Water governance and water users in a privatised water industry: participation in policy-making and in water services provision: a case study of England and Wales

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Abstract: This paper examines how individuals can influence decisions about the delivery of water services in England and Wales. It first examines the capacity of individuals to shape government policy and then turns to an analysis of the private sector. In particular, we ask whether recent restructuring in the water sector – notably changes in business models and governance structures – has increased the opportunity for individuals to influence the investment decisions made by private firms and their plans for restructuring. The paper concludes that privatisation and restructuring have had a limited impact on an individual water user’s capacity to influence decision-making. Water users remain dependent on penetrating state-controlled lobbying networks via sanctioned pressure groups. Recent changes in ideas about governance might have a much more significant impact on user participation in the future.

Keywords: England and Wales; governance; mutualisation; privatisation; public participation; securitisation.


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1 Introduction

“You could take a cynical view and assume that customers are only interested in price. But customers are also citizens who value a pristine environment … So a partnership must engage the public on all of these levels. Involving people in protecting water is about engendering a common responsibility for water.”

(Pamela Taylor, Water-UK, May 2002).

Few ideas have achieved more prominence in recent years than the claim that encouraging the participation of the public in decision-making increases the likelihood of generating a successful project or policy. Public participation has come to be seen as crucial to the production and success of a range of socio-environmental policies, including water management (Chambers, 1983; World Bank, 1994; Long, 2001).¹ (Arnstein, 1971; Rosener, 1983; Creighton et al., 1998; Delli Priscoli, 2000; Langton, 2000; Beierle and Cayford, 2002).² Some critics argue that the language of participation has now become so influential that it is positively dangerous (Cooke and Kothari, 2001). In the past these debates have had a lower profile in the UK water sector; however, this is now changing (DETR, 2000; Ofwat/WaterVoice, 2004; Bailey, 2003; Page, 2003). Whilst some research has already been conducted on public participation in environmental aspects of water and waste management in the UK (House, 1996; Petts, 2001; Twigger-Ross, 2002), little attention has so far been given to the role of the public in the service side of water supply. The aim of this paper is to address this gap.

Whilst the case study material relates specifically to England and Wales the paper speaks more widely to the EU context, particularly because of the harmonisation of national policies that is a consequence of the implementation of the Water Framework Directive.

The privatisation and subsequent re-regulation of the English and Welsh water and sewage companies in 1989 have had important implications for the service received by water users. Some of these consequences are frequently discussed in both policy and academic circles, such as the balance between prices and infrastructure improvements. Unlike other utilities, water prices have risen in real terms since privatisation, with negative impacts on vulnerable consumers (Drakeford, 1997). However, these water price rises have funded significant water quality and environmental improvements – enjoyed directly or indirectly by all water users (Environment Agency, 1999; Drinking Water Inspectorate, 2001; Fletcher, 2002).

Debates about the implications for water users of becoming shareholders have also been analysed. Privatisation was intended to foster ‘popular capitalism’ and it has enabled individual consumers to own shares in the water companies, although relatively few do (Saunders and Harris, 1990, 1994). However, research has neglected to address the consequences for water-users in other areas. Accordingly, this paper addresses the question: how has water privatisation changed the ability of the public to influence service delivery in the water sector? We focus on two issues: the influences that water users have in shaping:
• the central government’s water policy
• the service and management strategies chosen by private water companies.

In the first instance, we ask: how has privatisation shaped water users’ ability to participate in water policy planning and decision-making at a national level? In the second case we ask: how has the evolution in the regulatory framework and industry structure post-privatisation affected direct participation by water users in the management of privatised water companies? Put more simply, can water users influence the service delivered either by the central government or by water companies, and if so, how?

There are a large number of ways in which the public can participate in the decisions made by institutions within the public and private sector: from voting to consumer choice (albeit limited in the water sector, where natural monopoly characterises networked water supply despite privatisation), from petitions and protests to litigation. Our main focus in this paper is on those specific strategies that have been established for the purpose of involving members of the public in the formal processes of administrative decision making: consultation papers, public meetings, regular consultation with advisory committees, and appointment to decision-making bodies. The analysis is not directly concerned either with the formal constitutional process of electoral politics or with the marketing research performed by companies in order to understand customer’s opinions, choices, and behaviour. That is not to say that these spheres are unimportant, but they are not the avenues recommended by the current advocates of public participation. Instead we are concerned with the emerging mechanisms by which representatives of a water-using lay public are formally incorporated into decision-making processes of policy makers and service providers.

These questions are particularly pertinent in England and Wales at present for a variety of reasons. First, the division of the water services regulator (OFWAT) that deals with consumer representation is in the process of being restructured. The Water Act 2003 has legislated for a new Consumer Council for Water, which will begin work in October 2005. This will take on the customer-complaints handling functions of the existing Customer Service Committees (which have been rebranded as WaterVoice) and in addition will become a research-based consumer advocacy body. Second, after 1997 a change in the tenor of regulation produced dramatic changes in the policies of the private water companies. This ultimately led to a number of attempts by companies to restructure themselves either as community mutuals, or securitised not-for-profit bodies (Bakker, 2003). Third, political interest in ideas around ‘stakeholding’ (Blair, 1998; Mayo and Moore, 2001a) has produced some cautious experiments with new forms of public participation in state decision-making (Public Administration Committee, 2001). Fourth, private sector participation is being intensified across Europe by the opening up of municipal service provision to external competition. And finally, public participation is mandated as part of the new EU water framework directive (WFD) (Barraque, 2000; Bloch, 2001; European Commission, 2000; Kaika and Page, 2003; Page and Kaika, 2003). The European Commission’s interest in making participation statutory through the WFD reflects internal debates about democracy in the operating practices of the EU and also a major shift in European policy on water pollution (Gonzales-Anton and Arias, 2001; Swyngedouw et al., 2002). The perceived opacity and inaccessibility of the EU to European citizens is to be countered through participation enabling the ‘general public’ to be involved in environmental decision-making through specific mechanisms: in this case, the establishment and updating of river basin management plans. In addition to
fostering greater public involvement in EU decision-making, it is hoped that public participation will lead to behavioural changes in water use, particularly important given that the focus of EU water legislation has shifted from limiting point source water pollution to tackling diffuse water pollution. Given this shift in focus, it is thought to be necessary to try to change public behaviour; public participation is thus conceived in a dual role as a mechanism for education and behaviour change, and as a tool of deliberative democracy connecting the local with supra-national levels of governance. As a result of all these factors, the role of water users in the production of water policy is a subject of increasing importance, not only in England and Wales but also across Europe.

