

Water Charges Plan Consultation, CER/14/366, 31 July 2014

Submission by [REDACTED] 28 August 2014

By email

Introduction

1. In this 'consultation' document the CER presents what it asserts are its proposed decisions on the allowed revenue for Irish Water (IW) and on the water charges that will be paid by households and businesses for the period from 1 October 2014 to 31 December 2016. In its usual self-serving manner it presents a cleverly and disingenuously crafted context for its decisions and sets out 42 questions to direct and guide the responses from those who wish to participate in this process. This has become the standard approach to public consultations not only in Ireland, but in all other jurisdictions where they are employed. The intent is to secure participants' implicit consent to the process, to exclude or deter, so far as is possible, submissions that present substantive criticisms of what is proposed and, if such substantive criticisms are advanced, to provide a format that will allow these criticisms to be dismissed or rejected without assessing their merits or demerits.
2. In addition, the process deadlines are such that no objections to the CER's proposed or final decisions that might result in a delay in implementation will be entertained. The consultation process deadline of 31 August allows the CER less than one month to review the submissions, to craft its response to these submissions and to issue its final decisions (which, inevitably, will be almost identical to its proposed decisions) so that water charges may be levied from 1 October 2014. Such is the nature of 'public consultation' in Ireland.
3. In contrast, in some better-governed jurisdictions, public consultations of this nature are designed to allow a business whose revenues are subject to economic regulation to set out publicly any objections it might have to a proposed regulatory determination – and similarly allows other interested parties to set out any objections they might have. In Britain and in some of those polities which have adopted and adapted the flawed British approach to economic regulation, a regulated business may refuse to accept the proposed and final decisions of an economic regulator. This generally leads to resort to a higher appeal body, if there is one, or to the courts. Generally, sufficient time is allowed between the issue of a final decision and the date for implementation of this final decision to permit any further proceedings to be conducted. But, in Ireland, where most of the directly regulated businesses are state-owned, there is really no requirement to allow for this period of time. The consent of the regulated state-owned business will have been secured prior to the issue of a proposed decision. Indeed, in most cases, it will have dictated the terms of the proposed decision.
4. As a result, this submission begins with an assessment of the target audience for this consultation documented identified by the CER. This provides the basis for presenting the actual, rather than the CER's confected, context in which these proposed decisions were formulated. Establishing the context then provides the basis for responding to some of the more relevant questions posed by the CER and to draw some conclusions.

The Target Audience

5. The CER declares that "[t]his consultation paper is for the attention of members of the public and members of the business community connected to the public water network, the water industry and all interested parties" (Document Information Page). In this way

the CER identifies three groups which are either interested in or have an interest in what is being proposed.

6. However, being interested in something and having an interest in it are two very different things. It is clear that all households and businesses which are connected to the public water and waste water systems will, or would be expected to, be interested in what is being proposed in this document. Having previously funded the bulk of the provision of water and waste water services via their tax payments, this is the first time households will be able to estimate how much they will be paying on a quarterly and annual basis. All they knew up to the end of last month is that all connected households would pay a charge, that the average annual charge would be less than €240 for the next two years, that there would be some free allowances and additional allowances for children and people with medical conditions and that some social welfare recipients will be awarded a payment to help defray the cost of this new bill. Businesses did not know whether the existing commercial water rates would continue or be changed and did not know what they would be paying.
7. It is also clear that those engaged in the water industry, as management, staff or service and equipment providers, either via the continuation of activities under the agreed 12-year service level agreement or via Irish Water (IW), have an interest in what is being proposed. But it is unlikely they will have much interest in what is being proposed. They know full well that their interests have been protected and the extent to which their interests are being protected is well known to them. And it was well known to them long before this document was drafted. It would not have been possible to draft this document until their full consent to the proposed changes was secured. So, while they clearly have an interest in what is being proposed, they will have little interest in it – unless any aspect conflicts with their understanding of how their interests are being protected. And, even if any aspect does conflict, they will not reveal their discontent in the form of a submission in this consultation process. They have far more effective and non-transparent means of communicating their discontent to the real decision-makers.
8. In some respects, the third, 'catch-all' group specified by the CER as "all other interested parties" is the most interesting. At first sight, it presents the CER as being open to submissions from individuals, groups, associations, organisations or firms which might have some knowledge and competence in specific aspects of the water industry or in public policy and economic regulation relating to the water industry. This, of course, is totally disingenuous.
9. All those whom the Government views as having the relevant knowledge and competence either have been involved in the sequence of decisions that led to the drafting of this consultation paper or, if not directly involved in the process, would be, and would be expected to be, broadly supportive of what is being proposed. As a result, none of those who were a party to the decision-making process that led to this consultation document (or those who participate in similar processes in other sectors) have an incentive to make submissions that would offer a critical evaluation of what is being proposed – and every incentive not to. All of these who might be in a position to offer a critical evaluation are compromised, constrained or conflicted to some extent or other. And if any individual involved in this process were minded to offer a critical evaluation he or she would find very rapidly that such a breaking of ranks would be career-limiting, if not career-ending. Therefore, it should not be surprising that the 'consensus' forged remains intact and any critiques that are offered, irrespective of the facts, evidence and analysis on which they are based, are instantly dismissed and rejected without consideration of their merits or demerits.
10. There will, of course, be submissions from the key 'stakeholders' – largely submitted out of courtesy to the CER and to confer some vestige of legitimacy on the consultation

process. To foster the optical illusion of the 'independence' of the CER, some of these submissions may, disingenuously, express disagreement with some minute details of the CER's proposed decisions. But the intent is to conceal the extent of the prior substantive agreement on all key elements of what the CER is proposing. And there may be supportive submissions from other parties who may be able to demonstrate some knowledge and competence, but the intent in these instances is largely to curry favour with the Government and its agencies.

