# Debt and new economic structures: the financialisation of water

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*This is a work in progress so comments are welcome but please do not cite or quote. This builds on an earlier paper on the financialisation of water (forthcoming) and will lead into work that is starting at SOAS on systems of provision for the delivery of water and housing. This is a preliminary overview at this stage.*

## 1 Introduction

Privatisation has transformed water delivery systems. While, for households little may have changed, the underlying institutional structure has metamorphosed so that global financial capital is now an integral part of the water supply. Privatised water is now deeply embedded in the world's financial sector. Water has been transformed from a public service to an asset class with complex financial transactions and ownership structures involving companies and investment banks from around the world. Delivery systems for water have been transformed to suit the interests of global financial capital.

## 2 Financialisation

Financialisation refers to the phenomenon that has emerged over the past two decades which has led to a huge increase in financial relative to non-financial economic activity while financial profits constitute an increasing share of total profits, particularly in the US and UK. There have been different definitions of the term. For Epstein (2002, p.1), "'Financialization' refers to the increasing importance of financial markets, financial motives, financial institutions, and financial elites in the operation of the economy and its governing institutions, both at the national and international levels".

Financialisation is associated with greater policy influence of a financial elite and a shift in emphasis and power from the 'real' to the financial economy. It captures a pattern of accumulation where profits accrue primarily through financial channels rather than trade or the production of goods. For non-financial firms, financialisation has meant that ownership is increasingly with financial investors and even non-financial owners prioritise shareholder value. Stock options have been used to align the interests of managers with those of shareholders (Rossman and Greenfield 2006).

Outcomes from financialisation include a short-term perspective and rising inequality. Managers, judged by the share price, are under pressure to pay dividends at the expense of wages and long-term investment. There is growing evidence of a persistent decline in the labour share of income (Rodriguez and Jayadev 2010). Palma (2009) provides an account of a new 'technology of power to help transform capitalism into a rentiers' delight' (p. 14).

## 3 Water privatisation and financialisation

The privatisation of water is part of the financialisation process. Bringing the private sector into water delivery contributes to a fundamental shift so that the system of provision is shaped to suit the interests of the global private (financial) sector. There are different dimensions to this. First, one of the key reasons for privatisation is that the private sector is considered to be more efficient than the public sector because of the discipline imposed by the profit motive. However, the notion of 'efficiency' is usually conceived and measured in financial terms. Public and private organisations have different objectives. The private firm has a duty to its shareholders to maximise profits. The government has a duty to its electorate. The process of privatising conflates these possibly very different objectives into targets that are often evaluated by monetary indicators.

Second, privatisation means that water is treated by the owners of private water companies as a commodity like any other. Typically, the private owner has the right to revenue collected from the sale of water, out of which expenses have to be paid and maybe a concession fee. The residual rests with the private operator and feeds into the company's overall profits and dividends. In the public sector, revenue may remain with the utility for reinvestment or be transferred to the state. Privatisation changes the management focus and can mean that a public sector strategy based on long-term investments to ensure the availability of safe and affordable water is replaced by a short-term private sector strategy based on maximising dividends.

Third, privatisation transforms a public service into a tradable asset. At present the buying and selling of water itself is limited but shares in firms that specialise in water privatisation are traded on the world's stock exchanges. Investment fund managers perceive water-related investments to be attractive as water scarcity is expected to increase and it is possible to invest in water related exchange traded funds and other investment products. This process connects households in countries across the globe that have privatised water to the world's richest whose investment fund managers have bought stocks in water related companies. This is discussed in more detail below.

Thus, privatising water – which is monopolistic in provision and essential to all life forms – ensures that management of this resource is carried out in a way that suits the needs of investors rather than users. It may be that to some degree these coincide – satisfied customers are more likely to pay their bills on time – but there are likely to be inconsistencies. For example, water companies' remuneration is usually based on the amount of water consumed and so they have a disincentive to encourage water management in households. Investment in water infrastructure is expensive and it takes a long time to recoup costs so private firms have little incentive to do this.

Finally, firms have an incentive to overstate costs and understate profits, to engage in transfer pricing and to do what it takes to avoid paying taxes. Regulating the sector is demanding. Privatisation does not mean that the state is no longer involved but the nature of the involvement is different. From being a service provider, the state is a financier of infrastructure and a regulator – but often without the revenue that is associated with payment of water bills. There is now a financial leakage to the private sector.

