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How (Not) To Do Public Policy: Water Charges and Local Property Tax

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Table of Contents

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My thanks are due in the first instance to Alan Ahearne for embracing this project, seeking and obtaining the funding for it, and providing the support and encouragement that doing this kind of work requires.

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Finally, a word of appreciation to Whitaker Institute staff, especially Gwen Ryan, who played a key role in getting the final product over the line.

Any errors, omissions or frailties of logic that have survived my interactions with all of the above are entirely of my own making.

Jim O'Leary

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Director’s Foreword

The Whitaker Institute is committed to producing innovative, evidence-based research into issues relevant to public policy in Ireland and abroad. Our objective is to influence and improve public policy by advancing the frontier of knowledge across a wide range of policy issues and disseminating to policymakers and others the results of our research.

Through the research of scholars at the Whitaker Institute and elsewhere, we have gained a richer understanding of the effects of public policies in Ireland. What is much less understood, however, are the strengths and weaknesses of the policy-making process in Ireland. How are good policy ideas generated in practice, and how are policies designed, implemented, communicated and subsequently reviewed? Can the process by which we go about making policy be improved, and if so, how? What role is played by the various actors in the process, such as politicians, civil servants, consultants, lobby groups, academics, the media and the general public? It is these important questions that motivated the work in this report.

The approach in this study is to focus on a recent policy success, the Local Property Tax (LPT), and a recent policy failure, water charges, and to ask: Why did one policy succeed while the other failed? In doing so, we are attempting to learn about the policy-making process and identify reforms that could make that process more effective.

High-quality research requires a strong evidence base. It was not obvious at the outset of this project that there was going to be enough information available to researchers to allow for a scientifically rigorous study. In the end, however, through meticulous desk research and interviews with many of those who were insiders in the policymaking process, Jim O’Leary has produced an extremely well-informed, thorough and compelling study.

Three findings in relation to the spectacular failure to introduce water charges stand out for me. First, the strong desire of policymakers to move investment in water off the national balance sheet, though understandable, greatly complicated efforts to design sensible policy. The report refers to this as “a treacherous basis for policy.” The fiscal space generated by moving water off-balance-sheet should have been considered a bonus, not an objective of policy. Second, the unintended consequences of some features of the charging structure such as free allowances were not well understood. Good policymaking requires all options and all aspects of the options to be investigated. Third, the government set unrealistic timeframes for implementation given the massive scale of the water project. Policymakers should be careful not to let perfect be the enemy of good. I find it striking that the Commission on Taxation in 2009 offered a much better blueprint for charging for water, but unfortunately its recommendations relating to water charges were ignored.

In contrast, the implementation challenges associated with the LPT were anticipated and well thought through in advance. Ironically, the Commission on Taxation’s recommendations on property tax provided the blueprint for the LPT. Of course, property tax is a live issue, with the LPT scheduled to be revisited this October in Budget 2019.

This is a report that I am confident will have impact on how policy is made. My thanks to Jim O'Leary for his dedication and diligence in producing a very valuable piece of research. I would also like to thank Angela Sice and Gwen Ryan at the Whitaker Institute for all their help on this project. Finally, I am very grateful to Galway University Foundation, and especially the Foundation's Chief Executive Tom Joyce, for supporting this project.

We all have a stake in making the policymaking process more effective. If we do not learn from past successes and failures, we are bound to repeat our mistakes.

Alan Ahearne
Professor of Economics
Director of the Whitaker Institute
NUI Galway

Executive Summary

- The Local Property Tax (LPT) was successfully introduced because its design was infused with a keen awareness of the importance of anticipating implementation challenges. In this regard, a key moment was the decision to give responsibility for collection and administration to the Revenue Commissioners.

- While the Revenue's involvement may have been a necessary condition for delivering the LPT's yield and compliance outcomes, it was almost certainly not a sufficient condition for the continued existence of the tax. This has required that the tax accord with common notions of what is fair—and that it be seen to do so. Equity, simplicity and comprehensibility, therefore, have also been important features, features to which the designers of the tax paid due attention.

- There is one sense in which the success of the LPT may be regarded as provisional: The political system has yet to demonstrate its capacity to adapt the tax to rising property values. To date, revaluation for the purposes of updating liability has been postponed once and may be postponed again.

- Moreover, the opportunity to use the LPT as a means of achieving a significant rebalancing of the overall tax burden, a potentially important secondary purpose, looks likely to be neglected. Instead it seems that policy will be geared towards ensuring that the yield from the tax does not increase appreciably.

- From the point of view of the policy-making process, there is a limit to the comparability of the LPT and water charges. The former was approached as a relatively straightforward revenue-raising exercise. By contrast, the proposal to charge for water was just one element in an ambitious, multi-faceted reform programme, the other main elements of which were the installation of meters on a nationwide basis, the establishment of Irish Water, and the setting up of a system of economic regulation for the sector.

- The scope and complexity of the water sector reform programme were, however, the result of policy choices. A decision to simply introduce water charges could have been made. This is not to suggest that the other elements in the plan actually pursued did not have merit, but that their inclusion multiplied the possibilities of error and misjudgement and the targets of protest, particularly given the timeframe adopted.

- The over-arching goal of the water sector reform programme was to establish a water utility that could independently borrow to finance a heavy programme of investment in water infrastructure. For this to happen, the water utility had to be classified outside the general government sector by passing the so-called 'Eurostat test'. This was a treacherous basis for policy, since Eurostat's classification methodology was complex and elusive, much more so than appears to have been anticipated by Irish policy-makers.