11. However, it will be surprising if there is not a large number of submissions from ordinary citizens and residents, and, possibly, some businesses, either highly critical of, or totally opposed to, what is being proposed. But the Government conveys the confident impression that it believes the legislation establishing IW, empowering it to conduct its business and empowering the CER to regulate the water sector is invulnerable to challenge. There appears to be no avenue either via the courts or using the normal democratic process that should apply between elections that might be used to delay or prevent the imposition of water charges – or to challenge the 'behind-the-scenes' deal that has been crafted among the key stakeholders.¹ Individuals or groups opposing the imposition of water charges employing, for example, elements of civil disobedience are likely to find that such activities have been criminalised.

The Political and Policy Context

12. The entire process of decision-making, since the Government consented to the Troika's demand to impose a system of water and waste water charges, has involved an almost entirely hidden elaboration of a consensus among key stakeholders with high-level decisions being delivered sporadically as faits accomplis. The detail has been hidden from public view and scrutiny until the participation and agreement of all of these key stakeholders were secured. The final link in the chain, the 'imprimatur' of the CER, which, in any event, was never in doubt, is reflected in this document. The key stakeholders stretch, at the top, from the Government, in particular the Ministers for Finance and for Communities, Environment and Local Government and their special advisers, through the higher echelons and relevant sections of these government departments, the managements, staff and unions in the Local Authorities, BGÉ and IW, the CER and the various government or government-sponsored agencies with some knowledge and competence in the water sector to various government-favoured academic, consulting, legal, PR, accounting and advisory individuals and firms. Oireachtas members of the governing parties were whipped to enact the enabling pieces of legislation. This establishes a formidable consensus that reaches deeply and widely in to the Irish economy and society – even if, by definition, it excludes the vast majority of citizens and residents whose daily lives will be affected by the decisions made via this consensus.
13. This is the standard process for formulating, enacting and implementing public policy in most sectors. There is no effective means of imposing democratic scrutiny or restraint. Any conflicts between the interests of key 'stakeholders' or between the interests of

¹ There are some indications, but probably nothing more than rumours, that some groups opposed to water charges are contemplating a legal challenge to this proposed decision by the CER. But any court challenge, if it were to be progressed, would be almost certain to lead to a judgement confirming that the CER has been empowered by the Oireachtas to make any decision it chooses – once it is consistent, either explicitly or implicitly, with government policy. Legislatures are perfectly entitled to make laws whose implementation damages the interests of the vast majority of citizens. It is not, per se, unconstitutional, since these laws are made when governing politicians and the influential special interests which benefit from their enactment are able to browbeat and fool a majority of voters. But this is unlikely to be sustainable indefinitely. That is the abiding virtue of democracy.

citizens and residents, either as consumers and users or taxpayers (or both), and the interests of providers of services are either suppressed or smothered. Citizens and residents are treated as objects to be managed rather than as subjects whose informed consent is required to formulate and implement public policies that will impact on their daily lives.

14. It is this process which led to the triple (fiscal, property and banking) blow-out in 2008. Apart from some limited changes in personnel at the top of some statutory bodies and cosmetic changes to the presentation of the functions of some agencies – supported by some revised enabling legislation, nothing really has changed. The entire process leading to these proposed water charges provides compelling and depressing evidence that the change of personnel in government, of the identity of special advisers and in the allocation of political patronage has had no discernible impact on the process of governance.
15. The only accountability, potentially, is political and is effective only when a majority of voters decides to eject from office the governing parties responsible for implementing specific policies that arouse public disgust and anger. And, even in this instance, it is rarely possible to link any specific policy with the decisions made by a majority of voters to eject a government from office. All governments in the modern era spin such a web of lies, half-truths and fictions that that, rather than any specifically articulated discontent, is probably more than sufficient for a majority of voters to eject them. For example, the proposed interim revenue and charging period (up to end-2016), which the CER disingenuously advances as being its decision, was determined by the political cycle and decided by the Government. The political toxicity of water charges meant that it desperately needed some arrangement on water charges that will get it, unscathed, beyond the next general election – but little further.
16. And governments in Ireland are little different from those in the other established democracies. The only possible differences – and these are largely differences in degree – are the extent to which the executive dominates the legislature in Ireland, the extreme centralisation of executive and administrative authority, the ability to forge and maintain a consensus of key 'stakeholders' (possibly a function of the small size of the polity) and the ability (approaching an art-form) to project optical illusions and to seek to suspend disbelief (which must be the envy of governments in other polities). For example, Ireland's triple (fiscal, property and banking) boom was an optical illusion projected almost entirely in Ireland. It enjoyed a comprehensive legislative and regulatory underpinning and this was required to suspend disbelief for as long as possible and to counter any substantive critiques highlighting the damaging nature of this optical illusion. It fed to some extent on much more comprehensive optical illusions projected elsewhere. The most significant was the optical illusion projected in the US, but also supported by British policy and regulation, based on a massive expansion of household credit, the shredding of long-standing financial sector regulation and the development of little-understood, and deliberately under-regulated, markets in complex derivative instruments. But the optical illusion projected by the EU's institutions that the governance of the Euro project was fit for purpose proved to be almost equally significant. In Ireland's case it was only a question of whether the illusion would be shattered by inevitable internal strains and contradictions or by external forces. In the end, the shattering of the optical illusion projected in the US led directly to the shattering of Ireland's own optical illusion. The impact was compounded by the subsequent shattering of the optical illusion projected for the Euro project.
17. In the same way that successive governments projected these optical illusions about the property and banking sectors and continue to project an optical illusion about the governance and functioning of the electricity and gas sectors, this Government is projecting an even more complex optical illusion for the water sector. However, the