The paper starts by looking at water users and government policy-making in England and Wales. It considers the changing mechanisms of public participation under public and private ownership. In particular it looks at the OFWAT Customer Services Committees, as a set of institutions and mechanisms for public participation created in 1989. It shows that the creation of these institutions was part of a broader shift in the relationship between water suppliers and water users: from a citizen’s right towards a customer’s service. The analysis explores why these institutions did little to change the mode of policy-making in the water sector, despite formally inserting ‘the public’ into the policy-making process. The paper then turns to the more recent period and considers the relationship between water users and the management of the private water supply companies. In particular, it considers the effect that restructuring water supply companies might have on public participation in water supply policy-making.

2 Water users and the water policy of government in England and Wales

One of the fallacies in much writing about the English and Welsh water privatisation is the suggestion that privatisation entailed liberalisation, leading to a ‘retreat of the state’– a dwindling role for government in water management. Though the rhetoric around privatisation opposed corporatism and lionised de-regulation, the reality (in the water sector at least) was a conspicuous process of re-regulation (Bakker, 2004). National government institutions were needed in order to make competition work, monitor water quality, implement EU policy and steer infrastructure investment. The elaborate regulatory bureaucracy that was established during, and augmented after, the privatisation of the water supply sector in 1989 is indicative of this process. Not only does the government continue to pursue its own water policy goals, but it also shapes the policies of the water companies through the tenor of the regulation it fosters. Whilst the water regulators themselves fiercely assert their own independence from specific governments, they operate within a legislative framework and a political context that shapes their options. The means by which water users are incorporated into the state’s policy making process are, therefore, still important. After a brief survey of historical changes in public participation, two main routes for participation will be considered: the Customer Service Committees, which operate under the auspices of the economic regulator (Ofwat); and the consultation exercises carried out by the government.

Prior to privatisation in 1989, public participation in a publicly owned water supply industry was understood to occur through the democratic structures of elections, which were expected to ensure that the government was representative of, and accountable to, public interests. In addition, certain non-state actors (pressure groups, NGOs, unions)
were incorporated by the government into the policy-making process via a continuous, low-key, personalised exchange of opinions and advice. According to standard politics texts (Coxall and Robins, 1998), the actors that were sanctioned to participate in this process were democratic in their internal structures, tended to make reasonable demands, gave reliable advice, used language akin to that of the government and could wield a degree of real economic leverage. Those that were excluded from the process had overall aims that were incompatible with the government and occupied generally contentious positions. Such non-state participants were expected to be discreet about discussions in Whitehall, not to ‘go public’ even when aggrieved and not to criticise Ministers. The statist model of participation deployed in England and Wales prior to privatisation thus utilised both an overt model of democratic participation and also this ‘back-room’ model of covert participation of non-state actors who represented – albeit indirectly and at times selectively – a range of public interests, including water users.

Before privatisation, elected governments at national and local scales were the central architects of water policy. However there was also a long history of nongovernmental actors influencing the production of the national government’s water policy. In this respect some water users were able to intervene in the government’s policy-making when lobbying through pressure groups. For example, analysts have identified property owners with riparian rights and Municipal Corporations as two groups with vested interests who set out to prevent the nationalisation of water supply in the post-war era (Sheail, 1983; Hassan, 1995). In 1973 the structure of the English and Welsh water industry was re-organised on a national basis by a Conservative government. Two-hundred local government water authorities, 29 river authorities and 1400 local authority sewage works were rationalised into ten regional water and sewerage authorities (Parker and Penning-Rosse, 1980). For some water users this nationalisation was experienced as a loss of community control; water supplies were perceived as having been appropriated by the state and water-users became increasingly alienated from the operators of their water supply (Strang, 2001, 2004). But nationalisation also enabled a subsequent Labour Government to introduce a system of inter-regional price subsidies in fulfilment of an election promise, which reflected a nation-wide concept of citizenship and the power of users to influence policy through their vote (Bakker, 2001).

After nationalisation, nongovernmental pressure groups remained influential. Nationalisation was driven by economies of scale, the engineering logic of integrated river basin management and an antipathy to local government. Given these driving forces two anomalies stand out. First, 31 private water supply companies survived the re-organisation untouched. They were small companies serving small populations, so their continuity stands against the scale benefits that were to be achieved through agglomerating suppliers together. Despite lobbying from water engineers and local government associations, these private companies survived because of the influence that corporate pressure groups (like the Confederation of British Industry) could wield over government policy. The second anomaly was that the new RWAs were not given authority over land drainage and flood control. Farmers did not want to lose control over floodplains, and used their influence through the National Farmers Union to ensure that power remained with the Ministry of Agriculture rather than being transferred to the RWAs. In both cases, specific pressure groups with particularly effective contacts in government were able to use their ‘back room’ influence to shape government policy. Water policy was formulated by government accountable to the electorate, but it was also
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profoundly influenced by non-representative nongovernmental pressure groups operating through personal networks within the state bureaucracy.

