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**NEW ZEALAND WATER AND WASTES ASSOCIATION
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THE WATER IDEOLOGUES

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Abstract

New Zealand is lagging many other countries in water industry reform and failing to realise the potential for achieving major consumer and environmental benefits. Many of the obstacles to change are political.

This paper considers arguments that are typically advanced in opposition to proposals to operate water and wastewater services on market-oriented lines and introduce private sector participation. It explains why they are largely based on either ideology or mistaken analysis. Water industry professionals need to challenge politicians and the wider community to find better ways of managing a costly and increasingly scarce resource.

Introduction

I believe there is little need to persuade an audience of water industry professionals of the case for water industry reform in New Zealand. In professional circles the arguments are broadly accepted. No less an authority than Alliance MP Laila Harre has said that "every consultant in this country will advise you to corporatise, to commercialise and to privatise."¹ However, she went on to say: "They are all wrong". Clearly the obstacles to water industry reform are not technical but political and ideological. It is these obstacles I wish to address in this closing session of your conference.

Water industry reform should be defined. I am talking primarily about the supply of water, wastewater and stormwater services to towns and cities. The main elements of a water industry reform strategy would include proper pricing of services where it is economic to do so; the provision of services through commercial rather than bureaucratic structures; the involvement of the private sector as manager, operator or owner of water supply assets; and the use of mechanisms such as tradable permits to allocate water where supplies are scarce. All of these elements have the common feature of moving water supply away from political control and towards the normal market environment in which consumers interact with suppliers to obtain most of the goods and services they need.

Market-oriented reforms have been implemented in most other industries and utilities in New Zealand and around the world, initially in the face of much the same kind of political and ideological opposition as we are seeing today with water. But in the light of experience, socialist arguments for the 'public ownership of the means of production, distribution and exchange' are not easy to sustain nowadays. Reforms in the water industry have the potential to achieve the same kind of efficiency gains and unleash the same kind of innovations that we have seen in one

¹ Interview with Jenni Anderson on Radio Pacific, 22 May 1997.

industry after another following market-oriented reforms. It is time to expose and challenge the arguments of those still entrenched in support of political control.

Opponents of market-oriented reforms have a habit of labelling them as 'ideological'. The word embodies the two terms 'ideas' and 'logic'. In this sense, every policy position has a body of ideas and logic behind it: the debate is over the quality of the ideas and the logic. More often, however, the term ideologue is used to denote someone who is impervious to evidence and analysis. My position is that there is now a large body of evidence in favour of market-oriented water industry reforms. In this paper I want to look at who the true water ideologues really are.

It is not hard to recognise the basic ideology behind the opposition to market reforms. Laila Harre tells us that commercialisation means running water and wastewater services at a profit, and of course profit is an obscene word. David Close, a Christchurch city councillor, tells us that it is the lure of profits that is causing private companies to turn "their greedy eyes" on council-owned assets.² He also says "there is no reason why private sector providers will be more efficient than public sector providers".³ Margaret Murray of the same council says private ownership would mean increased charges for consumers.⁴ Noeline Forsyth in a submission to the Auckland City Council tells us that water is owned by the people, "it is produced free", and that we should cut out the middlemen - the wholesaler and the retailer. Stuart Macaskill, chairman of the Wellington Regional Council, wants a publicly owned regional monopoly.⁵ Jim Delahunty, a long-time socialist theoretician, is leading an action group to protect "vital and necessary community-owned assets".⁶ We can recognise in all these statements the language of the collectivist ideologies that held sway in many parts of the world until less than a decade ago.

I have dealt with the economic logic - or rather the lack of it - of many of these arguments in a recent paper and will not traverse the same ground here.⁷ Instead I will focus on the ideological and rhetorical arguments in the debate and bring out the refusal of the reform opponents to confront facts and experience.

² *The Press*, 12 July 1997.

³ *Sunday Star-Times*, 13 April 1997.

⁴ *The Press*, 18 July 1997.

⁵ *The Evening Post*, 2 July 1997.

⁶ *The Evening Post*, 20 June 1997.