## 4 The UK leads the way

Private water companies are active players in the financialised world. Water privatisation in the UK in 1989 preceded most others and has evolved so that initial listings on the London Stock Exchange have been transformed into a complex web of financial structures with ownership in some cases resting with offshore companies based in tax havens. Thames Water, for example, the largest of ten water companies in the UK, was acquired by RWE, a German infrastructure company in 2001 for £5bnbefore being sold to Australian Finance company Macquarie in 2006 for around £8bn.[1] According to press reports, just before the sale to Macquarie, RWE took an estimated £400m out of the business and loaded it up with more debt with a complex financial restructuring of the business through the issue of new bonds.[2]

The current ownership structure is complicated. Thames Water is owned by Kemble Water Limited which is owned by Kemble Water Holdings Ltd. The investors in Kemble Water Holdings Limited comprise Macquarie's European Infrastructure Funds 1 & 2, certain other Macquarie-managed funds and various non-Macquarie investors made up largely of pension funds and other institutional investors and pension funds from Europe, Canada and Australia.[3] In 2011, Macquarie sold a 9.9% stake to the Abu Dhabi Investment Authority [4] Owners of Thames Water also now include the China Investment Corporation who have an 8.7% stake[5] and in 2012, 12.4% was acquired by the UK's largest pension fund, the BT Pension Scheme for an undisclosed sum.

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[1] http://www.guardian.co.uk/business/2006/oct/17/utilities

[2] http://www.independent.co.uk/news/business/news/rwe-takes-163400m-out-of-thames-water-ahead-of-selloff-414961.html

[3] http://www.thameswater.co.uk/about-us/7565.htm

[4] http://www.4-traders.com/MACQUARIE-GROUP-LIMITED-6491460/news/Macquarie-Group-Limited-Macquarie-Auctioning-Stake-In-UK-Water-Utility-Report-14236546/

[5] http://www.telegraph.co.uk/finance/newsbysector/mediatechnologyandtelecoms/9301589/BT-Pension-Scheme-seals-deal-for-13pc-stake-in-Thames-Water.html

This is an attractive investment. In 2011 Thames Water made operating profits of £650m but paid no corporation tax and has paid out £1.08bn in dividends over the past four years.[6] Meanwhile, the regulator, Ofwat has no mandate to regulate the broader corporate structures or tax affairs of the parent companies underpinning water services outside the appointed water companies. [7]

Another UK water company, Southern Water, the seventh largest of the ten water and sewerage companies in England and Wales is similarly entrenched in the global financial system. Southern Water was taken over in 2007 by Greensands Investments Ltd for £4,195m. This company is 100% owned by Greensands Holdings Limited which was reported by Ofwat (2008) to be owned by a consortium of infrastructure and pension funds and seems to be registered in Jersey.[8] According to an Ofwat (2008) report, the investors with three the largest shareholding in Greensands are:

- IIF Int'l SW UK Investment Limited (IIF) (a company registered in the Cayman Islands[9]) (28.1% equity stake).
- Challenger Infrastructure Fund (Challenger) has a 23.4% equity stake in Greensands via its ownership of Challenger Harbourmaster Holdings Jersey Limited.
- UBS AG has a 15.6% equity stake in Greensands which it will transfer to its UBS International Infrastructure Fund in 2008.

The remainder of the equity in Greensands is held by a total of 12 investors.

There has been an increase in the role of Asian investors in UK water companies. Wessex Water was bought by Malaysian firm, YTL, in 2002. Cheung Kong Infrastructure (CKI) Holdings Limited took over Northumbrian Water in 2011.[10] CKI is a limited liability company incorporated in Bermuda and listed on the main board of the Stock Exchange of Hong Kong Limited (Ofwat 2011). The company is owned by a Hong Kong billionaire Li Ka-shing. In addition to Northumbrian Water, CKI also owns three UK electricity distribution companies distributing about 28% of the electrical power in the country as well as gas businesses. In July 2012, CKI reported an 18% rise in interim net profits mainly on the strength of its UK portfolio which includes Northumbrian Water.[11]

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[6] The Guardian 10th November 2012 'Water companies pay little or no tax on huge profits'. http://www.guardian.co.uk/business/2012/nov/10/water-companies-tax

[7] http://www.guardian.co.uk/business/2012/aug/05/thames-water-tunnel-simon-hughes

[8] https://www.jerseyfsc.org/registry/documentsearch/NameDetail.aspx?id=125134

[9] http://vessta.com/en/1000041145-IIF-INT-L-SW-UK-INVESTMENT-LTD..html

[10] http://uk.finance.yahoo.com/news/HSBC-Holdings-PLC-HSBC-Bank-afxcnf-3555398602.html

[11] http://www.ft.com/cms/s/0/90cf6e40-d187-11e1-bbbc-00144feabdc0.html#axzz2DLDUZBNF

The scale of investment required to participate in the sector rules out all but the biggest players. The consolidation of financialisation has meant that few have the resources to take on the huge global players. According to an article in the FT (July 2012) about Mr Li-Kashing, the owner of CKI, "it has become harder for UK pension funds to join the market since overseas investors have become so prominent and prices have risen. Many home-grown funds are too small to afford the expertise needed to make the most of such complex investments". [12]

More research is required to analyse the detailed ownership structures of the UK water sector. In addition, the impact on investment and on consumers needs further analysis. However, clearly the financial sector has become more deeply involved in service delivery with ever more sophisticated tools and structures. This is a major transformation from the Regional Water Boards that were responsible for water until 1989. Ownership is increasingly with financial firms and shares are bought and sold according to corporate strategy. Complex ownership structures and financial transactions are often outside the scope of the regulator, Ofwat. Aside from the details of ownership in the sector, the process of sales and acquisitions also supports the financial sector with major finance companies such as Nomura, JP Morgan, Macquarie etc providing financial services and advice on complex transactions.