- The objective of passing the Eurostat test also had strong and unhelpful implications for water charges. In simple terms, it meant that the average household charge had to be higher than it would otherwise have been.

- The design of the initial (July 2014) tariff structure was also constrained by the decision to grant a 'free' water allowance to all households. An inescapable implication of this choice was that, for a given customer revenue target, the charge per unit of water used had to be higher than otherwise. This in turn meant that the degree of dispersion of household bills was amplified with many households facing bills that were several multiples of the average.

- The universal free allowance is one example of a policy choice made before its implications were properly understood and without the alternatives being rigorously assessed. Another example relates to metering, where the cost benefit analysis (CBA) evaluated a programme of universal mandatory installation (the approach chosen) against the *status quo* of no meters, but did not evaluate any of the intermediate solutions. Moreover, the CBA was carried out after the government had committed to universal metering.

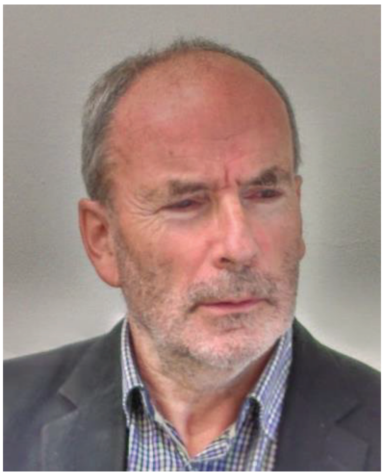
- Metering also provides an example of a serious disconnect between policy design and implementation. Here, foreseeable events delayed the start of the installation programme and widely-known technical problems reduced its scope, such that the initial promise on which policy was based, namely that charging would not start until metering was complete, was undermined.

- The government found itself battling against a rising tide of opposition to water charges in the autumn of 2014. The proximate cause was the charges plan announced in July of that year, but we would suggest that the ultimate source of the problem was a failure to appreciate the scale of the regime change that was being attempted — a shift from zero prices to a volumetric charging system that would generate sufficient revenues to pass the Eurostat test — and to design a set of suitable arrangements that would have eased and lengthened the transition.

- A sense of trying to achieve too much too soon is suggested by the approach to the tariff structure. The same is true of the overall water sector reform programme. All in all, in examining policy on water, our reading of the evidence is that it was driven by a vision that would have been more appropriate for a 7–10 year timeframe than a 3–5 year period.

- A more incrementalist approach, albeit one guided by a clear strategic purpose, would, we think, have offered a much better chance of success. Such an approach was proposed by the Commission on Taxation in its 2009 report. It recommended that charges be gradually raised from an initial modest fixed amount to a full cost recovery level based on volumetric billing eventually. It also favoured optional rather than mandatory metering.

About the Author



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Jim's career has spanned the public and private sectors and the groves of academe. He is a former Chief Economist with Davy Stockbrokers, Senior Fellow in Economics at NUI Maynooth, and Irish Times columnist. He has worked in the ESRI and the NESC, and as an Economics advisor in two government departments (An Taoiseach in 1983-84 and Finance in 2010-11). He has also served on a number of boards including Aer Lingus, AIB, Gresham Hotels, and Bank Zachodny WBK (Poland), as well as the National Statistics Board and the Public Sector Benchmarking Body.

Chapter 1: Introduction

Background

Two of the most contentious measures introduced as part of the severe fiscal consolidation necessitated by Ireland's recent economic and financial crisis were the Local Property Tax and water charges.

The two measures had an amount in common. Initially it was envisaged that each would raise of the order of €500m annually.[1] They also shared a troubled history. Attempts to implement water charges in the 1990s had run into sufficiently strong opposition as to render them a no-go area for policy makers for the next decade or more. The fate of the modest and short-lived Residential Property Tax, abolished in 1997, had a similar inhibiting effect on policy in relation to the taxation of property.

The crisis, in particular its catastrophic consequences for the public finances, meant that all bets were off. Revenue-raising measures previously deemed politically unacceptable were forcefully propelled onto the agenda. The first formal indication that government was proposing to reintroduce water charges and a new property tax came in the Fianna Fáil–Green Party *Renewed Programme for Government* in October 2009, a position that was re-affirmed 12 months later in the same government's *National Recovery Plan*, and subsequently in the *Programme for Government* adopted by the new Fine Gael–Labour administration in March 2011.

It is fair to say that at that stage there was no compelling reason to expect that one of these measures would be materially more unpopular or problematical than the other, yet it transpired that one was successfully implemented while the other was a failure, arguably on a scale comparable to the poll tax debacle in the UK in the 1980s.

Purpose and motivation

The main purpose of this report is to understand better why the Local Property Tax was successfully implemented and why the attempt to introduce water charges failed. A subsidiary purpose is to investigate whether and, if so, how the policy-making process facilitated success in one case and militated against success in the other.

In this connection the aspects of the policy-making process that we pay particular attention to relate to how decisions were taken, how alternative courses of action were evaluated, whether the implications of the decisions taken were well understood, and how strong was the connection

[1] According to the National Recovery Plan of October 2010, when fully operational, water charges were to raise €500m per annum and property tax €530m.

between policy design and implementation. An additional motivation in all of this is to search for lessons that may be applicable to policy-making generally.

It is important to point out that, although the core questions we address in relation to water charges and property tax are the same, our treatment of the two measures is not symmetric. This asymmetry is because water charges present a much more complex set of issues. The introduction of the Local Property Tax was motivated by a straightforward objective which was to raise revenue. In contrast, charging for water was just one element in an ambitious and wide-ranging reform of the water sector proposed by the Fine Gael–Labour government, the other key elements of which were a national meter installation programme, the creation of a single water utility, and the setting up of a regulatory framework for the sector. The evolution of policy in relation to water charges cannot be understood in isolation from these other elements.