⁷ Kerr, R L, 'Reform of New Zealand's Water Utilities: The Snail's Pace of Progress', paper presented to the AIC 1997 New Zealand Water Management Conference, 24 March 1997.

Arguments against market-oriented water reforms

'Water is an essential commodity'

It is often said that water is essential to life, with the implication that this rules out market provision. Yet much else, such as food, is essential to life, and probably not even the old guard in the Kremlin would insist today that food production and restaurants should be publicly owned. The amount of water that is in fact essential to life is very small - most is used for other purposes. Moreover, water is not an expensive commodity in New Zealand - in the Wellington region the costs per resident range from \$1.10 per cubic metre to \$1.38. The average household's water bill is low compared with what it spends on liquor (\$17.60 a week) and is comparable with its expenditure on gambling (\$6.10 a week). Some facts and a sense of perspective in this debate would not go amiss.

'Water is a precious asset'

Speaking to Laila Harre, interviewer Jenni Anderson described water as a "precious asset". This is almost the reverse of the previous point, and certainly of Noeline Forsyth's argument that it is produced free. Anything that is scarce has value, and the treatment, reticulation and discharge of water is obviously very costly. Moreover, the scarcer and more precious any commodity is, the more we usually want to ensure it is priced, put to its most valued use, and not wasted. Hence Deputy Prime Minister Lee of Singapore recently announced a four-fold increase in water tariffs for domestic users in that country saying the government wanted "to drive home the point that water was a precious and strategic resource."⁸

'The next thing they'll want to privatise is air'

It doesn't actually follow in logic that because it is a good idea to privatise a steel mill or an airline it is also a good idea to privatise the police, the courts or the military. If pure air is not scarce, no direct costs of supply are involved, people can't be excluded from consuming it, and so there is obviously no point in pricing air (other than boutique supplies in cans). On the other hand, air space may be rationed or priced (e.g. by height restrictions on buildings). So too with the radio spectrum, which is also scarce. In some areas, pure air is scarce because of emissions. In those situations emission controls (e.g. bans on open fires), taxes and tradable permits are possible solutions. These amount to pricing air. Moreover, if action against global warming turns out to be justified, similar strategies will need to be applied. It is strange to say the least that councils such as Christchurch and environmental groups which promote such approaches for air are opposed to the use of the same mechanisms for water.

'Water assets are owned by the public'

Apart from the quite extensive private rights to water and the examples of private ownership of water supply systems, this is true in New Zealand's case. But public ownership does not mean

⁸ *The Australian Financial Review*, 17 June 1997.

ownership by politicians - the true owners are individual ratepayers. Clearer property rights in water assets would be established if ratepayers were given proper title to them in the form of shares. They would then have the choice of deciding whether to hold or dispose of their shares, or if the council sold water assets they should receive the proceeds.

Clearly public ownership does not imply costless supply. Large expenditures are involved in building and operating water and sewerage systems. The only issue is whether they are financed by user charges or rates.

'The need for profits will push up prices'

This was the cry of the Kremlin central planners for 70 years. Curiously, experience showed it was the West that produced cheaper and better goods. 'Cutting out the middleman' did nothing to improve efficiency. To the contrary, the lack of a profit requirement simply bred cost-padding and waste, as we saw in New Zealand in organisations like ports and power companies prior to corporatisation. The introduction of normal commercial disciplines, including the requirement to make a profit, has typically pushed down prices in real terms, often dramatically so. The ideologues seldom acknowledge this point. The belief that the profit motive leads to higher prices overlooks the point that it provides a strong incentive to identify what consumers value and to meet their needs at least cost. Watercare Services has recently said that preventing it from paying a dividend to its owners leads to under-pricing, overuse and ultimately higher costs. Many who profess to be concerned about consumers and the environment never seem to get the point: Alliance MP Jeanette Fitzsimons still managed to describe Watercare's concern to reduce costs by operating like a normal business as "fleecing the public".⁹

'Public enterprises perform as well as private enterprises'