The picture that emerges is one in which water users had an intermittent influence through the use of their vote, and in addition, the potential for influence if they could articulate specific ambitions through a sanctioned actor who was involved in the government’s policy-making process. However in many cases the fact that these lobby groups were water-users was ancillary to their other interests and concerns. These groups were organised not around using water so much as owning riparian land, owning water supply networks or some other characteristic, which gave a group a particular interest in intervening in the policy process. Whilst other areas of policy making in England, such as planning, housing and transport had experimented with more innovative forms of public participation in the 1970s (Boaden et al., 1982) the same was not true with water policy. Even in planning however, such experiments were abandoned with the shift in the Government’s ideological priorities in 1979 (Davies, 2001). There was little institutionalised involvement of the public in the making of water policy prior to privatisation except for those individuals who chose to contribute to government consultation exercises.

2.1 Privatisation and the new institutions of public participation: customer service committees

The 1980s were marked by a dramatic shift away from state and towards private management of utilities. This shift was in part engineered by a political and economic elite that believed that the state had failed to meet the needs of a growing economy and that the market was a more efficient arena for containing competing interest groups. Under this new dispensation, citizens were reconstructed as customers of utilities and the government was reconstructed as a (temporary) regulator, whose role would wither away as the market matured – a scenario that proved unworkable in the case of the water sector. The locus of decision-making changed after privatisation; new institutions (private companies and public regulators) became the places where the key decisions were made (Rees, 1998). Given that neither private companies nor government regulators are democratically accountable institutions, the water-user was inevitably distanced from decision-making.

This shift also entailed a transformation in the mechanisms of public participation. Whereas the public participation of the late 1960s had been seen as a means of opening up government bureaucracy to citizens, the public participation of the 1980s represented a different view again of the relationship between an individual and the state.

“Instead of being directly involved in the process by which public policy is made and services delivered, the individual is expected to exercise choice in his consumption of services and to have his rights as a consumer protected by law. As such it is participation in the consumption of public goods rather than their production.” (Boaden et al., 1982)

Specific institutions were created to represent the public as consumers across the range of privatised utilities. Customer complaints and the recourse to legal action became the mechanisms through which the public were expected to assert their influence rather than votes and parliamentary lobbying.
At the time of privatisation, water users were incorporated into the institutions of regulation through the establishment of regional Customer Service Committees under the auspices of the economic regulator, the Office of Water Services (OFWAT) (Gilland and Vass, 1994; Winward and O’Neill, 1997; Hall, 2002). These institutions were expected to provide a forum through which the public could articulate with both government and the water companies. Advocates of privatisation argued that they also brought greater public transparency to policy-making than had existed under public ownership. However, these new bodies have not dramatically changed the manner in which the public influence water policy. They have evolved as bodies whose main function is to handle customer complaints. Consultation remains the most frequently used strategy of participation in the process of producing policy and as such water-users remained on a low rung of the ‘ladder of participation’ (Creighton et al., 1998; Delli Priscoli, 2000; Langton, 2000). Furthermore the ‘back-room mode’ of nongovernmental influence over decision-making has remained intact. So the new institutions of public participation had to deploy old strategies to try to influence specific policy decisions. The consumer representation wing of OFWAT started to act in the same way as other pressure groups. It used its relatively privileged position as part of the regulatory apparatus to lobby on behalf of consumers quietly and behind the scenes. The choreography of participation (that is, the cast of actors involved in decision making and their relationship to each other) changed dramatically, but the style of the dance (how the decisions were made) was broadly similar.

The OFWAT customer services committees (CSCs) were designed to represent the interests of all consumers within the regulation of water services at OFWAT (Section 28, Water Industry Act 1991). Upon their creation in 1989, the 10 CSCs were fully integrated into the government’s mechanisms for service regulation of the private water industry. Every water company was assigned to a specific CSC. Each CSC comprised a chair and between 10 and 20 members of the public. The Chair of the CSC was appointed by the Director General (DG) of OFWAT, and paid a part-time salary. The other CSC members are unpaid volunteers who were appointed on the recommendation of the Chair. Members are recruited via advertisements in the local press and approaches to a range of bodies and major employers. Each CSC also had a small team of salaried staff and OFWAT also provides the CSCs with legal, financial, technical, press and public relations support. Altogether this cost OFWAT £1.282 million in 1999–2000. The OFWAT National Customer Committee (ONCC) is made up of the Chairs of the ten regional CSCs. It is not a statutory body, and was created after the rest of the system was established in order to provide a vehicle through which the CSCs can talk to one another and can communicate with OFWAT with a single voice.