This means that the analysis we have conducted cannot simply be reduced to a ‘compare and contrast’ exercise. In terms of the scale and scope of the policy challenge, water charges and local property tax were very far apart. This is necessarily reflected in the scale and scope of the challenge faced by analysts trying to understand how the two sets of policies evolved. In prosaic terms, and as the balance of this report’s content indicates, we ended up devoting a good deal more time and effort to understanding why water charges failed than to understanding why the Local Property Tax succeeded.

Methodology

Much of the work involved in this project was in the nature of desk research. This research included the review and analysis of a wide range of documents, including official reports, Dáil proceedings, election manifestoes, consultants’ reports and press coverage, most of which are readily available in hard copy or on-line. Other very useful material included cabinet memoranda, Ministerial briefings and e-mail exchanges between public servants where these had already been made available under Freedom of Information legislation (and was helpfully drawn to our attention by officials).

We also carried out interviews with many people who had been involved in one capacity or another in the development of water policy or policy in relation to property tax. These policy actors included senior politicians, policy advisors, civil servants, and policy analysts. We interviewed these people on condition of anonymity. The interviews were invaluable, especially because of the differing perspectives they provided and the appreciation of context that they imparted. It struck us on more than one occasion during the course of the project that a serious risk in carrying out this sort of research is the risk of developing tunnel vision: The more one immerses oneself in the detail of a particular policy area, the more one’s attention is deflected from the wood to the trees.

In this connection it is worth saying at the outset that, given the extraordinarily difficult circumstances of the time, the unprecedented strain the system of public administration was under, and the acute stress that individual public officials were subject to, it would be a source of wonder if no policy errors were made.

Structure of the report

The rest of the report is organised in six chapters. Chapter 2 sets out the historical background to water charges and local property taxation, telling the story of how they waxed and waned as items on the policy agenda from the time of the decision to abolish domestic rates in 1978 to the arrival of the Troika in late 2010.

Chapter 3 provides a detailed account of the policy making process behind the Local Property Tax, from design through implementation and subsequent review. Chapter 4 provides a similar forensic account of how water charges evolved with particular emphasis on the rationale for the various elements of the original tariff structure announced in July 2014 and the logic behind the government's revised charges plan of November of that year. Chapter 5 describes the process that led to the establishment of Irish Water before providing a detailed account and explanation of the company's failure to pass the so-called Eurostat test.

Chapter 6 examines the development of the Local Property Tax and the evolution of water charges from the perspective of the policy-making process and draws conclusions as to why, from this perspective, one was a (qualified) success and the other a failure. Chapter 7 sets out some concluding thoughts, addresses some common explanations for the water charges debacle and summarises the main findings of the report.

Chapter 2: Historical Background

Property taxation

The history of both property tax and water charges in Ireland is intimately bound up with the 1978 decision to abolish domestic rates. The domestic rates system was in essence a local property tax levied on private houses and based on valuation. The system had become discredited, in large part because the valuation base dated from the 19th century, and was seen to be inequitable. The system had also become unpopular because the burden of the tax had been increasing rapidly.

On the other hand, domestic rates provided local government with a very important source of revenue. Abolition therefore left a big gap in the accounts of the local authorities and created a situation whereby their dependence on central government increased sharply. Hence, in 1978, grants from central government amounted to the equivalent of 61% of the current income of the local authorities, up from 40% in 1976.

The abolition of domestic rates also had implications for the composition of the overall taxation burden. In particular, it resulted in a structure in which taxes on property accounted for an unusually small proportion of total tax receipts by international standards. A very modest attempt to redress this imbalance occurred in the 1980s with the introduction of the Residential Property Tax (RPT). This was a tax on private residences, as its name suggests. It was levied at a rate of 1.5%, but liability for the tax arose only when each of two thresholds was exceeded: a threshold in respect of the property value, and a threshold in respect of income. Moreover, the thresholds were set at relatively high levels.[2]

The RPT generated very low yields. In 1995 and 1996, the last two years in which it applied, the yield from the tax amounted to the equivalent in euros of just €33m (or 0.1% of total tax receipts). In 1996, the total number of assessments for the tax was 21,500 – corresponding to less than 2% of all households.[3] Despite its narrow incidence and low yield, the tax was unpopular and was abolished in 1997 in advance of the general election of that year. After the demise of the RPT, nothing much was heard of property tax in Ireland for more than a decade.

Although taxes on the stock of property were a relatively unimportant source of government revenue through the 1980s and subsequent decades, the same was not true of taxes levied on property transactions (for example, stamp duties and Capital Gains Tax). Revenue from such taxes was exceptionally buoyant in the Celtic Tiger years, and especially from 2002 to 2006. During the latter period, revenues from these transaction taxes rose from €1.8bn to €6.8bn, or from 6% to 15% of total tax receipts. The sheer buoyancy of tax revenues generally during this

[2] The thresholds in 1996 were £30,100 for income and £101,000 for property value, corresponding to around €75,000 and €450,000 respectively in today's terms. The tax was payable only on the margin above the property valuation threshold.
[3] Commission on Taxation. *Report*. 2009, 157.

time conspired with the politically problematic nature of property tax to ensure that the latter remained off the policy agenda.