I often wonder what people like David Close make of the worldwide move to privatisation - one of the most dramatic trends of our time - and the evidence of the often vastly improved performance of privatised firms. Maybe they simply haven't noticed: a couple of years ago David Close stated at a local government conference that a right-wing regime was still in power in Chile and wrote that the office of the Business Roundtable was in Auckland. Maybe they are just in denial, and no amount of research evidence will change their minds. The point David Close makes that "there will be efficient and inefficient providers from both sides of the divide"¹⁰ is true but quite irrelevant as a guide to sound policy. The evidence now shows unmistakably that government-owned companies on average and over time perform less efficiently than privately owned companies.¹¹ Politicians who resist these findings on ideological grounds are recklessly gambling against the odds with taxpayers' and ratepayers' money.

⁹ NZ Herald, 22 August 1997.

¹⁰ Sunday Star-times, 13 April 1997.

¹¹ For a summary, see The Treasury, 'Briefing to the Incoming Government', 1996, The Treasury, pp. 116-119.

As long as local government ownership is locked in, there are dangers of poor governance compared with the private sector. The absence of contestable ownership means efficiency is likely to suffer. Political and commercial objectives are likely to be confused, even if structures are put in place to help cope with that problem. As well, ratepayers are forced to bear unnecessary commercial risk, and councils are diverted from their core role of ensuring the provision of genuine public goods.

'Water supply is a monopoly industry'

Even if this were true, it would not constitute an argument against corporatisation or privatisation. The stock exchange and the banks' clearing system are or were quasi-monopolies, but few would argue they should not be run as businesses or be privately owned. However, as Simon Hunter has recently pointed out, there may be a monopoly "for the network of pipes but not for the products and services provided through those pipes".¹² He added that "[i]t is clear that the 'water industry' is still a pipe-industry dinosaur". It will be even more of a dinosaur if people like Stuart Macaskill have their way and enforce a network services monopoly on the Wellington region.

Moreover, there are some substitutes for water, and some sources of supply other than public systems, so market power is not entirely unconstrained. There seems nothing about the water industry that New Zealand's regulatory regimes based on the Commerce Act and information disclosure cannot handle, and any concerns about monopoly behaviour on the part of privately owned water companies are no more serious than with Local Authority Trading Enterprises (LATEs) which also have a profit objective. Many councils are corporatising their water operations as LATEs or are considering doing so. Clearly they are satisfied that the combination of these regulatory regimes and the existence of some forms of competition in the industry are adequate controls on monopoly behaviour. If these arguments are accepted for corporatisation, no further issues are raised with privatisation.

Evidence on water industry reform

Fifteen years ago there was limited evidence on the benefits of commercialisation, corporatisation and privatisation, for the obvious reason that such policies had not been applied on a wide scale. Today there is abundant worldwide evidence of the effects of such reforms, including for utilities that are directly comparable to water. And, for several years now, evidence which has been accumulating on water industry reforms which ought to be compelling to anyone whose mind is not ideologically closed. There is only space to touch on only a few examples of such evidence in this paper.

¹² Hunter, S, 'The Water Industry Enigma', *New Zealand Strategic Management*, Autumn 1997.

Charging for water

Usually the first step in reform should be to introduce an efficient system of charging for water. As the London *Financial Times* recently stated in an editorial:

There are three ways to allocate a scarce resource: by price, by rationing or by wringing your hands in public and asking people to behave more responsibly. The last is traditionally favoured by British politicians trying to match demand for water to supply from dried up reservoirs and leaky pipes.

In most industrialised countries, water is metered and paid for by volume. But in the UK, about 90 percent of domestic users still pay a fixed annual water charge. So in hot dry weather they soak their lawns with high-quality drinking water.¹³

A trial by Watercare and the Auckland City Council found that non-metered domestic consumers used around 35 percent more water than metered domestic consumers. A study for the Wellington Regional Council found that residential metering would reduce daily consumption by 20 percent and peak consumption by up to 50 percent. At least 11 councils are now introducing user pay policies or considering doing so. A recent report by the Industry Commission in Australia has recommended moves to full-cost water pricing and tradable water entitlements to reduce water wastage in that country.

