



## Abolition of Domestic Water Charges in Ireland

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This note is presented as part of a joint initiative on Economic Incentives and Water Resources Management implemented by the World Bank's Agriculture and Rural Development, Environment, and Water Supply and Sanitation Departments and the International Food Policy Research Institute (IFPRI).

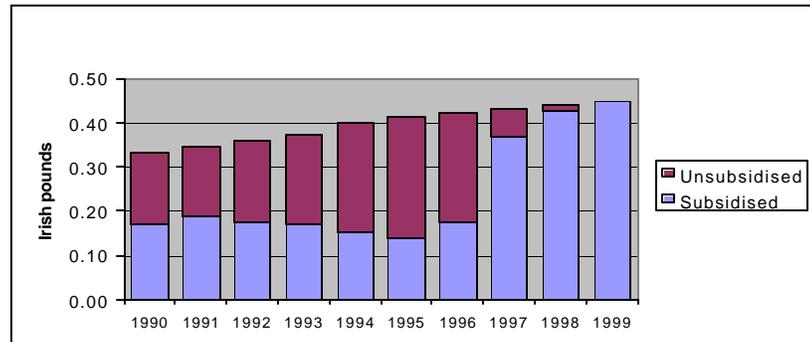
The abolition of domestic water charges in Ireland shows how income distribution issues are ignored at one's peril. In brief, the abolition of domestic water charges was conceded prior to an election in Ireland in 1996, on foot of a threat to a government seat from an "abolish water charges" candidate. The existing water charges were unpopular with certain sections of the community, for several good reasons. Being unmetered they were not related to quantity, the bill was infrequent and therefore large (arriving at reportedly awkward times for some families, for example, at the same time as back-to-school expenditures) and the method for dealing with vulnerable families was not standardized and not always adequately addressed. Some local authorities had sought a standardised method for dealing with the problem, which was not forthcoming. Because the income considerations were not adequately addressed, Ireland slid into what can only be called Negative Environmental Fiscal Reform and abolished domestic water charges altogether. This has several adverse effects.

Although the marginal cost of water did not change with the abolition of charges, a boom in house construction has added over a fifth to the housing stock. Bye-laws are gradually tightening up on water-using

equipment but without metered charging there is no encouragement for individuals to consider seriously the water using characteristics of new dwellings. Increased wealth has brought higher ownership of water-using equipment. Under an 'absent hand', a generation of people is growing up without realizing that water is expensive to deliver. According to a water industry source, Irish households use more water than UK metered equivalents. Investment costs are rising as water is accessed from further afield and from water bodies that are potentially sensitive fish habitats. Some public sector establishments are also traditionally exempt from water charges, and it is known that one proposal to invest in re-circulation of 'grey water' in an education establishment was turned down where correct (or shadow) prices might have shown the investment to be worthwhile. With excessive water use not discouraged, Ireland is climbing up the marginal cost curve more quickly than necessary, owing to wastage by customers and suppliers. Investment will need to be undertaken sooner than otherwise and extra costs will be incurred. Population growth, declining household size, higher standards and, potentially, global warming call for increased capacity and underline the importance of good economic signals.

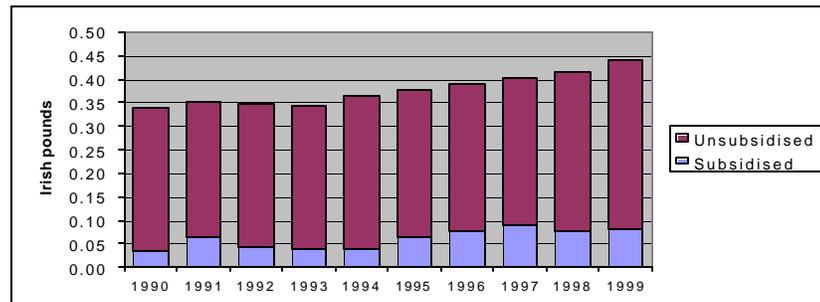
Water services are the responsibility of local authorities, which receive a subsidy from central government. Charges to industry, by contrast with households, were not abolished and the aim of present policy is to reflect costs fully in the charges faced by industry, phased in over a few years. Management information is sparse but the current cost and subsidy per cubic metre of water consumed were recently estimated, and are illustrated in Charts 1 and 2. Capital expenditure on water supply would add between a third and two thirds again on top of the current costs.

Chart 1: Current cost and subsidy per cubic meter of water consumed by the domestic sector (estimates)



1 Irish Pound = \$US 1.4259 in 1998

Chart 2: Current cost and subsidy per cubic meter consumed by the non-domestic sector (estimates)



A recent survey indicates that a majority of people would like to pay for water according to the amount used. Although domestic water charges are not on the political agenda, local water authorities are financially stretched. The Minister for Finance recently said that he favoured water charges in principle and a member of the opposition front bench was quoted as favouring them “provided people are not also paying for them to central government”. This reflects the oft-stated view that environmental charges would represent “double taxation”, despite the fact that income taxes have been reduced of late; at the last general election in May 2002 a small party mounted a campaign similar to that of 1996, that was “anti-bin charges” and “anti-local charges”. Meanwhile, persons familiar with the water industry

suggest that reintroduction of domestic water charges, with metering, is inevitable sooner or later.