Government can rely on the comprehensive consensus of key stakeholders it has forged and seeks to maintain and on the legislative underpinning whose enactment it has had whipped through the Oireachtas. It can also rely on public discontent with the quality of water and waste water services in some parts of the fragmented Local Authority-run system, on a measure of public support for rationalising and integrating this fragmented provision in Irish Water and on a sullen resignation to the imposition of some form of water charging. By spinning its usual web of lies, half-truths and fictions it can easily win the contest with those who remain opposed to the concept and practice of water charges – and it has ensured it has all the legal powers to do so. But what gets lost in this futile contest is that there is more than one way to structure, fund and finance the water industry – and that the current approach favours these ‘key stakeholders’ (or special interest groups) at the expense of all households (and, potentially, all other businesses).

The Role of the CER

18. While there was some objective validity in the decision to transfer the water system assets and the responsibility for water system services to the newly established Irish Water as a wholly owned BGÉ (now Ervia) entity, this does not imply, as the key stakeholders are at pains to assert, that it made sense to empower the CER to apply economic regulation to the sector. (The transfer of assets and responsibility was also politically convenient in that the associated arrangements have been structured to provide a measure of compensation to the management, staff and unions of BGÉ for being compelled to divest its non-network businesses.)
19. And, while it highlights the challenges it is confronting in regulating the water sector – for example, in response to the establishment of a new regulated entity replacing local authority provision and to a complete change in the funding model, the CER is adamant that its proposed approach to regulation of the water sector is entirely consistent with the approach it applies to the electricity and gas networks. It may indeed be possible to identify aspects of consistency in what it is proposing, but there is a total failure to address a much more important question: why is the economic regulation of 100% state-owned entities actually required?
20. This question is rarely posed and, if it is, the stock response is to highlight the requirement in primary EU legislation to establish National Regulatory Authorities (NRAs) for the electricity and gas sectors. The situation is less clear-cut for the water sector, but this point is generally extended to cover it. In addition, even if state-owned entities dominate the electricity and gas sectors and perform activities that have monopoly characteristics, it appears to be generally accepted that the activities of private sector participants in these sectors should be subject to regulatory oversight and that an overall framework of economic regulation is required. Furthermore, it also appears to be generally accepted that a framework of economic regulation should be in place in the event of a partial or total reduction in state ownership of some electricity or gas sector entities. As a final point, it can be contended that the commercial freedom typically granted to state-owned enterprises, in particular when they perform activities that have monopoly characteristics, both allows and encourages them to behave towards service users in a manner similar to private sector entities and that economic regulation is required to protect the interests of service users.
21. However, this rationale for economic regulation of the electricity and gas sectors does not prescribe or define the nature of economic regulation that should be applied to state-owned enterprises performing activities that have natural monopoly characteristics. The generally accepted default approach is to regulate them as if they were private sector entities. This is the approach which the CER applies to the electricity and gas network business units of the ESB and Ervia (and the electricity network ownership and operations activities of Eirgrid) and which it proposes to apply to Irish Water.

22. There are no valid, objective reasons for this; there are, in fact, numerous good reasons why this approach should not be pursued. But these good reasons are consistently ignored because the principal reason why this approach is pursued is that it is politically convenient – and politically convenient on a number of fronts.
23. There appears to be almost unanimous agreement – and this agreement has been long-standing - across the Irish political spectrum that the electricity, gas and water networks should remain fully in state ownership. Even those who are opposed to the imposition of water charges subscribe to this nostrum. The reasons for this almost unanimous agreement are many and varied. Hardly any have a rational, logical basis; most are driven either by adherence to an out-dated, irrelevant ideology or by a desire to retain and exercise political and economic power (or, sometimes, both). The one good reason – that the private sector, by virtue of its focus both on the short-term maximisation of post-tax returns on equity and capital appreciation and on the long-term acquisition, retention and exercise of economic power, simply can't be trusted to own businesses performing activities that have monopoly characteristics and to provide services efficiently to final users without gouging them – is rarely, if ever, advanced. This is a persistent and serious problem in most advanced economies and if it is to be tackled it will have to be tackled collectively – for example, by the EU's institutions.
24. Successive governments have adhered to this popular consensus about state ownership of the electricity and gas networks and this now also applies to the water network. It is impossible to conceive of this, or any future government, proposing even a partial sale of these assets to the private sector. As a result, it appears that the current ownership arrangements will continue indefinitely – and that the governance arrangements will remain unchanged. This means that the Ministers for Communications, Energy and Natural Resources and for Communities, Environment and Local Government will retain responsibility for formulating policies, respectively, for the electricity and gas sectors and for the water sector, for ensuring the enactment of the enabling legislation and for implementing these policies, will continue to appoint, respectively, the boards of the ESB and Ervia and the board of Irish Water and will appoint, presumably with some collaboration, the commissioners of the CER.
25. This exercise of under-scrutinised, largely unrestrained political power is entirely typical in the Irish system of democratic governance. Ministers are rarely exposed to effective scrutiny by Oireachtas Committees and are generally careful to avoid challenges in the courts. The media fail miserably in their duty to citizens and residents to investigate and report on the exercise of political and economic power. They often lack resources, appear too lazy to tackle and communicate the complexity of policy and regulation to their listeners, viewers or readers, or are constrained by consideration of future advertising revenues or by close association with the political apparatus. The principal constraint Ministers encounter is the need to forge and maintain a consensus of the key stakeholders in the sectors for which they are responsible. However, the exercise of this power exposes them – and their party's Oireachtas members whom ministers have ensured have been whipped through the division lobbies - to the ultimate accountability described in Para. 15 above.
26. Governing politicians everywhere seek to evade being held accountable before their voters between elections. Irish governing politicians are no different. The most effective means of doing so is to delegate responsibility for the implementation of politically unpalatable policies to statutory bodies or agencies. It is even better if it proves possible to delegate responsibility not only for the implementation but for the actual decisions to a statutory body which can be sold to the public as being 'independent' of government. This has proven to be an effective means of insulating governing politicians from the often damaging political impacts of unpalatable, but necessary, decisions. And this, much more than the dictates of primary EU legislation or the desire to establish effective

