

## **Nick Herbert: Putting water management on a sustainable footing**

I would like to thank Marketforce and the Institute of Economic Affairs for hosting this, their 10th annual water conference and inviting me to provide the closing address.

As other speakers have said, this conference is extremely timely. The water industry is facing a number of very significant challenges over the coming years.

Changes need to be made now in order to meet those challenges and ensure a strong industry and a sustainable supply of water in the future.

### **The Key Challenges**

Before the parliamentary recess the Government published its climate change projections, which offered a stark warning of the problems ahead. These are effects which, regardless of the measures we take on mitigation and any deal reached at Copenhagen, will happen as a result of the greenhouse gases we have already produced since the industrial revolution. The projections show a reduction in summer rainfall of up to 28 per cent in the next decade and an increase in winter precipitation of up to 14 per cent.

Over the next two decades, the population is expected to rise by 10 million. There will be further housing development and continued pressure on supplies. With climate change having a significant impact on supply, we will need to prepare for long dry periods such as those in the summers of 2005 and 2006, and for potential problems with abstraction as rising temperatures reduce river flows, possibly by as much as 80 per cent in the summer. While overall demand is expected to increase, our supply will be under greater stress.

WWF has warned of the impact this will have, for example, on our chalk streams which are already under serious threat from over abstraction. I will be seeing for myself the damage being done to these fragile habitats tomorrow when I visit the River Itchen.

And this morning I visited the London Wetland centre at Barnes, run by the Wildfowl and Wetlands Trust who, together with a number of other charities and NGOs are calling for 2009 to be made the year to act for water to ensure a sustainable future for our most precious natural resource. Their Blueprint for Water shares many of the themes of the slow water approach which we outlined in our Quality of Life review and warns of the pressures facing our waterways.

Despite these environmental problems some progress has been made, with fish and mammals returning to our rivers in encouraging numbers, but the Water Framework Directive adds further pressure by requiring even greater improvements to our river bodies. The targets set and the measures used to achieve them must be carefully considered so that all those involved - polluters, public and industry - play their part.

Affordability continues to be a key concern to customers, especially those in areas such as the South West. With 13 per cent of all bill payers, and 40 per cent of those on low incomes, currently spending more than 3 per cent of their disposable income on water - the general classification for water poverty - we must continue to be vigilant about water poverty becoming as serious as fuel poverty.

The challenges of climate change, environmental improvement and affordability are considerable, and a variety of reports have already been carried out, or are currently being finalised, to consider them.

The Environment Agency's Water Resources Strategy, the Cave review and the interim Walker review are all welcome for the contribution they make in their specific areas. But in themselves they are only a partial response to the problems and cannot be enough to make the necessary changes. For that, we need a holistic response, leadership and a clear direction from government. Hilary Benn's speech yesterday was entitled 'Presenting the Government's strategy for water', but I've struggled to find anything remotely strategic in it.

The Government seems to have no sense of the importance of these issues. Yesterday the Secretary of State pointed to the fact that the next parliamentary session will be a short one - as if this was not always going to be the case - and warned that there may be water legislation in "two bits", presumably with flood measures coming first, and water industry measures coming after the election. But we are concerned that a Bill may be dropped from this final session altogether. The Government will have serious questions to answer if, two years after the Pitt report, there is not only no legislation for the water industry but also nothing to address the urgent problem of flooding.

The recent consultation on the Cave review showed a worrying lack of enthusiasm for Professor Cave's recommendations. For example, the decision to row back from completely abolishing the threshold on retail competition brings into question the commitment to this, the first step towards greater competition in the industry. The success of this cannot be measured just by savings made by customers. Retail competition, as seen in Scotland, will begin to expose the costs involved in various parts of the value chain and pave the way for competition in other areas.

The disparate water reviews and a lamentable lack of government direction or decision reinforce my view that what is needed is a white paper to tie all these disparate elements together and set out a clear direction for all stakeholders. Should we form the next government we will publish such a white paper as soon as possible.

We are now twenty years from privatisation, which yielded significant results and tackled the problems caused by public underinvestment, but the challenge now is to make sure the industry is fit for the problems of the future.

Our commitment to an early white paper for the water industry will ensure that the good work done to address the challenges I have outlined is consolidated

into a clear vision for the industry. We will also take the opportunity to learn lessons from the latest price review for the future regulation of the industry.

### **Changes Needed**

Our white paper will set out the detailed changes needed to the industry, the regulatory regime and those behavioural changes we need to encourage in customers. I believe that three key principles should underpin our approach: conservation, fairness and transparency.

### **Industry Changes**

As Professor Cave outlined earlier, competition has a significant role to play. Through mechanisms such as tradable abstraction licenses, the legal separation of vertically integrated companies and improving access for new entrants we can move closer to understanding and unlocking the true value of water, improve and encourage measures for water conservation and offer a better deal to customers.

The industry must do more to conserve water itself and help incentivise water efficiency. We cannot continue to apply pressure to customers to reduce their usage if we do not also focus on companies' records. Companies have done much to improve leakage, for example, but more can still be done. Unlocking the true value of water will also encourage greater action on leakage as the level of economic leakage threshold rises.

### **Regulatory Changes**

I have already outlined where regulation has failed to provide fairness for customers when Ofwat were unable to allow companies to deal with charging for surface water drainage in the way they felt most appropriate for their customers. Companies must be given latitude here to introduce innovative tariffs which meet specific local needs and Ofwat must be given the clear direction from government to allow it.

