

MR TURNBULL2 October 1984

c Mr Redwood

WATER STRATEGY - E(NI) ON 3 OCTOBER1. Rate of Return

E(NI) decided in July to require a real rate of return of 5% on all new Water Authority investment. The question is now what return to require from the existing assets, which allegedly have a replacement cost value of £22 billion. Treasury argue for a move towards 5% RRR by the year 2000 which implies an increase of RPI plus 3% every year for 15 years. Patrick Jenkin and Nicholas Edwards regard this as quite unsaleable, and argue for leaving the RRR on existing assets at around the present level of 1%.

We think the instincts of DoE and Welsh Office should - for once - prevail over Treasury logic. The replacement value of £22 billion (reduced from an earlier estimate of £28 billion) must be to some extent questionable: not all the assets will need replacing, and some of them cannot even be located. And a relentless price increase of RPI plus 3% over 15 years does not merely look like an abuse of monopoly power - it would be!

On the other hand, Treasury are right to argue that the taxpayer (through the industry's EFL) should not have to support the consumer. We therefore suggest that the right course to adopt is to raise charges by just enough to reduce the industry's EFL (currently about £250 million) to zero over 5 to 10 years. At that point, the industry would be self financing but not using its monopoly position to contribute to the state coffers. We judge that to be a defensible compromise, with charges rising at around RPI plus 1% to 1.25%.

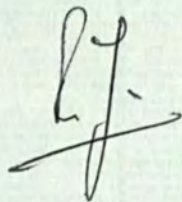
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It is for DoE and Welsh Office to determine financial targets for each of the 10 Water Authorities, but the long term objective must be for each to become self financing. And it is likewise for each authority, since none is connected to another, nor needs to be, to determine the balance of investment between fresh water supplies and sewerage.

2. Metering

Any technique which makes consumers cost conscious at the point of consumption is to be welcomed. In this case, the prime requirement must be a cheap, reliable water meter which costs little to install. For a market of nearly 20 million in the UK alone, human ingenuity can surely rise to the challenge? Although general metering will not help the short term finances of the Water Industry, the long term benefits look worthwhile, so we support the Patrick Jenkin/Nicholas Edwards proposals.

The one caveat we would enter concerns 'extra operating costs' - presumably to do with reading meters. Surely we are not going to continue with gas and electricity and water meters being read separately, by three large workforces?



ROBERT YOUNG

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