That was to change with the advent of the economic and financial crisis. As the property market spiralled downwards after 2007, the number and value of transactions dropped sharply, as did the associated tax revenues. By 2009, receipts from stamp duties and Capital Gains Tax came to just €1.3bn, 80% below their peak of three years earlier, and representing barely 4% of a greatly depleted total tax take. At the same time, the condition of the overall government budget had been transformed from small surplus to yawning deficit. In these circumstances, the identification of new and robust sources of revenue became an urgent priority.

One such source had been tapped in Budget 2009, namely the Non-Principal Private Residence (NPPR) charge. This was a charge, set at €200 per dwelling, payable by owners of private rented accommodation, holiday homes, and other non-principal private residences. The charge was levied and collected by local authorities and was used to fund the provision of local services.

The NPPR charge was projected to yield €40m in its first year. In the event, it greatly exceeded expectations and generated €66m in 2009. It went on to yield close to €300m over the four years of its existence (it was abolished in 2013). In terms of yield, therefore, the NPPR was a resounding success. It is not obvious that it was as successful in terms of compliance, however, since it is not known how many people were actually liable for the tax.

The then government, formed after the May 2007 election, was a coalition of Fianna Fáil, the Green Party and the Progressive Democrats. Of these parties, only the Green Party had explicitly addressed the issue of property tax in its election manifesto, and that was to propose that commercial rates be replaced by an annual site value tax (see Box 1 for more details).[4] The Green Party did not manage to convert its coalition partners to this idea during the talks that led to the formation of the government, but the programme for government that emerged from those talks included a commitment to establish a Commission on Taxation to review the structure, efficiency, and appropriateness of the overall taxation system. The Commission was established in early 2008, and its terms of reference specifically mandated it to consider options for the future funding of local government and to examine the balance between income, capital, and expenditure as sources of overall tax revenue.

The Commission on Taxation completed its work in September 2009. Its report was comprehensive and voluminous, running to more than 600 pages. A substantial part of the report was devoted to the issue of property taxation and comprised a careful exposition of the relevant principles together with a set of detailed recommendations.

The Commission proposed an annual recurring property tax to be applied to all residences (with the broad exception of local authority housing and social housing), to be based on the open market value of the property, and to be payable by the property owner. It also proposed that

[4] The party's election manifesto stated: *'The Green Party will replace commercial rates with an annual Site Value Tax on all land, except primary homes, agricultural land and State property that is used for non-administrative purposes, based on the value that a particular piece of land would have'*.

regard had be given to ability to pay through the provision of a general waiver in respect of house-owners with incomes below a certain threshold and an option to defer payment in certain circumstances.[5]

Box 1: Site Value Tax

Site Value Tax (SVT) is, as the name suggests, a tax on the value of a site. In other words, it is a tax on the unimproved value of land. Therefore, liability for SVT is not influenced by the structures built on a piece of land; Instead it is very much a function of location and zoning.

Consider two adjoining plots of land of identical size and zoning where one is vacant and the other has a house built on it. Liability for SVT will be the same for both plots. In contrast, liability for a tax levied on the market value of property will be higher in the case of the second plot. Alternatively, consider the same two plots of land with a modest single-story two-bedroom cottage on one, and a greatly enhanced and extended version of the same house on the other. Again, liability for SVT will be the same for both plots, while a market-value based property tax will result in higher liability for the second.

These examples draw attention to one of the key arguments in favour of a SVT which is that it encourages development: it is effectively a tax on the unproductive use of land (e.g., land-hoarding). Conversely, SVT does not penalise those who maintain, extend or otherwise improve their properties. A related argument in favour of SVT is that, by dint of its discouragement of land-hoarding, it can help avert speculative bubbles in the property market, and hence reduce the risk of property market crashes. There is, therefore, a solid economic rationale for using site value as the basis for a property tax, and this is acknowledged even by those who do not advocate its introduction. On the other hand, the administrative requirements of an SVT are challenging. For one thing, given that the methodology for estimating site value is not readily available to most residential property-owners, its implementation on a self-assessment basis would be infeasible.

Lyons (2011) sets out one such methodology: a method known as hedonic price regression.[6] This is based on the proposition that the value of each property is made up of a number of components including: location, size, type (e.g., semi-detached, detached, terraced). Regression analysis based on large samples can be used to estimate the contribution of each of these components to a property's overall value. This way, the value of the site that the property occupies can be isolated and calculated. SVT liability may then be determined with reference to the value calculated in this way.

This sort of methodology may be rigorous and scientific, but it is not readily comprehensible to most taxpayers and arguably lacks transparency on that account. It was considerations such as these that led to site value being rejected as the basis for a property tax by the Commission on Taxation in 2009 and by the Inter-Departmental Group on Property Tax in 2012.

An aspect of the Commission's proposed property tax that is worth emphasising (and to which we will return in the next chapter) is that it was to be based on full market value, and not the narrower and more arcane site value measure. The Commission did consider the latter option, albeit briefly. Its verdict was that while the site value concept was supported by a strong economic

[5] The Commission did not specify a level for the waiver threshold but said that such a threshold 'should have regard to criteria such as long-term social welfare rates and the annualised minimum wage'.
[6] Ronan Lyons. *Residential Site Value Tax in Ireland: An Analysis of Valuation, Implementation & Fiscal Outcome*. 2011.

rationale, it was not a pragmatic option, given (i) the hurdles involved in constructing the requisite valuation system, and (ii) the difficulties in explaining the rationale for such a tax to the public.