economic regulation that operates genuinely in the public interest, explains the willingness of governing politicians over the last 20 years to establish economic regulators in various sectors.

27. The CER, since it was established in 1999, more than most statutory regulatory bodies, has proved its worth to a succession of governing politicians in this respect. And it is clear, with the imposition of this additional responsibility for the water sector, that it is expected to continue proving its worth for this generation of governing politicians – and for their successors. When the CER assumed regulatory responsibility for the electricity sector in 1999 there was a huge back-log of investment in both electricity generation and the networks. For various reasons, electricity prices had been kept below economic costs for some time. These low prices, combined with a rapidly growing economy, led to increased demand for electricity – and to a demand for investment in electricity infrastructure. There was a clear policy requirement both to increase prices to generate the increased cash-flow that would part-finance investment and to supplement this part-financing by direct or indirect Exchequer equity injections. But the governing politicians at the time were afraid to authorise higher electricity prices and found they were either unable or unwilling to part-finance the huge electricity system investment required. The first EU Electricity Directive of 1996 did not require the establishment of an electricity sector regulator, but the governing politicians spotted the opportunity to establish a body to which they could delegate responsibility to remedy the problems being caused by their political cowardice and their failure to govern in the public interest.
28. The CER stepped in to, or was propelled in to, the breach. With regard to the ESB's networks – this is relevant in relation to the water system assets, the CER valued the assets for regulatory purposes far in excess of the book value or any contestable market value. When setting the return on investment it applied a cost of capital as if the network business units were in the private sector and owned by responsible shareholders. When it came to projections of capital and operating expenditures, the ESB invariably set its initial projections far in excess of what it required. This allowed the CER to cut back these projections and to trumpet the 'savings' it had made on behalf of consumers. But it is impossible to assess objectively the efficiency or necessity of these projected spends. The consistent failure by the ESB (except in one instance²) to contest the CER's decisions suggests that the CER has been consistently generous with final consumers' money.
29. All of these decisions led to the setting of excessively high network user charges that fed in to significant increases in final prices and generated sufficient cash flow to allow the ESB to finance huge network investment from borrowing and retained earnings. This avoided the need for part-financing from the Exchequer and, in fact, allowed the generation of a healthy stream of dividends to the Exchequer. The effect was to impose a hidden, regressive financing tax on final electricity consumers which allowed

² In 2010, when the CER was setting the allowed electricity network revenues and tariffs for the period 2011-2015, it set the cost of capital (or return on investment) below what the ESB, at the time desperately accumulating funds to close out its acquisition of Northern Ireland Electricity (NIE), wanted. The ESB directed all its available fire on the CER, both publicly and behind the scenes. Not surprisingly, the CER capitulated and awarded the ESB its desired higher cost of capital. Ironically, the ESB, so used to a compliant regulator, tried the same tactics with the Northern Ireland utility regulator when it cut its allowed revenue on the Northern Ireland networks. However, the utility regulator held firm and forced a reference to the UK Competition Commission. The Competition Commission subsequently found largely in favour of the regulator. The knock-on effect is that other sector regulators in Britain have been forced to reduce their estimates of the cost of capital in line with the decision of the Competition Commission. It is unlikely that shareholders in these regulated businesses are very happy with the ESB.

successive governments to evade their public shareholder responsibilities (and actually rewarded them for their irresponsibility at the expense of final consumers) and provided surplus funds to allow the ESB to expand its empire on the island and overseas. And it continues to this day. When its remit was extended to the gas sector in 2003, the CER applied precisely the same approach to the gas networks – with precisely the same effects on final gas consumers. A recent IMF working paper³ highlights how the impact of an initially equilibrating shift in relative prices in favour of the nontraded sectors can overshoot the equilibrium, become embedded in expectations and investment decisions, distort and damage the functioning of the economy and generate asset bubbles. The CER, in company with many other statutory agencies, played a key role in authorising and embedding this shift in relative prices which continues to damage the economy. This paper does not, of course, reflect the views of the IMF, but it provides a persuasive assessment of some of the key causes of Ireland's triple blow-out – and contributes to an explanation of why economic recovery has been so slow.