## 5 Water financialisation elsewhere

Developments in the UK have so far not been replicated elsewhere. Most water in Europe is in the public sector and there have been remunicipalisations in some locations (Paris, Hungary). Privatisation in Europe is dominated by two companies: Suez and Veolia (Hall and Lobina 2012). These companies are also the top two investors in water privatisation globally over the past two decades according to the World Bank's Private Participation in Infrastructure (PPI) database. Most of the activities of these companies take place in Europe but they have investments around the world including in Latin America, Asia and Africa (including Niger, Gabon), although activities in developing countries are on the decline (Hall and Lobina 2012).

For the financial sector, water presents an attractive business opportunity. For example, according to Investopedia, July 2011:

> "Recent years have seen an upswing in the demand for investments that seek to profit from the need for fresh, clean water. If the trend continues, and by all indications it will, investors can expect to see a host of new investments that provide exposure to this precious commodity and to the firms that deliver it to the marketplace."[13]

Several specialist water-focused investment funds have emerged to take

[12] Financial Times 25th July 2012 'A long view of investments from Hong Kong'
[13] http://www.investopedia.com/articles/06/water.asp#ixzz2DQWQcUvP

advantage of the anticipated scarcity such as the Pallisades Water Indexes, and there are Exchange Traded Funds that specialise in water. These water investment vehicles hold shares in companies that are involved in producing water equipment such as filtration as well as companies that manage and distribute water such as Veolia and Suez and utilities such as Severn Trent in the UK.

As with the private equity firms in the UK water sector, ownership of stakes in these investment funds is with high net worth individuals as well as pension funds. Water privatisation, therefore, in the context of financialisation, connects the world's wealthiest investors as well as pension funds with households paying their water bills around the world. Revenue from water sales contributes to corporate profits which are distributed as dividends to those that own the stocks, with remuneration for financial advisers along the way. The combination of water financialisation and privatisation has created a channel for the global trickle-up of income and wealth, even more so when ownership rests with companies based in tax havens.

For this to be of any benefit to households and to society, the process would need to be associated with considerable improvements in efficiency as well as substantial investment in infrastructure. Neither of these is readily apparent from an initial review of the literature and detailed meta-level analysis finds no empirical effect of cost savings from private production (Bel et al 2010).

## 6 Water privatisation and debt

Water privatisation has long been linked with donor conditionality in developing countries (eg Actionaid 2004). Now it seems that debt is the catalyst that is forcing water privatisation on to the agenda for indebted European countries (Hall and Karunananthan 2012). This is despite the trend elsewhere in Europe towards less rather than more privatisation as some contracts have not been renewed and others have been remunicipalised (most notably, Paris) (Hall and Lobina 2012).

Under pressure from donors,[14] the Greek government has announced a wide ranging privatisation programme including rail and road transport, airports and ports, utilities, gaming and public real estate holdings.[15] As part of this programme the government is planning to sell 23% of Thessaloniki Water utility EYATH, and 10% of Athens Water and Sewage utility EYDAP, although the government will retain a 51% controlling stake in these companies.[16]

[14] Reuters, 14th May 2011 'EU, IMF pushing Greece to fully privatize utilities – reports'
[15] http://www.minfin.gr/portal/en/resource/contentObject/id/2f09efef-f916-4450-8236-de0606f1e12d
[16] http://www.minfin.gr/portal/en/resource/contentObject/id/2f09efef-f916-4450-8236-de0606f1e12d

The objectives of the programme include: 'leveraging private investment to help restructure the Greek economy, safeguard the public interest and contribute to the on-going fiscal consolidation effort.' [17] However, the likely result is that the privatisations will be difficult to achieve in the current economic climate so will be at knock down prices and they will be of little benefit other than to further entrench the interests of private financial capital in the delivery of basic services.

## 7 Conclusion

Privatisation creates a transformation in socio-economic relations with regard to water. There are numerous alternatives to privatising water and examples of successful public water utilities are widespread (see for example McDonald and Ruiters 2012). There is no need to privatise. Water privatisation is being pushed by donors even though there is very little evidence that it will raise much revenue or will lead to cost reductions. The process of privatising and regulating will be costly. However, privatisation can be expected to ensure that these utilities become part of a global financial system of water delivery which has brought financial benefits to the wealthiest. In the name of easing the European debt crisis, basic services will be managed to suit the needs of the world's richest investors suggesting that in water –as elsewhere - the global power system is increasingly shaped to suit the needs of private financial capital.

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