Shortly after the Commission on Taxation reported, the coalition parties sat down to renegotiate their government programme, conscious of the critical need to cut government spending and raise revenue. On the revenue side, ideas that appeared unattractive two years earlier now commanded close attention. One of them was the Green Party's proposed site value tax. The *Renewed Programme for Government*, published in October, committed to the introduction of such a tax. The wording of the commitment provides a strong sense that the principal motivation was to offset the loss of stamp duty receipts.[7] It also hints at the administrative difficulties involved in its implementation.

A year later, the government published its *National Recovery Plan* (NRP), described as the blueprint for returning the economy to sustainable growth, and coming at the end of a three-year period during which GNP had contracted by a cumulative 8% in real terms. The proposal to introduce a site value tax was repeated, albeit in a somewhat altered guise. It was now envisaged that there would be a two-stage implementation process, with a flat €100 per household charge levied on an interim basis, to be followed, when valuations had been completed, by the final site value tax. The NRP was also specific in relation to yield, targeting an amount of €180m in 2012, the year in which it was intended to introduce the interim measure, and €530m from 2013 when the more permanent tax was expected to be in place.

Interestingly, it was envisaged that the tax would not only apply to households (of which there were an estimated 1.8 million) but would also apply to zoned lands 'that would equate to an estimated further 700,000 houses'.[8] Thus, it was calculated that the average charge per dwelling (or equivalent), consistent with the target yield, would be just over €200 when the tax was fully operational.

Within weeks of the NRP being published, the government entered negotiations with the EU and IMF over the terms of an €85bn package of emergency funding for Ireland. The agreement reached with the Troika contained commitments in relation to property tax, but it is important to note that these commitments did little more than transpose the proposals already set out in the *National Recovery Plan*, and were foreshadowed by the *Renewed Programme for Government* of October 2009. It is not correct to suggest therefore that property tax was imposed on Ireland by the Troika, even if its implementation, once committed to by government, was closely monitored by the Troika.

Water charges: the 1990s

One of the ways of filling the hole in local government finances created by the abolition of domestic rates in 1978 was through the levying of user charges for services such as water,

[7] *'Starting with the necessary valuation and registration process, we will move to introduce a Site Valuation Tax for non-agricultural land. This system will provide a fair and stable basis for offsetting stamp duty on residential property.'*
[8] *The National Recovery Plan: 2011-2014*, 98.

wastewater, and refuse collection. Such charges were first permitted under the *Local Government (Financial Provisions) Act* of 1983.

Indeed, the introduction of such charges became a necessity since, following the passage of the 1983 Act, the rate support grant to local authorities was reduced. In the years that followed, many local authorities throughout the country started to levy water charges. An attempt to do so was also made in Dublin, but was abandoned at that stage in the face of opposition.

The situation in Dublin changed in 1994. At the start of that year, the area previously administered by Dublin County Council, which had been a single local authority, was divided into three — Dun Laoghaire–Rathdown, Fingal, and South Dublin — and each of the new councils introduced domestic water charges within weeks of being established. In Fingal and South Dublin, the charges were set at £90 and £70 respectively; In Dun Laoghaire–Rathdown, the charge ranged from £50 to £90, depending on the rateable valuation of the property. In each case, the charge was invariant with respect to consumption. In each case too, there was a waiver system in place and this appears to have been quite generous since waivers were availed of by relatively large numbers of households.[9]

The water charges were unpopular and met with considerable resistance. The rate of payment was slow and arrears accumulated. Non-payment was encouraged by a growing anti-water charges protest movement which organised under the umbrella of the Federation of Dublin Anti-Water Charge Campaigns (FDAWCC) and elected Joe Higgins as its Chairperson in September 1994. Soon after, the campaign was provided with another tangible focal point when the first disconnections for non-payment were effected by South Dublin County Council in December.

December 1994 also saw a change of government at national level. The short-lived Fianna Fáil–Labour administration was replaced by a coalition of Fine Gael, Labour, and Democratic Left. The latter two parties, but especially Democratic Left, were hostile to water charges and were especially uncomfortable with non-paying households being disconnected. As a result, legislation was introduced in early 1995 to curb the powers of local authorities in this regard and to require them to secure court orders before disconnecting customers.[10] Water charges themselves remained in place, however, and the campaign of protest and non-payment continued.

In April 1996 a by-election was held in the Dublin West constituency to fill a vacancy caused by the death of Brian Lenihan Snr. Joe Higgins contested the election as an anti-water charges candidate. Higgins had stood in the same constituency in the general election of three-and-a-half years earlier and had secured less than 4% of the first preference vote. This time he polled almost 24% and came close to winning the seat. The sharp increase in the Higgins vote was almost precisely mirrored in the collapse in support for Labour, whose share fell from 22.6% to 3.7%. By contrast, the share of the senior government party, Fine Gael, was little changed at 13% compared with 14% in 1992.

[9] As of November 1994, based on figures supplied to the *Irish Times* and quoted in the edition of 9 November, some 30,000 households out of a total of 155,000 across Dun Laoghaire–Rathdown, Fingal and South Dublin County Council areas were expected to qualify for waivers.
[10] *Local Government (Delimitation of Water Supply Disconnection Powers) Act, 1995.*

The Dublin West by-election dramatically illustrated the political toxicity of the water charges regime then in place and drew particular attention to the Labour Party's vulnerability on the issue. By December 1996, the government had decided to abolish the local authority service charges altogether. In May of the following year, the *Local Government (Financial Provisions) Act* was passed, giving effect to this decision and to the related decision to address the problem of local government financing by assigning the proceeds of motor taxation to the local authorities.