30. Unfortunately for the government, the CER is unable to apply the same magic to the water sector that it continues to apply to the electricity and gas sectors. But it is being required to cast a different and more complex spell. The maximum average annual household bill of €240, announced by the Government announced prior to the Local and European Parliament elections in May 2014, was the output of a complex set of calculations that ensured a balancing of the interests of all of the key stakeholders subject to any constraints imposed by EU rules. On one side, there was a requirement to generate sufficient revenue (1) to keep the management and staff of Irish Water in the style to which they wish to become accustomed, (2) to fund the previously agreed 12-year Service Level Agreement with the Local Authorities, (3) to ensure financing of investment without imposing excessive strains on Irish Water (or, its parent, Ervia) and (4) to minimise the need for government subventions and financing. On the other side, there was (1) the pressing political requirement to minimise the average annual household bill during this 2-year interim, or transition, period (intended to get the Government through and beyond the next general election) and (2) binding Eurostat rules on the maximum amount of direct government subvention to Irish Water. These Eurostat rules have led to the weird and wonderful situation of the Government 'buying' water and waste water services from IW, but with an upper bound being imposed on the revenue it generates for IW from the 'purchase' of these services, and allocating these services 'for free' to households. This allocation of 'free' services is supplemented by a new welfare transfer to selected welfare recipients. It would make far more sense to apply the total of the currently proposed subvention and additional welfare spend as targeted subsidies to households.
31. The CER is doing its best to convey the impression that it, with the support of its retained consultant, NERA, has generated these calculations entirely independently. The Government has supported the projection of this fiction of the independence of the CER with the issue of a Policy Direction by the Minister for Communities, Environment and Local Government to the CER. But the reality is that the CER and NERA have merely fleshed out, with some limited modifications, the basic set of calculations previously agreed behind the scenes by the key stakeholders.
32. Having secured this consensus among the key stakeholders – and agreement on the basic calculations for revenues, subventions and the average annual household bill, the Government is now determined to distance itself fully from the design and application of water charges and to impose this responsibility solely on the CER. This, of course, makes a total nonsense of economic regulation as it would be understood and applied in

³ Bakker, B. and Lipschitz, L., 'Conventional and Insidious Macroeconomic Balance Sheet Crises', IMF Working Paper/14/160, August 2014.

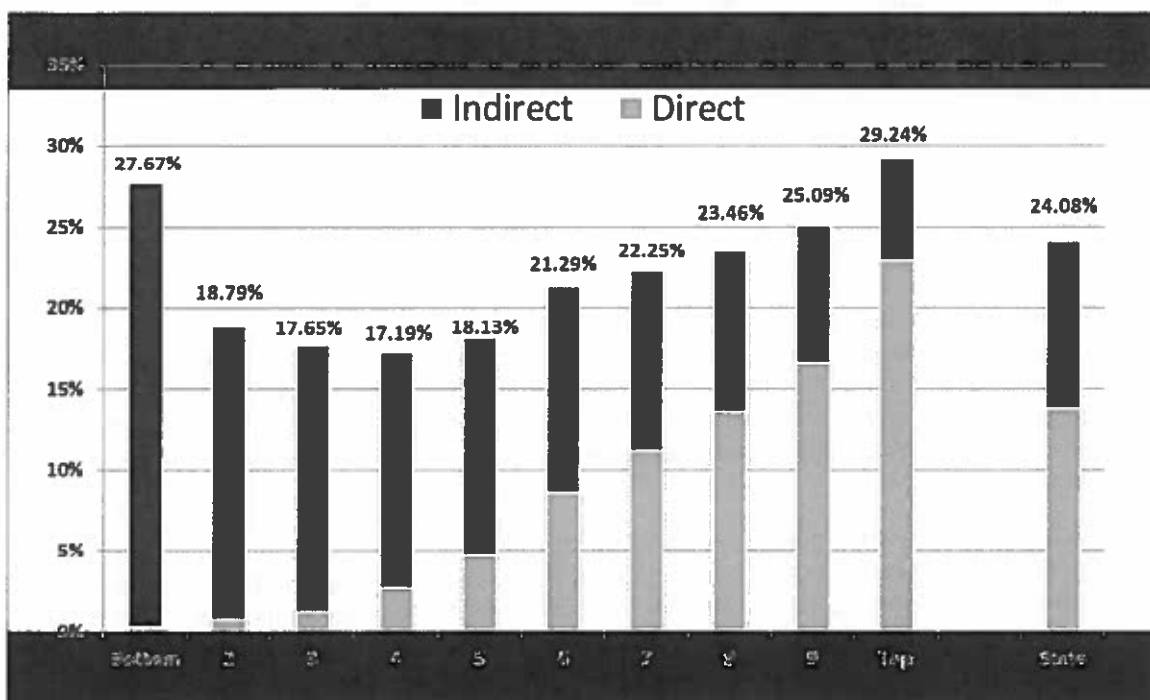
other better-governed jurisdictions, but the key stakeholders are so engrossed in projecting this wonderfully convenient optical illusion that they fail to recognise what they are actually doing. It is for the regulator, independently, to determine the efficient allowed revenue and to determine the efficient level and structure of charges. If the Government wishes to apply a subvention to reduce the level of charges actually paid by households to below the efficient level and to alter the structure of charges to favour the interests of some households over those of others, this has absolutely nothing to do with economic regulation. These are pure political and policy decisions, and the governing politicians setting policy to achieve these outcomes should be held politically accountable for their decisions – and not the economic regulator. But the enabling legislation allows governing politicians to evade this accountability and to impose it on an unelected statutory body. This is just one further example of the continuing failure of effective democratic governance in Ireland – and it is symptomatic of this pervasive failure across all sectors of the economy.