Owen Cook, communications manager of Watercare Services, is reported as saying the only way Waitakere City can reduce city-wide water consumption is by rationing.¹⁴ He is said to be lined up with David Close against industry reforms. I would welcome public debate on whether Soviet-style rationing and queuing is the only - or the best - strategy for consumers in New Zealand.

¹³ *Financial Times*, 20 May 1997.

¹⁴ *Sunday Star-Times*, 13 April 1997.

Water industry reforms in Britain

Opponents of reform in New Zealand seem to know very little about overseas water industry experience other than the reforms to the British water industry since 1989. It has always escaped me why Britain, which has hardly started to introduce a sound charging policy for water and where the industry is in many ways run by a regulator, should be a subject for special attention in considering options for reform in New Zealand.

I have recently given my overall interpretation of British water industry experience¹⁵ and will only add two points here.

The first is that its New Zealand critics frequently cite highly misleading or inaccurate data. For example, Jeanette Fitzsimons recently stated that prices have increased on average by 159 percent since privatisation,¹⁶ though elsewhere she has claimed that they have "tripled to the New Zealand equivalent of \$1,000."¹⁷ However, the Office of Water Services (Ofwat) has recently said that the average annual bill for water services has risen by about £45 in real terms in the five years since privatisation (representing a real increase of about 25 percent.¹⁸ It estimated that £30 of this increase was due to higher standards for drinking water and environmental quality, £10 for growth in demand and £5 for improved service standards for customers. Moreover, what Ms Fitzsimons did not point out was that the price increases in the first five years were sanctioned by the British regulator to finance investment requirements and that the price limits recently set for the period 1996-1999 are 1.5 percent p.a. and for 2000-2004 just 0.6 percent p.a. The need for large capital expenditures arose because supply systems had been allowed to run down under political control, and indeed was a major reason for privatisation. It is also clear from other studies that "[a]lthough bills have risen to finance the new capital assets, they have not risen as much as they would have as a public authority."¹⁹ This is the relevant benchmark when judging the effects of privatisation.

Similarly Ms Fitzsimons has claimed that investment in water supply "fell by 20 percent in the last year".²⁰ What she fails to point out is that, according to a recent NERA study,²¹ capital expenditure by the water service companies totalled around £16.2 billion in the *six* years since privatisation, at 1995/96 prices. In the same price terms, slightly less than this amount was

¹⁵ Kerr, *op.cit.*

¹⁶ *Wanganui Chronicle*, 22 April 1997.

¹⁷ *Sunday Star-Times*, 6 July 1997.

¹⁸ In the National Audit Office Report on The Work of the Directors General of Telecommunications, Gas Supply, Water Services and Electricity Supply (1996), p. 260.

¹⁹ Peter Matthews, 'A Suitable Case for Privatisation', paper presented to the 1997 AWWA/WEF Joint Management Conference, San Francisco, 23-26 February 1997.

²⁰ *Sunday Star-Times*, 6 July 1997.

²¹ 'The Performance of Privatised Industries', a report by National Economic Research Associates (NERA) for the Centre for Policy Studies, February 1997, Volume 4, p. 156.

undertaken by their predecessors over the *thirteen* years preceding privatisation. Naturally the rate of investment is falling off as water companies have been catching up with the backlog.

The second point is that even when the critics get their facts right, they seldom attempt to paint a fair and balanced picture of the British water experience. It is true that there have been some weak features, which is hardly surprising given deficiencies such as the absence of metering and a heavy-handed regulatory regime. But studies clearly show that most trends have been positive "across most dimensions of service quality, especially in the areas of drinking water quality, river quality and compliance with discharge consents."²² The NERA study, which is one of the most comprehensive on the industry to date, ranked water on a par with telecommunications as the most successful British privatisation. One would hardly judge that to be the case by listening to talkback radio callers in New Zealand who only seem to have heard of the increases in water company chief executive's salaries (which don't appear to be at levels which are anything out of the ordinary for what are very large companies).