The parliamentary debates on that piece of legislation offer some interesting and some prophetic statements from a number of contributors. Brendan Howlin, then Minister for the Environment, who was responsible for piloting the new legislation through the Dáil, speaking in the debate on the Second Stage in April, expressed his belief that 'the concept of charging for services is essentially a good thing'. He went on to say:

'*However, a problem arises where the charge has no relation whatsoever to the amount of the service used. This has been the case in respect of charges for domestic water and sewerage services…Charges for water and sewerage facilities…were predominantly flat rate charges unrelated to usage. This flat rate practice created serious inequities in the system. For example, it is simply not fair that an individual living in a small one, or two-bedroomed house should have to pay the same amount as a family or a number of people living in a large five or six-bedroomed house.*'[11]

Only one political party, the Progressive Democrats, took a pro-water charges position. The party's Environment spokesperson, Máirín Quill, condemned the decision to provide households with unlimited treated water free of charge as 'an act of gross environmental vandalism' and something that put Ireland 'in direct conflict with European policy in this area'. She went on to outline the Progressive Democrats' policy on water, a policy that was restated in their general election manifesto two months later, as follows:

'*The Progressive Democrats favour metered usage, with each home fitted with water meters; making a basic water allowance for each household which would be free of charge; a rate of tariff on usage above that basic allowance and a waiver system for those not in a position to pay.*'[12]

This policy was to prove remarkably similar to the one that the government attempted to implement almost two decades later.

Although strong views were expressed on water charges in Dáil debates, and despite the salience of the charges in the Dublin West by-election, the issue was not one around which a coherent and consistent stance was adopted by any of the bigger political parties during the 1990s. The positions of the Progressive Democrats and Democratic Left have already been noted. As for

[11] Elsewhere in the same speech, Minister Howlin dismissed the possibility of basing charges on usage on the grounds that metering was not a viable option because of cost.
[12] These remarks were made in the course of a contribution to the Second Stage debate on the *Local Government (Financial Provisions) Bill* in April 1997.

Fianna Fáil, Fine Gael, and the Labour Party, water charges merited no mention whatsoever in their respective general election manifestoes in either 1992 or 1997.[13]

Water charges: 1997 to 2010

Not surprisingly, water charges did not feature prominently in the 1997 general election campaign. The only political parties that considered the issue worth mentioning in their manifestoes were Democratic Left, who claimed credit for their abolition, and the PDs, who advocated their reintroduction, albeit following a programme of meter installation that it was envisaged would take a decade to complete starting from 2001.

Still, the issue did not quite go away. Over the next few years there was sporadic evidence to suggest that the Irish government was under pressure from the European Commission to reconsider its position on charges. At the same time, the EU was preparing a major initiative on water policy which eventually took the form of the *Water Framework Directive* (WFD), agreed in 2000.

The WFD's direct relevance to water charges lies in the fact that it seeks to promote the sustainable use of water resources. Article 9 of the Directive addresses the issue of the recovery of costs for water services. It requires Member States to take account of the principle of cost recovery in accordance with the polluter pays principle. Paragraph 1, second sentence, of Article 9 instructs Member States to ensure (by 2010) that water pricing policies provide adequate incentives for consumers to use water resources efficiently. Paragraph 2 requires Member States to report *inter alia* on the contribution made by the various water users to the recovery of the costs of water services.

Critically, from an Irish point of view, Article 9 goes on to state:

'Member States shall not be in breach of this Directive if they decide in accordance with established practice not to apply the provisions of paragraph 1, second sentence, and for that purpose the relevant provisions of paragraph 2 for a given water-use activity, where this does not compromise the purposes and the achievement of the objectives of this Directive.'

This is the much-vaunted derogation secured by Ireland in negotiations at the Council of Environment Ministers. It is worth noting that in the Statutory Instrument that subsequently transposed the relevant provisions of the WFD into regulations governing the activities of Ireland's local authorities in relation to water policy, the 'established practice' referred to in Article 9 was

[13] Moreover, the voting behaviour of their respective county councillors in relation to water charges in Fingal, Dun Laoghaire–Rathdown, and South Dublin evinced no consistent pattern. In Dun Laoghaire–Rathdown, for example, the motion calling for the introduction of domestic charges put to the Council in February 1994, saw Fianna Fáil and Fine Gael members on each side of the divide and all three Labour members in support. At the same time, on South Dublin County Council, the introduction of a water charge was opposed by the Labour members and, once again, the Fine Gael members were divided on the issue. Even the Progressive Democrats displayed inconsistency across the two constituencies, with their councillors supporting water charges in South Dublin but opposing them in Dun Laoghaire–Rathdown.

defined to include the prohibition on imposing water charges for domestic purposes contained in the *Local Government (Financial Provisions) Act* of 1997.[14]

The next notable piece of legislation, prompted in part by the WFD, but also by the need to overhaul and streamline a large body of existing domestic law on water, much of which dated from Victorian times, was the *Water Services Act of 2007*. This Act had an unusually protracted passage through the Oireachtas. The bill was first introduced in late 2003 but it was not enacted until May 2007.

The original bill had nothing to say about water charges, or privatisation of water. However, these issues were to the forefront in the Dáil proceedings. Numerous TDs saw the bill as paving the way for charges and for selling water assets to the private sector. One of the cues for such suspicions was the section of the bill dealing with water meters, although there was nothing new about meters in an Irish context and existing water services legislation already provided the power to install them. The question asked explicitly by one TD, but clearly on the minds of many others, was 'why are meters necessary if it is not the intention to bring forward water charges?'[15]

In the event, then Minister for the Environment, Heritage and Local Government Dick Roche accepted amendments that greatly reduced the grounds for these suspicions. A section was added that explicitly prohibited charging for domestic water supply, thereby providing a double lock, given that the 1997 Act referred to above already contained such a prohibition. Another new insert prohibited the transfer of any water services authority's assets to any party except another water services authority or a group water services scheme, effectively ruling out privatisation.

