



Scottish Council for
Development and Industry

SCDI PRESENTATIONS TO BUSINESS STREAM CUSTOMER EVENTS

THURSDAY 1st OCTOBER 2009, AUDI CENTRE, GLASGOW

BY JANETTE HARKESS, DIRECTOR OF POLICY AND RESEARCH

AND

TUESDAY 6th OCTOBER 2009, CARMELITE HOTEL, ABERDEEN

BY IAN ARMSTRONG, NORTH EAST MANAGER

- 1. Good morning. Thank you Mark and thank you to Business Stream for the invitation to speak at this Customer Event.**

- 2. SCDI's purpose is to strengthen Scotland's competitiveness by influencing Government's policies to encourage sustainable economic prosperity. So it will not surprise you that the provision of high-quality, yet affordable, water services is a priority for SCDI's membership of businesses, trades unions, local authorities, educational institutions, the voluntary sector and faith groups. We welcome the opportunity to share with you our views on the changing economic context in which water services are being provided and on the implications for services in what is now a competitive water market for non-household customers, particularly over the next regulatory period to 2014.**

- 3. The economic context is one with which we are all familiar. Following the worst global financial crisis since the Great Depression at this time last year, the global economy has plunged into the first global recession since the Second World War. The latest forecasts from the OECD are that the UK**

economy will contract by a total of 4.7% in 2009 and will continue to shrink for the whole of the rest of the year, even while economies which were initially affected even more badly begin to recover. In contrast to some previous downturns, the recession in Scotland appears to be every bit as deep as the rest of the UK. The latest Scottish GDP figures covering the first quarter of this year showed that the Scottish economy contracted by 2.4%, the third consecutive quarterly decline.

4. The construction sector, which contributes around £10bn to the Scottish economy, has been one of those most badly hit. A survey just published by the Scottish Building Federation has found that 8500 building workers lost their jobs in the first eight months of this year, on top of the 20,000 job losses last year. The Civil Engineering Contractors Association has said that the current recession has led to a downturn of around 15% in both total civil engineering turnover and employment in Scotland.
5. In the last 12 months, SCDI has worked with members in every sector to influence Government policy to encourage a sustainable economic recovery. Above all, this has included the

necessary action to improve Access to Credit for businesses by repairing the balance sheets of the Scottish and UK banks. However, the construction sector has been a particular priority because of the need to maintain capacity and retain investment in skills and training if it is to build the increased number of new houses the Scottish economy needs in the longer-term. We brought together the industry to produce *Building Scotland's Future - A 10 Point Action Plan for Construction*. One of our key recommendations was for accelerated capital spending and Government in Scotland has since brought forward £120m of investment in affordable housing which has created 1,000 jobs.

6. The latest business surveys suggest that confidence is slowly beginning to recover. Sectors such as renewable energy, food and drink, and tourism have remained comparatively strong, and the sharp decline in manufacturing output would appear to have been partly the result of destocking, which has been completed. However, the Fraser of Allander Institute's latest forecasts for the Scottish economy anticipate a weaker recovery in Scotland than the UK as a whole, with positive growth of only 0.6% in 2011 and 1.4% in 2012, still well below our 1.9% growth trend.

- 7. A major factor for this poor performance will be because public spending in Scotland will come under pressure as the debt incurred in stabilising the financial system, accelerating capital spending and reflation of the economy comes home to roost. UK debt is projected to rise by £175bn in this financial year alone.**

- 8. Paying this back will take time and lead to the first cuts in the Scottish budget since devolution. The Centre for Public Policy in the Regions at Strathclyde University has recently projected that Scotland's budget outlook is for a real terms decline of 8.5% or £2.5bn in the 4 year period between 2009-10 and 2013-14. And, in their view, the risk is on the downside because UK economic recovery may be slower and the level of debt interest repayments may be higher than now forecast by HM Treasury.**

- 9. If, as Mervyn King said, the last decade was the 'nice decade', the next will be one of tough choices. Frankly, a period of prolonged pain on both sides of the tax and spend equation faces us. We need to start planning our long-term response now.**