Since CSC members were a self-selecting group they initially had a tendency to represent a particular fraction of society, which had the time, inclination and financial independence needed to become involved in such activities. However, interviews with the CSC secretariat suggest that there has been an active policy to diversify the interests and experience of those members of the public who make up the membership of the CSCs. One of the features of this structure of public participation is that turnover in membership is relatively slow. Unlike other forms of participation (in which new bodies and groups are convened for specific local developments and evaporate quickly after meeting) the CSCs are permanent bodies on which members sit for a number of years. Whilst this has the advantage that they can become more knowledgeable about the range of issues they address, and more informed about the behaviour of governments and
Despite this elaborate (if relatively cheap) institutional structure for consumer representation, the shift in the practice of participation is less dramatic than it seems. The CSCs broadly continue the model of back room consultation and they have not given
the public any real power to intervene in policy-making. The CSCs have no statutory power to access information from water companies or to demand changes in the behaviour of water companies. Interviews with the water companies suggest that they view attending CSC meetings as a bit of a burden and they treat the opinions of committee members as comic illustrations of their lack of understanding of the realities of running a business. Nevertheless the companies find it useful to attend the meetings both as a means of gathering information and as a strategic part of the game of jousting with the economic regulator. In order to exert any influence over the companies CSCs have developed precisely the kind of personal, informal, amicable networks with the private industry that have always been the hallmark of nongovernmental participation in England and Wales (Simmonds, 2001). Equally the CSCs have developed a very close relationship with central OFWAT staff. This has enabled an informal exchange of information about water companies to occur. This is based on the understanding that the CSCs will respect the commercial importance of some of the material and will treat it as confidential. CSCs have evolved to become acceptable participants by making reasonable demands, giving reliable advice, using language akin to that of the government and not challenging the limits of their remit. This is not to say that they have not been in conflict with the water companies, the rest of OFWAT or the Government, but that at a fundamental level they do not disagree with the central thrust of policy or structure of the industry. The CSCs then represent continuity in the mode of participation, but have introduced a voice for a new participant, the ‘average customer’.

Recent developments have severed this institutional link between the CSCs and the core of the service regulator. In 2002 the CSCs were reconstituted as a more independent water watchdog called WaterVoice. This shift follows similar moves in other utilities and anticipated the legislative changes in 2003 and the establishment of the new Consumer Council for Water in 2005. It is based on the principle that consumer bodies should be separate from the institutions of the state. This change is a disappointment to those pragmatists who suggested that the strength of the CSCs was their access to information via OFWAT. There is also considerable scepticism amongst CSC members about the merits of the change. As yet it is too early to say whether these changes will provide water users with a more influential institutional vehicle through which to try and change government policy or whether it will be weakened because it is more distant from OFWAT. The 2003 legislation has certainly created opportunities for the new Consumer Council for Water to be more actively involved in policy-making, but it remains to be seen how an individual water user could become involved in that process. Certainly they could try to become a member of the Council, but vacancies are limited and membership requires a substantial investment of time and energy. Much will also depend on the directions chosen by the body’s leadership.

2.2 Public involvement in consultation

The second main way in which members of the public are invited to directly involve themselves in questions of water services delivery is through the government’s consultation exercises. But do they get involved, and what impact does contributing have? One way to answer this question is to examine the government regulator’s consultation exercises and see who participates. Whilst the regulator is not synonymous with central Government it is a body that operates on a national scale, and it is a key institution for policy-making under the current arrangements.
Over the last few years OFWAT (2000a) has made a concerted effort to widen the number and type of participants involved in consultation. The number of consultations has risen sharply from an average of two/year from the period 1990–1996 to nine/year from 1997–2000. Recent OFWAT consultation exercises have succeeded in reaching a wide range of different participants. There were 1,250 responses to the last 35 consultation exercises (1997–2000). One exercise led to just five responses whilst another led to 122. The average number of responses to a consultation paper was 36. The largest number of responses came from commercial firms, including the water companies. However, in simple numeric terms the private sector did not completely dominate the responses (Table 1). Other branches of government were also significant contributors to debates, but the remaining two categories are of particular interests to an assessment of water-user involvement. ‘Associations’ are lobby groups that represent the material interests of their members (for example Water UK is an association representing the interests of Water Companies and Unison is an association representing the interests of workers in the water sector) whereas ‘civil society’ groups tend to have goals not directly orientated to their own material interests and are based around interests which unite individuals from different sections of society (for example Surfers Against Sewage is an NGO campaigning on a range of issues relating to marine pollution). Thirty-one different associations and civil society organisations were regularly involved in consultation between 1997 and 2000.

Table 1  Responses to OFWAT consultations by category

<table>
<thead>
<tr>
<th>State</th>
<th>Market</th>
<th>Civil society</th>
<th>Associations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of individual responses</td>
<td>247</td>
<td>525</td>
<td>325</td>
</tr>
<tr>
<td>Proportion of total (%)</td>
<td>20</td>
<td>41</td>
<td>27</td>
</tr>
</tbody>
</table>

Table 2  The proportion of responses from different interests within the category ‘civil society’

| Concerned individuals | 53% |
| Environmental NGOs | 20% |
| NGOs concerned with social issues such as poverty or disability | 12% |
| NGOs representing domestic consumers | 11% |
| NGOs which act as self-declared watchdogs, policing utilities | 4% |

The civil society category is of particular interest to a discussion of public participation. As with the other categories it is not homogenous and several of the sub-divisions take strongly opposing positions on a number of policy issues, such as full-cost pricing, which is (broadly) advocated by the environmental lobby and opposed by the consumer lobby. The individuals who involve themselves with the consultation process tend to respond in very large numbers to a very limited number of consultation exercises. Over half of the responses from individuals came from just two consultation exercises – one on the proposed mutualisation in Yorkshire and another on future water charges. In contrast, one or two environmental NGOs respond to nearly every consultation document. Very few of the individual responses came from shareholders, who seem to be very passive participants within formal consultation mechanisms. Initially it appears odd that the NGOs whose central concern is with UK utilities (such as Waterwatch, the National
Campaign for Water Justice and the Public Utilities Access Forum do not often participate. However, since these groups often campaign against the continuing privatisation of the water sector they epitomise the idea of outsiders whose overall aims are incompatible with those of the government and are effectively excluded (and choose to self-exclude) from lobbying.