33. There are no substantive reasons, apart from the pressing political desire to 'fix' household water charges at a low level during the run-up to and to a little beyond the next general election, why the first revenue review period could not have a five-year, or even longer, duration. The 12-year Service Level Agreement, which covers most of 'controllable' Opex, is in place and IW has developed Capex projections for most of the rest of this decade. The problem, of course, is that this would reveal how the current average household bill, which the CER has been forced to reveal will average €594 over the next two years, would increase over the extended review period. This average is already well in excess of the average bill in England and Wales and, unlike the average bill in England and Wales which is expected to track inflation, has only one way to go. And that is up. The Government clearly wishes to conceal this unfolding reality and that is the principal reason for this 2 and quarter year interim review. But households are unlikely to be fooled.
34. Another reason is the regressive nature of water charges as a means of funding the water sector when compared to current funding largely from general taxation. Recent research⁴ indicates that the household tax contribution curve in Ireland has a U-shape across the gross income deciles, as illustrated in the following figure.⁵

⁴ Collins, M.L. and Turnbull, D. 'Estimating the Direct and Indirect Tax Contributions of Households in Ireland', NERI Working Paper No. 8, November 2013.

⁵ The contentions and results advanced in this paper have been questioned: <http://economic-incentives.blogspot.ie/2013/12/irelands-regressive-tax-system.html>, since they are intended to advance a particular ideological and political viewpoint. However, despite this, they provide a useful context to highlight the regressive nature of water charges.

Figure 0-1: Total Household Tax Contributions, % Gross Income



Source: op. cit. p13

35. The percentage contribution of households in the bottom decile is almost as high as that for households in the top decile. The percentage contribution falls through the second and third deciles, reaching a minimum for the fourth decile. It is only from then on as household income increases through the deciles that the incidence of taxation becomes progressive. This suggests that, under the current funding of the water sector, households in the bottom decile, relative to gross income, are contributing almost as much as those in the top decile. Under the proposed funding, based on water charges, a household with the same number and ages of members in the bottom decile will pay exactly the same as an identically constituted household in the top decile – and they will be worse off in absolute terms. This, perhaps, is why the Government has decided to provide additional welfare transfers of €100 a year to approximately 400,000 welfare recipients.⁶ It would, of course, be far better if, as an effective means of compensation for those in the lower income deciles, the CER were prepared to determine appropriate water charges for commercial users and the Government were prepared to remove the implicit regressive financing taxes in the electricity and gas sectors (and to reduce excessive charges in other sectors). But this would seriously upset the consensus of key stakeholders who benefit handsomely at the expense of final consumers and service users and to whom the Government believes it must pander.

Questions on Interim Revenue Review

36. It is totally insulting and disingenuous for the CER to seek to solicit views from respondents, who have not been party to the behind-the-scenes deliberations and are unlikely to have access to data and information beyond what the CER is willing to present, on Irish Water's establishment and pre Q4 2014 incremental operation costs (Q1), on Irish Water's proposed capital expenditure (Q2), on the CER's proposals for Irish Water's capital expenditure (Q3), on Irish Water's approach to prioritisation [of capital expenditure] (Q4), on methods to evaluate Irish Water's proposed opex (Q7), on

⁶ This, of course, will also benefit some households above the fourth decile.

the CER's proposals for Irish Water's opex (Q8) and on the level and cost categories to which CER propose to cut Irish Water's establishment costs (Q9). It is insulting because the CER is able to employ its alleged superior knowledge to dismiss any suggestions made and to infer that any commenters lack the necessary understanding and competence. It is disingenuous because the inability of respondents to provide substantive comments, for whatever reasons, implies consent to what is being proposed.