- 10. Indeed, tough decisions are already being taken. The draft Scottish Budget recently announced by the Scottish Government contained reductions for a number of departments. Most worrying for SCDI, the Centre for Public Policy in the Regions has identified that the main cuts fall to those capital and current spending areas most usually linked to the economy and long-term growth. Scotland's public capital programme will be £625 million less next year than was available for 2009-10. The Scottish Building Federation has found that, as a result, 59% of companies are even less confident about their prospects for the next 12 months compared with this previous year.**

- 11. SCDI has supported the acceleration of public sector spending as a prop for private sector recovery. So it is a real concern to us that investment in our future economic prosperity seems to have been hit disproportionately hard in the draft Scottish Budget when it should have become an even higher priority. We intend to organise a Budget Debate with Finance Spokespeople from the main parties in the Scottish Parliament and SCDI members to discuss our priorities and influence the process.**

- 12. So, what does this Age of Austerity mean for water services?**

- 13. Firstly, the cost of all utilities will be an important issue for businesses which face a range of pressures on their margins and fierce global competition. This is especially true for companies in chemicals, paper, food and drink, and electronics. If Scotland wants to retain these industries, their skilled jobs and export income, and be attractive for inward investment, water charges will need to be affordable and not uncompetitive.**

- 14. Secondly, in locations where the private and/ or public sector wants to invest, the provision of water services should be an enabler rather than a constraint on development. Scotland cannot afford to miss out on opportunities for economic growth.**

- 15. Thirdly, the importance of Scottish Water's investment programme for the construction industry should be recognised. The work comprises approximately 25% of Scotland's civil engineering outturn and 5% of total construction outturn, and it has been vital in sustaining activity. If Scotland wants a strong**

and capable construction sector, new investment should be programmed to provide stability and certainty in workloads.

16. **Fourthly, while SCDI believes that under the current model public investment should be a high priority for the public purse, if this proves unsustainable, with higher charges are economically and socially unacceptable, further external funding streams should be explored. The Scottish Government's Draft Budget has proposed that Scottish Water would retain borrowing powers in line with those in the Draft Determination, but it is the case that the budget for Scottish Water and Climate Change have been reduced by 18.6% and for Water Quality by 72.5%. Scrutiny and fresh-thinking should not wait for a crisis.**

17. **These are all significant challenges. But Scotland is in the fortunate position that, within a robust governance and incentives framework, our water industry has been transformed in recent years. Since 2002, Scottish Water has delivered a 40% reduction in its operating costs. Household bills have become the 4th lowest in the UK down from 7th in 2004-05. Constraints on development caused by a lack of capacity within Scottish Water**

have been a major cause of frustration among local authorities, developers and local communities. But while SCDI does still hear examples of delays in the system, these constraints have reduced dramatically in the most recent regulatory period. Indeed, the experience in the water industry is now being highlighted as a possible example for other parts of the public sector to follow in seeking to cope with severe budget cuts.

18. Most recently, Scotland became a world leader in introducing competition into the water industry with over 130,000 businesses and public bodies able to compare, contrast and choose their water and sewerage services supplier based on which best meets their needs. Business Stream is one option.

19. A speedy, efficient connections process is a priority for sustainable economic growth. Experience of SCDI members with Licensed Providers for non-domestic connections has been mixed since the opening of the market in April 2008. Perhaps inevitably for a new system, developers have reported delays and frustration. The Draft Determination suggests that the “interfacing has not been fully effective because of lack of

clarity in the Operational Code and an over reliance on Scottish Water to progress the connection process”. However, performance has been improving and the message is beginning to be understood that licensees are able to offer competitive pricing, higher quality and consistency of supply, better environmental standards, and improved customer services.

20. In our submissions to the Water Industry Commission for Scotland on the next regulatory period from 2010, most recently our response to the Draft Determination, SCDI has called for this progress to be maintained. We welcome the proposals for a stable and affordable charging regime coupled with geographic harmonisation. There will be falls in charges in real terms over the 5-year pricing period and the competitive market for non-household water services should ‘compete away’ Licensed Providers’ margins, benefiting businesses even more. We trust that competitive deals will be offered to businesses in all regions, and that lucrative customers will not be cherry-picked.

