies may not be feasible or desirable at this early stage of the development of the Irish water sector. However, the initial set up of Irish Water is very important in

⁶ *Irish Water Phase 1 Report* The Role of Competition in the Provision of Water Services, pg 119, PwC.

⁷ Ibid.

facilitating some level of competition in the Irish water sector, both now and in the medium to long term.

26. It is critical that competition be applied to the model now where appropriate to ensure continuous improvements in efficiency. PwC state that *"Competition for the market and the procurement of major works, capital delivery, operations and also relating to customer services (billing call centres etc) could be an important feature of Irish Water).*⁸ We support this recommendation. This type of competition for the market already exists in Ireland and should continue to be used. Contracts must be fully contestable – i.e. the process for the award of contract must be transparent, and open to as many bidders as possible. It is also important that these contracts are limited to the minimum scope and duration necessary to allow them be adequately remunerated when providing the service.

27. It is important that the way in which Irish Water is established avoids putting in place anything which could prevent the emergence of competition in the future. It is equally important not to create a state-owned monopoly water company with expectations that such a model may continue indefinitely.

28. There is a lot to learn from international experience where the regulation of water services is much more advanced. For example, the UK's Office of Water Services (Ofwat) has over 20 years experience in regulating water services in England and Wales. They are proficient in the use and limitations of benchmark competition and are also researching the benefits and possibilities of water trading. Although the water infrastructure in Ireland would not currently facilitate these types of competition, the recommended structure for Irish Water should foresee and facilitate the possibility of such a market developing later.

⁸ Ibid