37. It is only possible to note that Irish Water, following the usual practice of the ESB and BGÉ, may have included more than can be justified in its projections and the CER, in line with the recommendations in NERA's assessment report, has trimmed these estimates and projections. This allows the CER to play the usual game and trumpet the 'savings' it has made on behalf of water service users. But, given the asymmetry of information, the inability to assess or affect the pre-agreed long-term Service Level Agreement and the considerable uncertainty involved, nobody external to the process can have any idea whether these 'savings' are real or not. Nor is it possible to make any assessment of the potential efficiency gains that might be secured – or, indeed, how these might be secured.
38. With regard to the questions on [capital expenditure] output monitoring (Q5), on consultation on the approach to monitoring (Q6), on incentivising improvements in quality and customer service (Q13) and on the CER's proposals to monitor Irish Water (Q15), the ability of the CER to do anything useful in the interests of service users is highly questionable. Using typical Eurocratese, the European Commission, in its Autumn 2103 Review of Ireland's Economic Adjustment Programme observes that "[t]he incentive structure provided under the revenue cap (RPI-X) model (i.e., financial incentives for shareholders) may not work well for Irish Water, since it will be 100% state-owned" (p32). It notes, hopefully, but probably wryly, "that other incentives could be designed." Of course, the Commission can't say it, but it is total nonsense to pretend that any sort of sensible financial incentives may be devised or applied in the context of 100% state ownership. They don't work well even when the regulated business is in the private sector. Therefore, any sort of incentive scheme or monitoring of outputs is a total optical illusion.
39. Although it seeks comments on its treatment of depreciation and asset categories/lives (Q10), on its approach to setting Irish Water's allowed rate of return (Q11), on its proposed cost of debt uncertainty mechanism (Q12) and on its approach to setting the total revenue allowance (Q14), the CER, not surprisingly, glosses over the derivation of the opening Regulatory Asset Value. According to a report by a consulting firm retained by the Government and published in 2012 the net assets for the water sector on the books of the Local Authorities were estimated at €11.5 billion and may have an even higher value at end September 2014. But these assets have been fully financed on a pay-as-you-go basis from allocations from central government funds and contributions from commercial water rates. Even though these assets have been transferred to Irish Water without any payment being made, the CER has felt compelled to treat them as having a zero value for regulatory purposes.
40. It is not clear whether or not the Government, Ervia, Irish Water and the CER examined the possibility of estimating the value of these assets and requiring Irish Water, as a wholly-owned subsidiary of Ervia, to provide appropriate compensation to the state (and, ultimately, taxpayers) for acquiring these assets. It is entirely inappropriate that Irish Water, and, ultimately, Ervia, is receiving these assets as a 'gift'. However, if Irish Water were required to provide appropriate compensation water service users would be required to pay in their water charges annual depreciation charges and the full return on these assets until they were fully depreciated. It is possible that the view was taken that Irish Water, as a newly established entity, would struggle to finance the payment of appropriate compensation. But, as a wholly-owned subsidiary of Ervia acquiring

revenue-generating assets, it should not pose a problem for Ervia to raise the required finance over time on the international capital market to provide the appropriate compensation. The failure to present the pros and cons of this option in this consultation paper is a major deficiency. In addition, it is not clear how the transfer of these assets, which clearly have a value, will be treated on Irish Water's books from a legal accounting perspective. This also needs to be made clear – even if it is not primarily the responsibility of the CER.

41. The failure to explore this option of assessing a value for the existing Local Authority assets means that the CER, with presumably the involvement of the Department of Communities, Environment and Local Government (DCELG), the Local Authorities and Irish Water, has been forced to scabble around to generate an opening Regulatory Asset Value that exceeds €1 billion. The justification for the inclusion of some elements is dubious, but insufficient information has been presented to make an assessment.
42. As noted in Para. 19 above, the cost of capital is derived as if Irish Water is a private sector firm (with responsible shareholders). Even if it were to be treated in this manner – which is highly dubious in any event, the estimate of the cost of capital generated by NERA is excessive. First, the cost of capital is calculated in real terms. It should be calculated in nominal terms and then deflated. Key variables and parameters such as the cost of debt and the equity risk premium are generally expressed in nominal terms and taxation is applied to nominal values. Secondly, the convenient assumption of a zero debt beta is made, but this flies in the face of the underlying financial theory of the cost of capital and real world evidence and inflates the cost of capital. Thirdly, both the risk-free rate and the point estimate of the debt premium (both expressed in real terms) appear to be excessive when compared to the actual cost of debt experienced by the ESB and BGÉ. These also inflate the cost of capital. Finally, the application of capital allowances and other legitimate means to reduce or defer tax liabilities will keep the effective rate of tax below the marginal rate. Using the marginal rate inflates the cost of equity and the cost of capital. An alternative calculation, employing a more appropriate technique and more realistic estimates of key variables and parameters, suggests that the real cost of capital is likely to be between 3 and 3.5%. The cost of capital for the electricity and gas networks should be similar, but the CER has consistently awarded far higher rates of return.
43. Indeed, it is possible to make the case that the cost of capital should not be much more than the cost of debt, since the state does not behave like a private sector investor and the cost of debt will always exceed the state's cost of funds. Treating the state as a private sector investor and applying an excessively high cost of capital has the effect of imposing a hidden tax on water service users which has not been authorised knowingly by their elected representatives. It is clear that, since it has been prevented from applying its usual trick of inflating the opening RAB, the CER is seeking to compensate by inflating the cost of capital.

Questions on Domestic and Non-Domestic Water and Waste Water Charges

44. Despite its much vaunted independence, a clear political decision has prevented the CER from applying demonstrably economically more efficient two-part charges. Most of what the CER is proposing and on which it is seeking comment relates to transitional administrative arrangements and arrangements required in the absence of a full roll-out of water meters. The remainder relates to the direct implementation of government policy based on politically driven decisions and does not, and should not, have anything to do with economic regulation.