The above analysis is clearly simplistic. Often it is clear from consultation responses that most of the dialogue will be continued in the private domain of meetings between water industry representatives and government regulators, rather than in the public domain of consultation. Furthermore, OFWAT is also developing new and more innovative strategies such as stakeholder workshops, which could prove far more significant. What is clear, however, is that in certain instances individual water users are motivated to participate in substantial numbers in debates over service issues. The debate over the proposed mutualisation of the Kelda water company is a classic example. A far smaller number of individual water users are regular participants in a wide range of consultations, and when they do participate it is usually in their capacity as an office holder in a particular NGO. These highly motivated individuals are often very well informed and undoubtedly add considerable richness to the range of responses that OFWAT receives. However, despite these attempts to widen the range of participants in consultation exercises, the character of the process is such that doubts remain. Policy-makers retain decision-making power, and Ofwat or the government can always ignore the results of consultation exercises.

3 Restructuring the water industry: mutualisation and the ‘customer corporation’?

A second key arena of public participation is through interactions with the water services provider. Users – as customers in a privatised model – typically influence firms through a variety of mechanisms ranging from consumption choices to complaint mechanisms. In the case of the water industry, the persistence of spatial natural monopolies for domestic consumers and the widespread absence of metering (approximately 20% of domestic consumers are metered in England and Wales) implies that many of the conventional mechanisms for signalling preferences to private firms are absent. The proxy mechanisms created within the regulatory framework, as outlined above, were thus designed to facilitate the use of ‘voice’ by customers who cannot ‘exit’ (to paraphrase Albert Hirschman). In addition to these proxy mechanisms, new modes of consumer participation may arise from recent company restructuring initiatives – some of which explicitly call for more customer involvement. The roots of company restructuring initiatives lie in the tightening regulatory framework and decreasing profitability of the core water services businesses since 1989 (Bakker, 2004). In the English and Welsh privatisation framework, regulation of utility services applies only to the licence-holder – the ‘core’ business, supplying the regulated service. At the time of privatisation, a group plc structure, of which the core business is one subsidiary, was adopted by all water and sewerage companies (Figure 2). The core businesses of water and sewerage services were transferred to subsidiary companies acting under a license (formally known as the Instrument of Appointment) granted by the Department of Environment, Transport and Regions.
The boundaries of water supply areas were unchanged by the transfer to private ownership. In their existing regions of operation, the water and sewerage companies were appointed as vertically integrated regional monopolies, providing the entire cycle of services to their customers, from extraction of raw water, delivery of processed water, and collection, treatment and discharge of waste water. The smaller private companies – descendants of the statutory water companies established earlier in the century, engaged solely in water supply – were appointed to provide water services to their previous customer base.

**Figure 3** Water industry structure (2000), England and Wales
Although supply boundaries were unchanged at privatisation, the water industry has since undergone significant consolidation; from 39 companies (29 water-only companies and 10 public Regional Water Authorities) in 1989 to 16 companies in 2000 (Figure 3). In addition, given the difficulty of sourcing finance to meet future investment requirements and perceived future low-growth opportunities in the domestic market, water and sewerage companies in England and Wales have opted to intensify three restructuring strategies (Bakker, 2004):

- **diversification**: remaining vertically integrated and growing through take-overs and mergers and/or expanding into non-regulated businesses and other utility sectors
- **internationalisation**: becoming an international water business, through acquisitions (or through being acquired)
- **vertical de-integration**, hiving off the regulated business to concentrate on non-regulated activities (Bakker, 2001).

Each of these three options entails significant restructuring of the water and sewerage business.

Vertical de-integration is the most radical form of restructuring entailing the separation of asset ownership and water production, with one company owning the assets and operating as the license holder (the ‘Appointee’), and another company (or companies) being contracted to provide the water supply service. The ownership structure and financing arrangements for the Appointee would have to be innovative, given the low profitability (but also low risk) nature of the regulated business. Vertical de-integration would allow asset owners to contract out the supply of services on the basis of competitive bids from water operator companies – similar to the system in France, in which the owners of water and sewerage networks (almost always municipalities) award long-term operation and maintenance contracts through a process of competitive tender to private companies. Proposals for vertical de-integration made by several companies over the past few years thus represent potentially the most significant structural change to the industry since privatisation.

In pursuing vertical de-integration, companies have put forward a variety of restructuring proposals. A number of companies are considering the separation of ownership of the water utility assets from operations and the introduction of a competitive outsourcing strategy for service provision (Office of Water Services, 2000b). In its most radical form, the asset-owning firm would be entirely debt-financed, contracting out operations to independent service providers. In addition, some companies are considering whether a new structure of ownership might be appropriate for the asset-owning business, which would be owned not by shareholders, but by its customers (or a selection of them) or members in the form of a mutual or company limited by guarantee (or other not-for-profit vehicle).

The two formal proposals put to OFWAT to date have entailed two distinct strategies, of mutualisation and securitisation. In the first case, Yorkshire Water’s parent company proposed, in mid-2000, to ‘mutualise’ its core business. In doing so, the company appealed to a long tradition of mutual ownership in Britain. Kelda depicted the proposed model – labelled RCAM ((Registered Community Asset Model) – as a ‘stakeholder’ business, whereby assets are returned to consumers, and consumers benefit not only from increased control but also because the cheaper cost of capital may result in lower water prices.
The RCAM would have been a new company, owned by customers and operated on a not-for-profit basis, which would have acquired the assets and debts of Yorkshire Water, and taken over its water supply license. Wholly financed by debt, the RCAM would have outsourced the management of the supply of water and sewerage services to a Kelda subsidiary for an initial period of five years, following which competitive bids from other water and sewerage companies for subsequent five-year contracts would have been sought. Under Kelda’s proposal, any profits would be reinvested in the business or returned to consumers.