The distributive incidence of the present method of payment via the tax system is broadly progressive. Reintroduction of charges would need to deal with the perception of “double taxation” and, in particular, with the issue of regressivity. Unless it is seen to do so the electoral consequences could be serious. In the UK private water service operators cross-subsidize from rich to poor customers and Flanders operates an especially progressive tariff. Apart from likely mistrust of the adequacy of this approach, utilities may not be the best bodies to undertake such ‘social’ tasks and ought not to be distracted from their core role of providing an efficiently run service. Government departments of social welfare tend to have more focused expertise and routines for dealing with vulnerable households and inability to pay, though utilities obviously have a role to play as an interface and by having procedures in place for emergencies.

Unless mitigating tariffs were used, reintroduction of charges would need to be accompanied by a clearly well-targeted and progressive form of compensation. Compensation would provide the stronger price signals to encourage technology change and good water-using behaviour. The options for compensation are: (1) lump-sum compensation, (2) income-tested compensation and (3) an ordinary reduction of general taxes. Compensation via (1) or (2) could be better focused on distributive concerns and therefore more politically acceptable. We look here simply at option (1), lump-sum compensation, for which some estimates have been made.

Lump-sum compensation foregoes the benefits of using the revenue to reduce other taxes, but the guarantee of compensation to all could help

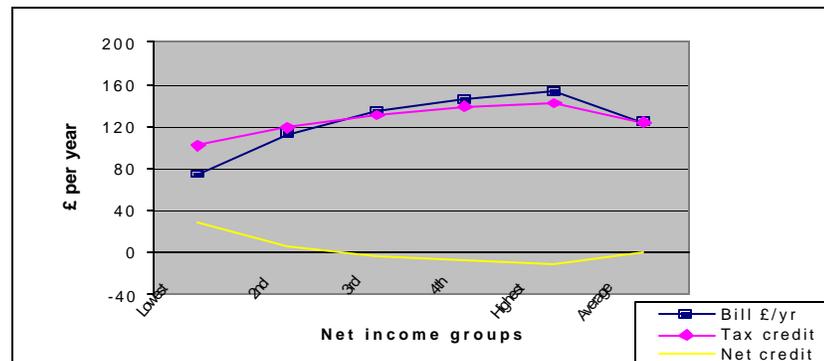
to implement the reform. This might be achieved through a mechanism such as ‘non-wastable’ tax credits that is being introduced in some jurisdictions, notably in the UK though not in Ireland as yet. These are like a negative income tax enabling people who cannot benefit from tax credits, by dint of their low tax bill, to receive compensation.

*Example of how revenue could be recycled as lump-sum compensation:* This example takes account of actual ownership of water-using equipment in Ireland by income group. It further takes into account the fact that use per head declines with increasing number of household members. Owing to shortage of Irish data, it uses UK water usage patterns and covers only current costs of water and waste water services. Evidently the charge on its own would be regressive, amounting to approximately 1.5 per cent and 0.35 per cent of net household income in the lowest and highest income groups, respectively.

Chart 3 shows the water services bill paid, called Bill £/yr, by income group and by the average household. To be progressive and arguably fair, compensation could relate to average water use per head that is typical of each household size. Compensation calculated on this basis is shown in Chart 3 as the line called ‘tax credit’. It can be seen that the credit starts at a level that is higher than the bill in the case of low-income households and then crosses it. Comparing the two lines, households on lower incomes are more than adequately compensated by this method, and those with higher incomes are under-compensated. The net effect, the difference between the compensation and the bill, is shown as ‘net credit’ at the bottom of the figure. For the average

household, shown on the right-hand side, the net credit is consequently zero.

Chart 3: Hypothetical calculation of the annual household bill in the event of charging for water services, tax credit and net change in the household's financial situation, by income group



This progressive outcome could only be achieved if a system such as non-wastable tax credits were in operation (called ‘refundable tax credits’ in Ireland). In addition to the need to set up such a system there is the task of obtaining the numbers of inhabitants in each household in order to allow the calculation of “credit due” in a way that takes account of higher usage per head in households with few inhabitants.

The recently introduced system of ordinary tax credits in Ireland is a small step that brings closer the possibility of granting non-wastable tax credits that would enable lump-sum compensation. It would then provide a simple way of redressing the regressive effects. At present however, tax credits can only benefit those households that are paying tax. Non-wastable tax credits are currently under investigation by a government working group.

The findings, interpretations, and conclusions of this note are the author's own and should not be attributed to the World Bank, its management, its Board of Executive Directors, or the countries they represent.

### **Additional Reading**

- Scott, Susan, and John Eakins (2002). "Household Income Effects and Implementation Options". Chapter 4 in: *Green and bear it? Implementing market-based policies for Ireland's environment*. Daniel McCoy and Sue Scott (editors), Dublin: Economic and Social Research Institute.
- Scott, Susan (2001). "Water pricing: conceptual and theoretical issues", in European Commission, *Pricing water - economics, environment and society*. Conference proceedings, Sintra 6-7 September 1999, ISBN 92-894-0681-X.
- Scott, Susan, J. Curtis, J. Eakins, J. Fitz Gerald, J. Hore (2001). *Time series and eco-taxes*, report to Eurostat. Ref no. KITZ99/274, Sub 99/39963.