Shortly after the 2007 Act became law, a general election took place. Once again, the manifestoes of the main parties were silent on water charges, though not on the broader issue of water services. The *Programme for Government*, negotiated after the election by Fianna Fáil, the Green Party, and the Progressive Democrats, followed suit. It featured seven action points on water, none of which related to pricing. By 2009, however, charging for water, like property tax, was firmly back on the policy agenda, and for the same reasons: the urgent need to raise revenue and to cut spending.

In pursuit of the latter objective, the government set up a review body on public expenditure — *The Special Group on Public Service Numbers and Expenditure Programmes*. This body was to come up with detailed recommendations as to how government spending could be cut sharply. It reported in July 2009 with a list of measures that would, if implemented, reduce total spending by more than €5bn, or almost 8%. The Group noted that the local government layer of expenditure was not within its remit, but that did not prevent it from offering the following opinion:

'The Group considers that local authorities should be self-financing in the longer term and that Exchequer support should be replaced with increased revenue generation from local sources, including such measures as may be suggested by the Commission on Taxation in its forthcoming report, and increased cost recovery levels for appropriate services. Charging for domestic water

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[14] SI No. 722 of 2003, entitled *European Communities (Water Policy) Regulations 2003.*
[15] Arthur Morgan of Sinn Féin, speaking in the Second Stage debate on 5th October 2004.

services would be consistent with this approach, and should in the Group's view be within the remit of a single national water utility.'[16]

When the Commission on Taxation published its report shortly afterwards, it did not disappoint. It was forthright in its support for domestic water charges. The Commission's detailed recommendations on water charges are worth reproducing in full:

- *Measures should be put in place immediately to ensure that the costs of water services provided are fully recovered from the non-domestic sector.*[17]
- *Domestic water charges should be introduced, as a sustainable approach to realising an acceptable conservation culture.*
- *There should be some level of incentivisation to ensure that consumers are encouraged to install meters.*
- *Charges should be phased in over a period of time.*
- *A waiver scheme should be provided for low-income householders.*
- *The charging should commence with a flat rate charge and change to volumetric billing for consumers once meters are put in place.*
- *Water meters should be installed in all new housing units.*
- *A public information campaign should clearly outline the rationale for water charges and the way in which they will be implemented.*
- *Water pricing should be introduced for all water consumers by local authorities based on a consistent methodology and applying the principle of full cost recovery.*

The *Renewed Programme for Government* of October 2009 contained a commitment to reintroduce water charges on the basis of a free allowance for households and tariffs for metered usage above this allowance. John Gormley, the then Minister for the Environment, Heritage and Local Government, brought a memo to cabinet in December of that year with a proposal to introduce legislation to give effect to this commitment, together with an undertaking to bring forward detailed proposals for a nation-wide meter installation programme. On the back of that memo, the cabinet agreed to commence the preparation of legislation that would provide a legal framework for the introduction of water charges.

At subsequent meetings in September and November of 2010, the government affirmed its intention to introduce water charges and carry out a programme of universal metering. Much of the discussion at the September meeting focused on issues relating to the delivery and financing of the metering programme, including the establishment of a new commercial semi-state utility for this purpose. At that meeting a proposal from Minister Gormley to set the free allowance at 40 litres per person per day was approved.[18]

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[16] *Report of the Special Group on Public Service Numbers and Expenditure Programmes (July)*. 2009, 57.
[17] This was a reference to the fact that the recovery of costs in relation to non-domestic water consumption was considerably less than 100%. In 2007, for example, it was just 74%, a figure quoted in the Commission's report (p.457).
[18] Equivalent to just under 15,000 litres per year. By comparison, the free allowance that formed part of the tariff structure announced in July 2014 was set at 30,000 litres per household.

The cabinet meeting of November was informed that agreement had been reached with the National Pension Reserve Fund to provide a commercial loan to fund the metering programme which was estimated to cost €500m. By this stage it had been decided that a newly created subsidiary of an existing semi-state agency would be the most appropriate entity to manage the procurement and installation of meters. Another outcome of the November meeting was the decision to set up an economic regulator for the water sector.

The government's intentions in relation to water were included in the October 2010 *National Recovery Plan*, which set out a comprehensive response to the economic and financial crisis. That document also provided the first official indication of how much money it was envisaged that domestic water charges would raise: of the order of €500m which, given the number of households on a public water supply, implied an average charge per household of close to €400.

It is worth noting that what the government was setting out to do at this point differed in a number of important respects from what had been recommended by the Commission on Taxation (and accorded more closely with what the Progressive Democrats had originally suggested in the mid-1990s). First, the government was proposing to commence with volumetric charging on the basis of universal metering, whereas the Commission envisaged commencing with a fixed charge and transitioning to a volumetric charging as meters were installed. Moreover, the Commission recommended that the fixed charge be set initially at a low level. Second, the government's proposal to grant a free allowance to all households was at odds with the Commission's view that such a mechanism would entail unwelcome administrative complexity and would work against the conservation objective.

Again, as with property tax, the proposed introduction of water charges was incorporated into the agreement with the Troika, but that agreement did little more than repeat the commitment contained in the NRP. Water charges, like property tax, cannot validly be portrayed as a Troika-imposed measure.