Some proponents of the RCAM model suggested that

“ownership of a regulated utility in this form would align the interests of the owners of the regulated businesses with those of its customers and in doing so would minimise political and regulatory risk.” (Office of Water Services, 2000c)

Others argued that the RCAM model represented “a failed attempt to pass the assets and liabilities of an unsuccessful private business back to consumers” (Social Enterprise Institute, 2001). Given that Kelda was proposing that the RCAM should purchase Yorkshire Water’s assets at what many industry observers judged to be an inflated price, and that the RCAM members – Yorkshire Water’s current customers – would be responsible for the company’s debt, the regulator commented that,

“although there appear to be clear benefits in the short-term for Kelda’s shareholders from the proposals, in its current form, the benefits for customers have still to be demonstrated.” (Office of Water Services, 2000b)

While maintaining that

“the separation of asset ownership from operations and the outsourcing of operations could offer opportunities for greater efficiency resulting from the introduction of competition for the operations market.” (Office of Water Services, 2000b),

the regulator acknowledged the danger of Kelda continuing to win the operations contracts by virtue of superior knowledge of the network, and argued that

“The potential benefits to customers of greater outsourcing and a reduction in the cost of capital are not dependent on the introduction of a new ownership structure and could proceed under the existing equity model.” (Office of Water Services, 2000b)

The apparent inability of the proposed company structure to cope with unexpected cost shocks in the absence of an equity buffer, and the lack of incentives to drive further efficiency gains in management, were other decisive factors in the regulator’s decision to reject the restructuring proposal.

During the debate over Kelda the economic regulator made clear that he was not opposed, in principle, to the idea of separating ownership and operation or new forms of ownership if this was seen to benefit the consumer, where ‘benefit’ was understood to mean an increase in competition and/or a lowering of prices. The second formal proposal for a vertically de-integrated water supply business, put forward by Dwr Cymru (formerly Welsh Water) was judged to meet these criteria, and was approved in January 2001. In contrast to the Kelda proposal, the Dwr Cymru proposal entails securitisation rather than mutualisation, creating a not-for-profit company owned by its members and limited by guarantee, rather than a customer-owned mutual. Glas Cymru, a new company
limited by guarantee under the Companies Act 1985, owned by its members rather than shareholders, and wholly financed by debt, was formed for the sole purpose of purchasing the assets from Welsh Water, which it did in May 2001. The members of Glas Cymru, who have no financial interest in the company and do not receive dividends, represent a variety of Welsh interests. Indeed, the strong support of the Welsh Assembly was a key factor in the regulator’s favourable decision, which was viewed as ‘a key test of Welsh devolution’ (Utilities Week, 2001a). It was also highly significant that Western Power, the owner of Hyder Utilities, which was the parent company of Welsh Water, wanted to exit the water business and was willing to sell the assets at a discount to their regulatory asset value.

Another key factor in the regulator’s favourable decision was Glas Cymru’s proposed financing programme, which promised a significant reduction in consumers’ bills. As the company noted,

“the water industry is very capital intensive and the cost of paying a return on money raised to finance assets is Welsh Water’s single biggest cost, currently absorbing nearly a third of Welsh Water’s annual revenues” (i.e. customers bills) (Cymru, 2001).

The switch to 100% debt financing, through investment grade bonds, entails not only a lower cost of capital, but also a greater surplus that can be invested in the network and in environmental protection, used to build financial reserves, or returned to customers. The advantages of Glas Cymru’s lower risk profile, particularly given its commitment to remaining a non-diversified company operating strictly as a regulated water business, were confirmed by Standard & Poor’s AAA rating of the company’s bond issue.

Following the success of Glas’ strategy, other firms have explored similar models. In March 2001, one of the small independent water holding companies, East Surrey Holdings (owners of the water only company Sutton and East Surrey) announced plans to change its structure in search of reducing the cost of capital. They plan to set up a credit-wrapped index-linked bond. This is a different form of debt finance, which enables the borrower to repay the debt at a very low interest rate. The difference between the real interest rate and the agreed lower interest rate is added on to the debt. Sutton and East Surrey hope to reduce the cost of capital from the 7.3% anticipated in their 2000 plans to around 4.5%. Anglian Water and Southern Water, two of the larger water and sewerage companies, also announced plans to ring-fence asset ownership from operations within their group company structures and refinance the ring-fenced utilities via debt rather than equity.

The ongoing restructuring of the English and Welsh water supply industry has prompted consumer organisations to demand a strategic review of water industry structures that would consider which structures serve consumers best, and how regulation should change to meet these new circumstances. Relatively little attention has been paid to the question of the implications of restructuring of ownership, management, and financing of water companies for customer participation. In the case of Glas Cymru, the self-styled ‘people’s company’, direct customer participation has not yet increased substantially (Taylor and Pickard, 2001). The consultation undertaken by Glas prior to the restructuring was made up of eight focus groups, a survey of ‘opinion formers’, and a quantitative survey of 1000 customers – out of 1.1 million customers served by Welsh Water (Office of Water Services, 2001). In summarising these customer consultation measures, OFWAT announced that it was ‘satisfied that Glas has conducted as full a
consultation as could be expected’ (Office of Water Services, 2001). Within the new company structure, customer participation mechanisms are not substantively different. Accountability to Glas’ customers will be ensured indirectly –via the Board being held ‘accountable’ to the OFWAT CSC for Wales and to the National Assembly for Wales. The importance of the support of the National Assembly for Wales was viewed as critical by OFWAT in its approval of the Glas proposal: in the absence of ‘strong objections’ on the part of customers, the support of the Assembly and the OFWAT CSC was a key factor in OFWAT’s decision.