21. SCDI is also encouraged that action is being taken to address the cross-subsidisation of £44 million a year from non-domestic to domestic water customers. However, it is still of significant concern that further research has identified that Scottish Water still “over-recovers” £25 million a year from non-household customers. SCDI believes that the cost of providing water and sewerage services should be reflected in the bill and it is clearly unfair and harmful for business growth if they are overpaying. For the same reason, recovery imbalances between SMEs and large companies on the water side and within non-household sewerage charges require to be addressed, though without undermining the competitiveness of an important water intensive industry such as Scotch whisky. SCDI strongly supports the principle that any significant increases in charge levels should be phased in gradually. Guidance as to the definition of a significant increase and the reasons for any increase should also be provided. We also consider that the exemption scheme for charities with modest financial resources, but with public benefits should be continued or only gradually phased out if the impact on them is regarded as too substantial.

- 22. Our concerns in relation to charging with the Draft Determination relate mainly to a lack of detail and timescales. A timetable for implementing area based charging for surface drainage for non-household customers is not included. Nor does the Draft Determination make it clear what impact unwinding of Trade Effluent subsidies may have on individual businesses or set out the period over which changes will be phased in. A lack of information may lead to customers jumping the gun because big increases in bills for treating trade effluent would make it more attractive to go off-network and establish their own treatment operation. So it must be ensured that increases in charges are in proportion to the service provided and do not encourage alternative trade effluent treatment provision.**
- 23. To develop the competitive market further, a series of changes is proposed which would give greater control to Licensed Providers in their interactions with customers and in turn enhance their ability to champion customers' issues. This should also mean that touch points with Scottish Water are reduced. The intention is to tackle inefficiency in the market. SCDI has made a number of comments on these proposals.**

- 24. Moving metering activity away from Scottish Water could be a positive move if it facilitates the rollout of smarter metering solutions which help customers reduce consumption and save money. But it is not clear in the Draft Determination if the proposed new organisation would be responsible for policy. For instance, on properties which are mixed domestic and commercial, encouraging innovation, or meter right-sizing.**
- 25. Allowing Licensed Providers to control trade effluent could also help customers. Licensed Providers bill customers and these changes could help both parties work much more closely together to manage effluent consents and discharges. But if Licensed Providers are asked to play in ‘policing’ non-compliance this could create some confusion because they would then not only be playing the role of customer champion. This suggests that compliance issues should remain the remit of Scottish Water to ensure transparency in the market place.**
- 26. Most significantly, the Draft Determination proposes to extend of the role of Licensed Providers into the domestic connection**

market. This is a proposal on which there is some disagreement among SCDI members. While it is widely appreciated that the intention is competition would benefit customers seeking new a connection, concern has been expressed, in light of some mixed early experience with suppliers, about the impact on projects.

27. To create more confidence, there is a need for more clarity on the proposals, in particular reassurance that the introduction of Licensed Providers will not simply add another, time-consuming stage to the approvals and procurement process. Under these proposals, Scottish Water would still remain responsible for approving a connection point, creating a risk that delays might still occur in the process. An alternative option might be to follow the electricity market where a Licensed Provider is appointed at the point of connection. Scottish Water would run the application process and decide the outcome of the application, with customers choosing their Licensed Provider at the point of connection. Clarity would also be helpful on how the payment procedure would be affected as at present developers pay Scottish Water both Inspection and Connection charges. Moreover, confidence could also be enhanced through the

introduction of a 'Customer Performance Charter' to lay down timescales for responding and providing quotations or scheduling of works to ensure that minimum standards are met.

28. Finally, the changes to Reconnections and Disconnections could also provide a more efficient process for customers. Both currently suffer delays in some cases and, while the proposals need some clarification, there is potential to speed them up.

29. In summary, non-household customers have the prospect of improved and more tailored levels of service, and almost all of them should also see their bills fall in real terms. In a period when energy bills will go up significantly, this is excellent news.