Reason Foundation study

Privatisation in the water industry can take many forms - such as management contracts, leasing, franchising and build-operate-transfer (BOT) schemes - all of which are worth exploring. In many cases, however, I suspect the largest benefits will accrue from full privatisation. A recent study by the Reason Foundation looked explicitly at the differences in performance between private (investor-owned) and government water systems in California. It found that:

- investor-owned water companies provide comparable water services to consumers at the same price as government-owned water companies, even though they pay taxes;
- investor-owned companies are substantially more efficient in their operation of water services than government-owned water companies;
- it is likely that government-owned water companies spend more on facilities than investor-owned water companies; and
- governments can better regulate an investor-owned water company than a government-owned water company.²³

²² NERA, *op.cit.* p. 48.

²³ Neal, K, Maloney, P J, Marson, J A and Francis, T E, (1996), *Restructuring America's Water Industry: Comparing Investor-Owned and Government-Owned Water Systems*, Reason Foundation, Los Angeles.

Drawing evidence like this to the attention of people like Stuart Macaskill makes little impact. He declined to comment on it and in response to a similar effort of mine to present information on a flawed consultant's report on the Wellington Regional Council's forestry assets he wrote:

... we have followed reputable private sector consultancy advice and he has rolled out his tame consultants to find fault. I wonder who is right?²⁴

This shows no interest in getting to the truth of issues. To avert argument altogether, Mr Macaskill has even proposed that central government should prohibit privatisation by an act of parliament. Such a position sits oddly with the local government sector's normal protestations about the importance of local democracy and council autonomy in decision making.

Privatisation of the Manila Water and Sewerage System

The world's largest water industry privatisation this year has been the Manila Water and Sewerage System. MWSS is a government-owned enterprise supplying water and sewerage services to the whole of metropolitan Manila. Sixty percent of the water it puts into supply either leaks or is stolen. About half its customers do not receive a continuous, 24-hour water supply. Cholera outbreaks, caused by sewage getting into water pipes that do not have positive pressure, are relatively common.

MWSS's operational area was split into two, and in January this year 25-year concessions were offered for each. The government published a standard concession contract, including provisions for the adjustment of prices under a range of carefully defined circumstances and a set of demanding targets for improving the quality and coverage of both water and sewerage services. Bids were invited in terms of the percentage by which the would-be concessionaire was prepared to reduce the existing average unit supply price.

The results astounded all concerned: from the June handover date, prices in the west area of Manila have fallen by 43.4 percent, while the winning bidder in the east contracted to reduce prices by no less than 73.6 percent. It would be interesting to put incumbent water suppliers in New Zealand to the same market test.

Private water supply in New Zealand

It has always been a source of some amusement to me that in one of the Alliance's fastnesses, Waiheke Island, water is privately supplied. But Waiheke is not an isolated example. It may come as a surprise to some of New Zealand's water ideologues to learn that nearly one half by number (much less of course by volume) of New Zealand's water supply schemes are privately owned. The Register of Community Drinking Water Supplies in New Zealand (Ministry of

²⁴ *Management*, May 1997. To be fair, other members of the Wellington Regional Council have shown more interest in examining evidence and analysis.

Health) lists 427 community drinking water supplies which are provided by bodies or individuals other than local authorities. This compares with 478 communities supplied by local authorities. Furthermore, much use of water occurs outside of reticulated systems. Many commercial users pump water from bores or other sources under their own consents; industry overall obtains 66 percent of its requirements from its own sources. Some 13 percent of households rely on private provision through rainwater, bores and the like.

The great majority of the water supplies run by bodies other than councils are institutions like schools, holiday parks, hotels, prisons and hospitals. These range in size from Massey University which has two bores providing capacity for a population of 10,000 through to schools collecting rainwater from their roofs for a population as low as 25 students.

Some 90 community water schemes are providing water to larger communities. The largest ones are run by or on behalf of military bases. Serco operates water schemes serving populations of 3,000 at Linton Army Camp, 2,800 at Waiouru and 1,000 at Ohakea. In addition, the Army itself operates a scheme servicing 1,700 at Burnham Military Camp. The Kaiangaroa Forest Village Trust operates a scheme servicing a population of 700. The Doubtless Bay Supply company in Mangonui supplies 1,200 people. In other cases water is supplied to communities as a by-product of other activities. New Zealand Steel provides Taharoa Village with water for 400 people. ECNZ supplies several communities with small quantities of water including 100 people at the Ohaaki marae. Similar, but generally smaller, examples can be found for a range of food processing industries including meat works and dairy factories.