Conclusions

45. The CER was established to make and implement some necessary decisions in the electricity sector that cowardly governing politicians were unable or unwilling to make and implement and to insulate these cowardly governing politicians from the political repercussions of these decisions. Since its establishment and up to this point it has been able to masquerade as an energy sector economic regulator applying a variation of the deeply flawed British-originated model of competition and regulation to the electricity and gas sectors, but, in reality, implementing explicit and implicit government policies. It is ironic that the Government's machinations to deal with the political toxicity of water charges have finally revealed the CER for what it has been since its establishment: an agency of government implementing government policies in the interests of key sector stakeholders and at the expense of service users – without any independence from politically-driven policy decisions. It is doubly ironic that the Government has done such institutional damage to the CER for what seems such a small gain.
46. This huge effort has been expended to establish the principle of household water charges and to extract approximately €300 million a year from households over the next two years to reduce the reliance on government funds. However, the underlying service provision by the Local Authorities has been maintained and, with the establishment of IW layered on top, total annual costs have increased. The touted benefits are in the future and, by definition, are uncertain. In terms of subventions, welfare payments and equity investment the Government will still be required to spend more than €1 billion a year of taxpayers' funds – injecting most of it in to Irish Water. Beyond 2016, as water charges increase the requirement for subvention from taxpayer's funds may decline and one can only hope that there is some credible analysis underpinning IW's boast that it will be able to save the exchequer €2 billion by 2021.⁷ But this is the equivalent of a fiscal 'three card trick'. Government funds are provided by taxpayers or sourced from borrowings which it commits taxpayers to service and repay. The less that government funds are used to fund the water sector, the more households (and businesses) will have to pay. And, as we have seen (Para. 35), even with additional welfare transfers, the impact will be regressive. The objective is to fool and bamboozle voters for as long as possible. It is unlikely, however, that, despite all this effort and behind-the-scenes machinations, the Government will escape the political punishment at the hands of voters of which it is so fearful. The Government may not be punished specifically for its handling of water charges, but its blatant self-serving machinations are contributing to a widespread and growing public discontent.
47. This interim review should be extended to a period of, at least, five years – and possibly longer. A genuinely independent body should be established (1) to assess the value of the water sector assets being transferred to IW, (2) to determine whether or not IW should be required to compensate taxpayers for the assets being transferred and, if yes, how much compensation should be paid and over what timescale, (3) to review IW's capex and opex projections, (4) to determine the appropriate cost of capital, (5) to establish the required revenue over this extended period and (6) to establish appropriate charges for both households and business users on a sound economic basis that will recover this revenue. It will then be for the Government to decide what subventions it will need to apply to modify the level and structure of these charges and their application to different categories of households. Given the amount of calculation and negotiation that has gone on behind the scenes and the initial analysis performed by the CER and its consultants, this should not postpone the determination of water charges for very long. But the process would be transparent and any subsequent modifications of the level and

⁷ <http://www.water.ie/news/the-creation-of-irish-wat/>

structure of charges and subventions applied would be subject to effective democratic scrutiny.

48. The CER has never functioned as an economic regulator, as it would be understood in better-governed jurisdictions, and should now be broken up. Since the electricity, gas and water networks are likely to remain indefinitely in public ownership, the CER's functions dealing with networks should be returned to the relevant line departments where the decisions it is forced to implement might be subjected to some measure of democratic scrutiny, restraint and accountability. Similarly, its safety functions should be returned to the relevant line departments. And those functions dealing with competition and markets in the energy sector should be transferred to the Competition Authority – which should be empowered to make ex ante decisions on the design and functioning of markets where none previously exist.
49. It is recognised that the CER will ignore most, if not all, of this submission. Its much-protested, but in reality non-existent, 'independence' from political and policy imperatives will be used to justify its stance. It is difficult to assess to what extent the CER enjoyed a measure of public confidence while it masqueraded as an independent economic regulator. It is unlikely that very many citizens, insofar as they took any notice of it, were fooled. But it can no longer suspend disbelief and project this optical illusion of 'independent' regulation. This is not intended to cast any aspersion on the competence, integrity or professionalism of the commissioners or staff of the CER. They are compelled, and, presumably, perceive themselves to be compelled, to discharge the duties conferred on them by the Oireachtas and to implement regulation in compliance with Government policy which has also been duly authorised by the Oireachtas. If any of the commissioners or members of staff were to publicly highlight the economic perversity of that they are being compelled to implement they would be crushed. It would be viewed as gross insubordination of the settled will of the Government and the Oireachtas. Their silence and apparent willingness to 'go with the flow' are perfectly understandable, but it is not in the public interest.
50. On the other side, the Government is determined to pursue the course it has chosen to the bitter end and it will allow nothing to deter it. The key stakeholders have been 'squared' and all of the necessary legislative and regulatory arrangements are in place. In the meantime, more and more voters, increasingly disgusted at being lied to continuously by the 'mainstream' parties that have dominated the political landscape since the foundation of the state and bearing most of the costs of these political decisions that benefit special interest groups, are rejecting these parties. Unfortunately, they are increasingly turning to prospective representatives who offer either inchoate governance or no governance. That is not their fault; they can choose only among the alternatives offered. It is not a pleasing prospect, but arrogant and over-mighty governments reap what they sow. Even if the Government, at this late stage, were to change course, it is likely it would have little impact on what has become a settled popular view. It appears to be committed to charge blindly forward towards a political fate it richly deserves – and its handling of water charges will contribute to the growing popular discontent that will deliver this fate.
51. The fundamental problem is that far too much under-scrutinised, unrestrained, unaccountable political and economic power is concentrated in an excessively centralised and expansive government apparatus and in the broad array of special interests (and their armies of advisers and consultants) to which it panders. Governments actively suppress, prevent and discourage both effective scrutiny of the formulation and enactment of public policy and any decentralisation of democratic decision-making. It is little wonder that the gap between 'Official Ireland' and a majority of voters has grown so wide. It is up to the voters to force a resolution.