

ECONOMIC REGULATORY FRAMEWORK FOR THE PUBLIC IRISH WATER SERVICES SECTOR CONSULTATION PAPER CER/13/246, 30 OCTOBER 2013

This note sets out my responses to the first two questions in the CER's consultation paper 'Economic regulatory framework for the public Irish water services sector - Consultation Paper CER/13/246, 30 October 2013.

Questions for respondents:

Q1. Do you agree with the proposed principles of the regulatory framework? If not, then please explain why.

RPI-X - The RPI-X is a simple principle but rather crude. If such an approach is used, it would make sense to use an index, other than the RPI, which better reflects the cost base of the water services sector. This will reduce financial risk to Irish Water and its investors and should thereby reduce the cost of capital and the price of water. It will also reduce the need of the CER to make adjustments because of the progressive divergence between the CPI and the inflation of Irish Water's costs.

A 'Water Sector Costs Index' (WSCI) can probably be constructed from existing indices, including RPI, by weighting the water services sector's main cost drivers such as construction costs, energy costs and public sector wages. Such an approach might look like

WSCI – X (rather than RPI-X)

where

$$\text{WSCI} = (a \times \text{RPI}) + (b \times \text{CCI}) + (c \times \text{ECI}) + (d \times \text{PSWI})$$

and

WSCI = Water Services Cost Index

RPI = Retail Price Index

CCI = Construction Cost Index

ECI = Energy Cost Index

PSWI = Public sector wages index

a, b, c and d are weightings based on an analysis of the water sector cost base (and can themselves be revised every six years), and $a+b+c+d=1$

This is a concept. If appropriate cost indices do not exist in Ireland (they do in some countries), some alternatives might be used or indices created by the bureau of statistics.

Q2. Are there any further/alternative principles of a proper regulatory framework that the CER needs to consider / or principles that need to be removed from the above list? If so, please provide an explanation for inclusion/exclusion.

Yes, competition, consultation, environmental and social sustainability, and value-for-money in regulation:

Competition – Effective competition is usually better at ensuring appropriate pricing than is regulation. Although networks may be natural monopolies in Ireland, there are other areas where ‘competition for the market’ can be used to control prices; for example, competitive procurement of goods and of operating and maintenance services. In the French water services sector, competition for service provision has played a more important role than regulation in price control. Using effective competition, wherever possible, should be a principle of price regulation for water services and the CER should promote this.

Consultation - The proposed principles are fine as far as they go but miss out a key principle required to balance the needs of the various stakeholders: consultation. CER should adopt as a principle a consultative approach involving consultation with all concerned stakeholders, particularly customers – the intended beneficiaries of regulation - but also Irish Water and its delegated service providers, the local authorities, and the other regulatory bodies that drive costs – the EPA. In section 5.4 Transitional Arrangements – Opex, the CER makes some critical assumptions about the ability of local authorities to achieve ‘significant efficiencies’. The CER should be consulting with the local authorities to get a better understanding of the local authorities’ situation which it should use to inform its regulatory decisions, particularly in early years.

Environmental and social sustainability – the proposed principles focus almost entirely on economic sustainability. Regulation should also have as a principle both environmental and social sustainability and should be compatible with and further the government’s policy on sustainable development as set out in its document ‘Our Sustainable Future’ published in June 2012 (attached). This paper outlines the policies that will guide Ireland’s sustainable development to 2020. It therefore sets the framework within which CER should regulate water services in Ireland. (The paper refers to the CER.).

In line with this paper, and transcribing text almost word-forward, the CER’s regulation of water services should:

1. Create a sustainable and resource efficient economy founded on a fair and just society, respecting the three core pillars of sustainability: the environmental, the economic, and the social;
2. Achieve positive economic, environmental and social outputs while at the same time ensuring equality and an appropriate balance between the three core pillars of sustainability.
3. Integrate Environmental and Social Indicators into Measures of Economic Progress

Value for money regulation – CER should ensure that its drive to ensure value for money in the water services sector includes its regulation. In this case, the CER should consider outsourcing the mechanisms of regulating the water services sector to OFWAT in the UK. This would offer economies of scale, facilitate benchmarking, take advantage of many years of accumulated experience, and reduce the risk of ‘regulator capture’ of the CER’s water activities by Irish Water and other influential sector players. It would probably be less costly too.

Keith Stallard

Katalyst21

keithstallard@katalyst21.com