Indeed, direct customer participation was viewed with ambivalence by OFWAT, which noted a risk that “members of Glas be captured by special interest groups” (Office of Water Services, 2001), and reiterated the need for “arrangements for the appointment and functioning of the members of Glas designed to make sure that they remain focused on its commercial success” (Office of Water Services, 2001). The key issues as outlined by OFWAT for customers were not participation but: reduced efficiency, reductions in bills, and safeguards regarding the allocation of risk. Restructuring and vertical de-integration, as undertaken by Glas Cymru, has not implied significant changes in direct water user participation in company decision-making.

The ambivalence over customer participation in water supply management evident in OFWAT’s decision on the Glas proposal was also evident in its decision to block the Kelda proposal for mutualisation. Here, OFWAT’s concerns centred on the risk of failing to attract the ‘right calibre’ of managers and to incentivise them, with the resulting weak management of the competitive tendering process resulting in lower performance (Office of Water Services, 2000d). Given the regulators’ duty to encourage efficiency on the part of water companies, the possible reduction in efficiency incentives was also of concern. Specifically, the ‘risk-averse’ nature of a customer-owned mutual (where customers bear liability) would, OFWAT argued, result in the board being less likely to seek efficiency gains than would be the case with an equity-financed private company. The possibility that customers might have other preferences that might impinge upon or even override the efficiency (and hence price) imperative did not appear to have been considered by the economic regulator. It is thus unsurprising that OFWAT has announced that the ‘mutual’ model is unsuitable for English water companies: from the regulator’s perspective an increase in direct user participation is fundamentally at odds with the requirements of the economic regulatory framework, particularly the paramount duty placed on the regulator of incentivising efficiency.

4 Conclusions

The capacity of water users to shape the government’s water policy in a privatised model is multi-dimensional. As citizens they may steer state water policy through the way they use their vote. Given the significance of state regulation in the post-privatisation framework this remains important. As activists they may try to influence policy by lending support to one of the special interest groups that have been sanctioned by, and are flourishing under the post-privatisation regulatory regime. As customers they may shape policy by using their local CSC (now WaterVoice) to raise their concerns over specific issues. As consumers they may influence strategy by either adopting or resisting company-promoted water management policies such as demand management and associated water saving technologies. As shareholders they may attempt to influence
company management at annual meetings. The government is also responsive to shareholder concerns because they still aim to widen the number of individuals investing in the stock market, as part of a general economic policy designed to encourage savings and investment in private pensions. Though the list of opportunities for involvement is long this is not meant to imply that water users are a powerful force in directing the trajectory of the Government’s water policy. This was not the case before or after privatisation; as long as public participation is restricted to ‘back room’ lobbying or mere consultation then users will be kept on the periphery of decision making.

Of all these roles though, privatisation and subsequent restructuring of the industry has tended to reinforce the recasting of water users as customers. Prior to privatisation water-users were seen as citizens; post-privatisation, they have been regarded primarily as customers. Privatisation entailed a transformation in ownership and regulatory structures (Foster, 1992; Newbery, 1999; Vickers and Yarrow, 1988) which implied a change in incentive mechanisms. Private ownership introduced the profit motive, backed up by shareholder pressure and City scrutiny. Price-cap regulation and comparative competition between equity-financed private companies introduced a new efficiency incentive. The role of consumers within this new incentive structure differs distinctly from the role of citizens in the pre-privatisation model. Water users no longer exercise their collective voice through public policy mechanisms. Rather, they have a new mode of influence – as individuals exercising their rights as customers, supported by a regulatory framework in which duties to protect consumers are legally imposed on regulators and were manifested through the Customer Service Committees. Until recently this shift has been in the interest of both the government and the private water companies. From the perspective of the state it accords with the bigger context in which the government discursively shifts the burden of keeping water users content onto private companies and scales down the expectations of what a water user imagines they have the right to demand. From the perspective of the companies it provides a discursive strategy through which to pursue a project of representing water as an ordinary commodity no different from any other.

Currently, an individual water user who wishes to influence the government’s water policy is invited to pursue three main avenues. They can

- contribute to debates at their local CSC (or WaterVoice group) by attending meetings or by seeking to be appointed to the committee
- participate in consultation as an individual
- participate in consultation through membership of an NGO.

Yet, if one of the groups currently involved in the operation of water supplies (for example OFWAT or a Water Company) wants to make a statement about public opinion they will tend to solicit a specialised sample survey from a polling company rather than turning to existing structures. So from the perspective of the water supply companies, current participation appears to be untrustworthy or insufficient; it does not seem to give them the answers they want. Whilst public participation is now widely seen as a necessity in conflicts around water resource management in England and Wales, it does not seem to have similarly captured the imagination of protagonists in conflicts over water services. OFWAT have undertaken a number of seminars and workshops as part of the process of developing new policy proposals (on such topics as customer bad debt,
depreciation and capital maintenance), but such experiments have been limited by issues of practicality.