I can only assume that people like Laila Harre and Jeanette Fitzsimons lie awake at night worrying about the exploitation of consumers, risks to health, and other evils that these operators are perpetrating daily.

Conclusion

I conclude that the case for market-oriented reforms of New Zealand's water industry is overwhelming. Jeanette Fitzsimons has argued that such reforms would take us back to the horrors of British nineteenth century water supplies. That does not seem to be borne out by recent British experience. If Ms Fitzsimons wants horror stories, she can find them much closer to hand. For example, a recent article reported that civic pride in Dunedin:

... was badly dented as a result of the council getting a provisional Ee Water rating from the Ministry of Health. The E meant that the quality of water leaving the treatment plants was "completely unsatisfactory", and involved a "very high level of risk" of protozoa such as giardia and cryptosporidium entering the water supply.²⁵

More recently the *Otago Daily Times* reported an interesting discovery by the council:

Previous calculations of the extent of sewage pipes in the city had been inaccurate, and new records showed there was 500 km less than thought.²⁶

That sounds like a lot of pipes. I suspect most private owners would be concerned to find such a quantity missing. However, I am not holding my breath in anticipation of mayor Sukhi Turner implementing market-oriented reforms.

Indeed I am not optimistic in the short term about progress in the water industry in general - I observed recently that it was advancing at a snail's pace. This is one of many areas where New Zealand is now falling well behind the rest of the world. With honourable exceptions such as David Hawkins, few civic leaders are prepared to put relevant information in front of their communities and make the case for change.

Water supply is essentially a private service, which is why consumers are charged for its use in most countries that are comparable to New Zealand. It is not a public good for which market provision is infeasible. Its benefits accrue primarily to users. Some councils continue to perform contortions trying to deny this obvious fact. The Wellington City Council managed to persuade itself this year that 75 percent of the benefits of water supplies went to non-users, citing as one of these benefits "improved bodily aroma in confined public spaces"!

The evidence in favour of reforms is any longer in doubt. On both economic and environmental grounds, it points overwhelmingly to the benefits of market solutions, with governments playing much more limited roles - essentially regulating for quality and controlling any risks of market power in the industry. But that evidence will not impress the water ideologues. They are not

²⁵ *New Zealand Local Government*, April 1997, p. 23.

²⁶ *Otago Daily Times*, 11 August 1997.

interested in what actually works: not for them Deng Xiaoping's attitude that "it doesn't matter whether the cat is black or white, so long as it catches the mouse." Where they are not simply misinformed or confused, their agenda is to maintain political control and their own position of power. Only a shift in community attitudes can change that situation.

Spokespersons for business organisations are suspected of having vested interests in the reform debate. In logic, such perceptions are easily countered, even in the case of outright privatisation. Given a competitive bidding process, investors could not expect to obtain higher returns from investments in water than from a worldwide menu of alternatives open to them, and if politicians cannot understand that argument a satisfactory alternative would be a share giveaway. Moreover, if the ideologues' view that prices would rise is right, how could businesses, which derive a third of their requirements from public systems, have a vested interest in privatisation? But opponents of reform will ignore those arguments, and many in the community will believe their rhetoric.

This is where industry professionals like yourselves have a major role to play if New Zealand is to catch up even with near neighbours like Australia on water industry reform. If the views of politicians who are ideologically driven or misinformed are allowed to go unchallenged on this and other issues, New Zealand will drift back to becoming a second-rate country again in a few short years. You understand more than most the potential gains from better approaches. You can encourage elected politicians to look at experience elsewhere and talk to firms that can bring new expertise into the industry. And as professionals, I suggest you have a professional duty to inform the wider community about the opportunities we are sacrificing by not pressing ahead vigorously with water industry reforms.