The principle of fairness is particularly relevant at the moment with the Government following our calls to legislate for the protection of voluntary groups from unacceptably high surface water drainage charges. These groups should not have had to wait as long as they did for the Government to recognise the need to protect them, but I am pleased to have encouraged the Secretary of State to act.

Equally, we have already recognised the concern of customers in the South West about the size of water bills. We are continuing to review the options for dealing with this.

The Consumer Council for Water have an obvious role in ensuring affordability, and we need to look at what greater role they can have in the price review process. The scope for negotiated settlements in the price review process is worthy of consideration and we will be exploring this.

In general, we need a new regulatory approach which is more in tune with customers' needs, has a clear focus on sustainability and provides incentives

to encourage responsible behaviour. I believe that environmental regulation works best when it focuses creative energy and innovation on real problems; when the rules are used to generate competition for reward, and to stimulate the striving for success. As I said in a recent speech in Brussels on environmental regulation, I would like to see the design of regulation focus not on constraint, but on the liberation of new approaches and ideas; a process of regulation that does not try to tell people what they cannot do, but sets them goals to achieve, and a clarity to regulation that assumes positive intent on the part of those who steward our natural resources and provides them with the rewards for doing the right thing.

For example, water companies should be given the freedom to encourage better practice by farmers to reduce the amount of diffuse pollution entering our rivers and streams. This both tackles pollution at its source and can save treatment costs in the long run.

The regulatory regime also needs powers to improve sustainability. Notwithstanding proposals for tradable abstraction licences which take more account of the value of water in different parts of the country, we need to encourage a greater sharing of the resource.

After a wet summer, we might have forgotten about the issue of drought. But we have seen very dry summers in the recent past and we will see them again. We live on a relatively small island where some regions are short of water and others which are not too far away have plenty of it. So whenever there is a dry spell, the issue of a national water grid is raised. I think that an actual grid can be ruled out as too expensive and environmentally damaging, but we could find ways of facilitating and incentivising more bulk water trading through a 'virtual grid'.

Regulation could encourage companies to trade treated water, where though the creation of small connections between companies those areas with surplus water could sell to those with less. If company A can supply water to company B more cheaply than company B can increase their own resources, for example through a new reservoir, then a saving can be made by the customers of company B and company A can make a profit.

This model needs more work. But a virtual grid has the potential to reduce both bills and the need for costly capital and carbon intensive projects to increase water resources. And it would help to ensure that water is made available to the areas where it is needed.

### **Behavioural Changes**

Finally, we need to encourage behavioural changes in water consumers to help reduce consumption and ensure sustainability. This is only part of the solution, but for too many this is seen as the only solution. Metering has a role to play, but we need to focus on conservation across the piece, rather than solely on demand side measures.

Even if metering only continues to grow at its current pace, affordability issues will continue to increase. Metering levels are projected to rise to 70 per cent

by 2020. As more and more people shift onto meters willingly an ever shrinking rump of unmetered customers will continue to pick up the tab. I look forward to Anna Walker's final recommendations on how we can help these customers through measures such as innovative tariffs.

As metering increases the industry must not miss the opportunity to get involved in the roll out of smart meters in the energy sector to ensure that customers have detailed usage information. As we outlined in our Low Carbon Economy paper, smart meters can incorporate information on both water and energy use to highlight the links between the two.

And customers need help to save water. The water industry has done much to encourage the take up of water saving devices such as hippos, and organisations such as Waterwise are on hand to offer support to those wanting to reduce their consumption, but business must do more. For consumers to make a positive choice when buying products that use water they need to be given more information. So I propose that a clear, universal, system of water efficiency labelling is introduced.

People are now used to buying electrical equipment and being told in unambiguous terms what its energy use is and how efficient it is. But the current myriad of systems in place for water use and efficiency do not provide the comprehensive point of sale information needed when people are buying, for example, dishwashers, washing machines and bathroom appliances. A clear rating system ranking products based on their water use and efficiency would empower customers to make the right choices and also encourage manufacturers to raise their game in terms of producing water efficient products. Evidence from the Energy Saving Trust shows that nearly two thirds of people are interested in water efficient products, but less than a third know where to buy them.

In Australia a water efficiency labelling scheme has been widely used to incentivise purchases of best in class water efficient products and has been shown to transform the Australian market rapidly. With political leadership here, industry and trade bodies could come together to create a similar scheme which would help the consumer and conservation alike.

### **The Price Review**

Understandably this conference has been dominated by PR09. In March I called for sensitivity to consumers during the process, and I welcome this emphasis in the draft determination. I appreciate that companies have raised some concerns that they need to be able to finance functions and that some problems have been raised. The capital incentive scheme, for example, clearly needs looking at, but this is the point of the process - for Ofwat to listen to representations before 26 November.

I am mindful that when we consider any changes to the sector we need to recognise the industry's need for stability, the potential effect on investor confidence and in turn on the costs for consumers over the long term.

There are more general questions to be raised about the need for reform of the price review process. The current system, requiring literally thousands of pages of data, can lack transparency - a case of too much data but not enough information - and can be overly onerous. Companies spend too long working on business plans throughout the review, taking up valuable resources which could instead focus on innovation.

## **Conclusion**

I believe that there is a general acceptance of the need for change in our national approach to water. Overall, the last two decades have seen considerable improvements to the environment and supply at no cost to the taxpayer. But problems of affordability are growing and the next two decades will bring new challenges. We need to put water management on a sustainable footing for the future, ensuring that both customers and the environment are protected, and that the industry remains a success.

Above all, we now need clear political leadership. That is what a Conservative government would aim to provide.

Thank you.