Political theorists have argued for the importance of reconnecting the public to government policy-making through structures of deliberation (Habermas, 1996; Benhabib, 1996; Dryzek, 2000; Mouffe, 2000). In addition crises associated with food, environment and technology (mad cow disease, nuclear waste disposal and genetically modified organisms) have reinvigorated public action in the UK and made transparent the substantial differences of view between different stakeholders. Over the last decade there has been an increasing recognition of the limits of the market as a mechanism for resolving contradictions between different interest groups, timescales, and spatial scales. In this context of an awareness of ‘market failure’ there has emerged a notion of ‘governance’ as a new normative model for steering conflicting interests in a mutually productive direction. This vision entails horizontal arrangements in which state, market and other actors agree to cooperate in an attempt to overcome their differences (Jessop, 2001). In this model citizens are reconstructed as one stakeholder amongst many. They have a right, and a responsibility, to participate in the project of resolving contradictions by becoming involved in governance arrangements (Spangenberg, 2001; Schmitter, 2002). In effect what emerges is a form of participatory governance that insists on some form of inter-personal reasoning as the guiding political procedure and argues that politics is essentially a public rather than a private act. Giving reasons for your opinions and listening to other stakeholders is central to this form of environmental governance. Such a vision requires a government that is responsive to public wishes, firms that are willing to participate openly and citizens who are capable of deliberation and are willing to set aside their strategic concerns. In the past both states and markets have failed to govern the environment successfully, and it would be unduly naive to imagine that governance arrangements are not also capable of failure. Nevertheless a commitment to engaging relevant social actors in an ongoing dialogue and process of mutual reflection has more potential to develop a range of strategies for anticipating failure and responding to it. This requires a commitment to creating conditions in which the scope for such deliberation is maximised by subordinating the influence of both market forces and also state intervention, a commitment, which is currently lacking in England and Wales.

Giving consumers of services such as health, education and utilities more control over service provision has received significant and growing attention within England and Wales (Mayo and Moore, 2001b), including high-profile support from some Labour MPs (www.themutualstate.org/). It may be that the state is ready to hand over some decision-making power to water users through more imaginative strategies than consultation. Advocates are calling for a transformation of the institutions and mechanisms of participation that would be organised around the concept of stakeholding and use structures such as citizens juries to actively involve the public in actual decision-making as opposed to mere consultation (Giddens, 1988, 2000). This transformation will not only continue a long-standing tradition of using participation as a strategy of citizen education, but also will (it is claimed) by-pass equally longstanding claims that participation is largely about justifying pre-determined bureaucratic decisions. It is as yet unclear whether the new Consumer Council for Water will emerge as merely another contributor to policy consultations like any other or whether it will provide an arena in which water users can become involved in decision-making as a matter of course.
Turning to the capacity of individuals to influence water companies, this paper argues that restructuring initiatives to date have not significantly altered the role of customers in water company management. The limited degree of participation available to customers is in part attributable to the contradiction in the regulatory framework between the obligations placed on the economic regulator (i.e. efficiency gains and permitting companies to finance their functions) and perceived impacts of greater consumer participation (i.e. decrease in efficiency incentives). Water customers are sanctioned stakeholders when they demand better, more efficient services. However, water consumers asking fundamental questions – for example, should we prioritise productive efficiency over all other goals? – have no formal, practical means of participating in water company policy-making or of influencing water company decision-making.

Privatisation and restructuring of the water industry has had only limited impact on an individual water user’s capacity to influence the government’s policy on water or the behaviour of water companies. The existing formal mechanisms for participation do not appear to be that much more significant than the wider range of longstanding participatory strategies. Water users remain dependent on penetrating the lobbying networks of the state via sanctioned pressure groups. However, as this analysis has pointed out, recent developments in the corporate structure of the privatised water companies and in the governance of public services in Britain may have a much more significant impact on meaningful participation in water management by users.

References


Water governance and water users in a privatised water industry


www.themutualstate.org/.
Notes

1 For references specific to developing countries, see Chambers (1983), World Bank (1994) and Long (2001).
2 For references specific to North America, see Arnstein (1971), Rosener (1983) and Beierle and Cayford (2002).
3 Another model that has been suggested is that of ‘thin equity’ – companies with a thin layer of participating shares, but not ordinary shares. No water company has made concrete proposals for restructuring along these lines.
4 A mutual is a ‘not-for-profit’ corporate body set up for the benefit of members, who hold shares in the mutual. These ‘shares’ are different to those issued by a company limited by shares, as the maximum value permitted to be held by any one member is limited, and there is no requirement for the total number of shares to be limited (it is usual that no limit is set). In some mutual models, members may be liable for any amounts unpaid on their sharehold in the event of liquidation of the company. Profit is used in the manner prescribed by the rules of the mutual – typically, either reinvested or distributed among members. The Registrar for Friendly Societies, registers mutuals and cooperatives and operates under the Financial Services Authority.
5 A securitised company is limited by guarantee and owned by its members rather than shareholders. Securitisation is the financing process whereby assets are sold to a new company, in order to be repackaged as marketable securities for sale to investors. The RCAM is not a conventional mutual – but they used the terminology.
6 This decision must be understood in the context of a process of the devolution of political powers to the regions of the UK. According to the Glas Cymru website the aim of the securitisation was “to restore ownership and control of Welsh Water to Wales” (http://www.glascymru.com/english/about_set.html; accessed 16th October 2001).
8 Glas Cymru is prohibited from diversifying into other activities, both by its Constitution and by an undertaking to OFWAT that it will not change the constitution without first consulting with the regulator (Utilities Week, 2001b).