30. I will now turn to the other key implications for water services from the economic downturn and the public spending squeeze.

31. It will be vital that the provision water infrastructure is an enabler for development. The Scottish Government's National Planning Framework 2 highlights that, with a legacy of underinvestment, substantial funding for maintenance and

enhancement is required, from the Borders to the Highlands. SCDI believes that it should not be simply left to developers to meet the cost of the additional capacity, particularly at a time when the commercial viability of projects will remain under severe pressure. Both developers and Scottish Water, in the form of new customers, will benefit from new developments and both should, in consequence, bear a proportion of the costs.

32. The Draft Determination allows £258.9m less for investment across the programme than the claim from Scottish Water. This is a significant difference amounting to 8% of the total. In arriving at the Final Determination, the Water Industry Commission should consider if the objectives of the Scottish Government can be delivered with this lower level of investment.

[For Glasgow Customer Event Only]

33. Here is Glasgow, in view of the climate change challenge and the regeneration opportunities, the Scottish Government's National Planning Framework 2, the long term spatial strategy for Scotland's development, designates the Metropolitan

Glasgow Strategic Drainage Scheme as a National Development. Substantial improvements in drainage infrastructure and water catchment management are required to reduce flood risk which stems from under-investment over decades. The development also has a key role to play in facilitating regeneration on the east side of the Glasgow conurbation. This demands a strategic approach in which drainage and catchment management measures are co-ordinated with major transport infrastructure projects such as the M74 Extension and East End Regeneration Route; the regeneration of the Clyde Gateway; and the developments of the 2014 Commonwealth Games facilities at Dalmarnock and the Glasgow and Clyde Valley Green Network.

- 34. The Metropolitan Glasgow Strategic Drainage Partnership, which includes Scottish Water, has been put in place to take forward this National Development. SCDI understands that, while it has not yet secured all the funding needed for the long-term scheme, there is sufficient funding within the Draft Determination to keep it on track. This includes work to find more cost-effective solutions. Hard engineering solutions are being replaced where possible by soft engineering solutions, such as Sustainable**

Drainage Systems (SUDS), which as well as addressing the drainage problem, also adds value, by increasing economic competitiveness, strengthening communities and improving biodiversity. Overall cost estimates for the scheme are reducing from their original projection, but they are still considerable and the partnership must continue to be adequately resourced.

[For Aberdeen City and Shire Customer Event Only]

- 35. A key challenge for the water industry in Aberdeen City and Shire over the next regulatory period will be in supporting the delivery of the recently approved Structure Plan. SCDI provided detailed comments on this guide for development up to 2030 and endorses its vision of making the North East an even more attractive, prosperous and sustainable European city region. Growth is planned in three main corridors and the aim is to grow the population by 40,000 over 24 years, with at least 2,500 new homes a year being built by 2014 and 3,000 by 2020, and at least 60 acres of land available to businesses at all times in a range of places within both Aberdeen City and Aberdeenshire.**

- 36. The plan recognises that development in these areas will bring about significant need for improvements to infrastructure, including new water and wastewater systems, and that the public sector, developers and landlords will all make a contribution. The region's main source of drinking water, the River Dee, is a resource which is already under pressure. The plan seeks to avoid having to increase the amount of water Scottish Water are licensed to take, as a result of the new developments, by stating that local development plans and supplementary guidance should therefore make it a requirement for water-saving technology to be used in all new development.**
- 37. SCDI is encouraged by the progress which has been made in installing meters into non-household sites and welcomes the proposal in the Draft Determination of £1m funding a year for three years for the first trial of household metering in Scotland.**

[For Glasgow and Aberdeen City and Shire Customer Events]

- 38. Turning to the construction industry, it is clearly sensible to ensure that any investment programme is deliverable. Previous**

programmes have stretched Scottish Water resulting in delay and deferment of projects has caused problems for Scotland's civil engineering and development sectors, not to mention cost increases. But significant improvements were achieved in the last one. There is no reason why such a programme could not be effectively delivered and managed were it to be properly planned and evenly spread over the regulatory period, and it is a concern that implementing substantial adjustments to Scottish Water's plans would force a review with the consequential effect that construction activity is put on hold and efficiency is lost.

- 39. SCDI does welcome the proposed lengthening of the regulatory period from four to five years. This will further improve stability and certainty in investment, which SCDI has supported. However, SCDI understands that this does not negate the need for overhang between investment programmes and that removing it would severely reduce workloads in transition periods. It believes that there is a continuing role for a limited and controlled overhang to smooth the investment profile. Moreover, the current parallel regulatory periods north and south of the border require both areas of the UK to compete for**

resources at the same time. SCDI continues to recommend that the Scottish and English programmes are moved out of step.

40. I want to touch, too, on the financial sustainability of these proposals. Their success is based, one hand, on increased customer numbers and revenue for Scottish Water, and, on the other, the ability of the Scottish Government to allow Scottish Water to borrow roughly in line with the Draft Determination. It is explained in the Draft Determination that prudent assumptions have been made about growth that are at the lower end of recently observed trends. However, in the current economic conditions, it is possible that the forecasts may be challenging.

41. Even if they are realised, Scottish Water will still need to be allocated £700 million of scarce Scottish Government funding between 2010-11 and 2014-15, and then further debt of around £170-200 million per annum, escalating at 5% per annum. For this the Scottish Government receives no Barnett funding and the Foreword to the Draft Determination highlights that, at some point, the Scottish Government may no longer be able to offer Scottish Water the full flexibility in the timing of its borrowing

that has been available in the last regulatory control period. If this is the case, the Water Industry Commission recommends using the Scottish Futures Trust as a vehicle for providing finance to Scottish Water or allowing Scottish Water to borrow commercially. SCDI agrees. Investment in water infrastructure, from any source, creates economic, social and environmental benefits. The focus in any debate on the future of water services should be how best to support sustainable economic growth.

42. So further changes to water services are almost inevitable. In closing, I want to raise some of the opportunities, from a development and industry perspective, emerging in the market. In particular, our understanding of the way tailored services are more closely aligning the interests of the supplier and customer, and will enable businesses to deliver on two of their main priorities in the next 5 years - saving money and going green.
43. While the Draft Determination does not make much reference to climate change, Scottish Water is both a sizeable contributor and in the front line of the response. Its capital investment programme to deliver water and waste water services that

comply with ever tighter drinking water and environmental standards is leading to a one to two per cent annual rise energy demand and increased carbon emissions. The Draft Determination accepts Scottish Water's proposals for investment likely to address the likely implications of the Flood Risk Management Bill and contains as yet undefined enhancement which could include studies of how Scottish Water could best adapt to and mitigate the potential threat of climate change. But it is surprising that the implications of the recently passed Climate Change (Scotland) Bill are not more fully discussed, particularly as Holyrood has set a very tough target of reducing carbon emissions in Scotland by 42% by 2020.

44. This is especially true, not only because Scottish Water monitors and is committed to addressing rising emissions, but because the Water Industry Commission itself has been promoting the opportunities which competition has created.
45. Vertically integrated companies have a clear financial incentive to develop further water resources and not to reduce their revenues too far. In contrast, the financial incentive is greater

for competitive suppliers to offer water efficiency advice where this is in the interests of the customer and a tailored service on waste management and surface drainage. This may include reduced use of power in treating smaller volumes of water, less harmful discharges to the environment and less power used in pumping sewage flows to the nearest treatment works.

46. Other suggestions include single online bills to multi-site users which save paper, postage and significantly reduce the carbon footprint of the billing process for supplier and customer. Discounts may become available to organisations that can restrict their use of water at certain times of day. Or water and wastewater capacity could be traded or shared between companies with different peak usage. This could reduce the need for abstraction in some areas and could at least postpone the need for building high carbon emitting desalination plants.

47. As with smart meters for electricity, the key point is that the customer has much greater control. And your water services can be designed around your response to the challenges we all face. Thank you and I will do my best to answer any questions.