Chapter 3: Evolution of the Local Property Tax

The 2011 Programme for Government

The programme for government agreed between Fine Gael and Labour in March 2011 endorsed the idea of a property tax. However, the endorsement was less than whole-hearted and fell short of a firm commitment to introduce such a tax. The actual formula of words used in the document was: '*Consider, arising from the previous Government's deal with the IMF, various options for a site valuation tax*.' The relevant paragraph of the *Programme for Government* went on to note that the tax would have to take account of the issue of mortgage distress as well as providing a reliable income stream to local government.

The status of what was included in the *Programme* in relation to property tax was comparable to the status of what the same document had to say about water charges. These issues, however important in their own right and however politically salient they were to become subsequently, were not to the forefront during the negotiations between the two parties. At the time, the country was seen to be facing an existential crisis. Resolving that crisis was going to require a fiscal correction of extraordinary severity comprising a daunting array of unpalatable decisions across the spending and revenue-raising spectrum.

A measure of the significance of property tax and water charges in this scheme of things is that they were expected to contribute less than €1bn to the €15bn budgetary consolidation planned for the 2011–2014 period. This compared with the near €3bn cut in the Social Protection budget that was envisaged in the *National Recovery Plan*.[19]

Besides, water and property tax were issues on which the two parties had adopted different positions. Labour's antipathy to water charges stood in stark contrast to Fine Gael's willingness to introduce them. On the other hand, Labour had signalled its acceptance of a property tax, whereas Fine Gael had struck a more sceptical note about it.[20] Given the potential for disagreement, it is not surprising that the wording used in respect of property tax in the *Programme for Government* was somewhat coy. However, the understanding that lay behind that wording appears to have been that a property tax was necessary, but that the particular form it would take would have to reflect party political sensitivities.

The initial agreement with the Troika contained not only a commitment to introduce what was called a 'new residential-property-based site value tax', but also a time scale. The *Memorandum*

[19] During our interviews with senior policymakers, one interviewee who was involved in the talks that preceded the formation of the new government recalled that the toughest negotiations between the two parties concerned the scale of the overall fiscal adjustment. Another interviewee recalled the main focus of the talks being about 'how to get the train back on the tracks' and characterised property taxation and water charges as issues of second-order importance.

[20] Labour's manifesto stated: 'Labour accepts that it will be necessary to introduce a site value charge, in order to prevent higher taxes on work'; The Fine Gael manifesto claimed that 'Fianna Fáil's proposal, now endorsed by the Labour Party, to introduce by 2014 an annual, recurring residential property tax on the family home is unfair'.

on Specific Economic Policy Conditionality specified that the new tax would be one of a number of revenue measures designed to yield a total of €1.5bn (on a full-year basis) in 2012, and that an increase in property tax would be one of several measures designed to yield a total of €1.1bn (again on a full year basis) in 2013. As to the yield from the property tax itself, the understanding with the Troika was that the time profile would follow that laid out in the *National Recovery Programme*: €180m in 2012, rising to €530m in 2013.

The first and second (joint) review of the Troika agreement, conducted after the new government came to power, and published in May 2011, reiterated the commitments in relation to property tax set out in the initial agreement. Had the incoming government sought to renegotiate those commitments, either at that point or subsequently, it is likely that it could have done so successfully, provided it was prepared to make up any loss in revenue by implementing alternative measures.

The Household Charge

One of the considerations set to complicate the introduction of both water charges and a property tax was that neither could be implemented on a satisfactory basis at an early stage. In the case of water, a volumetric charging regime, to which the government had committed itself, would have to await the installation of meters; In the case of property tax, a system of valuation was understood to be a prerequisite. Installing meters and completing a valuation process were going to take time. In the interim, revenue was needed and, in the case of the property tax, there was a specific undertaking that revenue would be raised in 2012.

The solution, in respect of property taxation, had already been identified in the context of the NRP: levy a fixed €100 per household charge as a temporary measure. A similar expedient was initially considered in respect of water. In May 2011, Minister for the Environment, Community and Local Government Phil Hogan, whose department was at that time responsible for the development of both sets of policies, indicated that he was considering the idea of a single flat charge, to be known as the Household Utility Charge, to cover both water and property tax elements.[21] It was an idea that was short-lived, partly because it was advanced in a manner that appeared to pre-empt discussion at cabinet level, and partly because of the perceived risks of conflating two revenue sources that would need to be separated for fiscal and administrative reasons before long.

It may be that Minister Hogan’s ill-fated kite had the effect of accelerating decisions. In any event, the cabinet decided at its meeting on 26 July 2011 to proceed with the €100 household charge with effect from January 2012 as a precursor to the introduction of a full property tax in 2014. It was estimated that 1.6 million households would be liable for the new charge, and accordingly it was projected to yield €160m. It was to provide a dedicated source of funding for the local authorities, with the proceeds being paid directly into the local government fund.

Two aspects of the charge are worth noting. The first relates to exemptions and waivers. The charge was payable by property owners. As such, local authority tenants, people living in other

[21] Harry McGee. "Property and Water Taxes at Flat Rate Next Year." *Irish Times*, 7 May 2011, 5.

social housing, and tenants in the private rented sector were exempt. Waivers were also provided for households in receipt of mortgage interest supplement (an acknowledgement of the problem of mortgage distress highlighted in the *Programme for Government*), and for people living in certain categories of unfinished housing estates.

Inevitably, there were plenty of demands for other categories to be exempt. The Minister's response, delivered in his speech on the Second Stage of the relevant bill in the Dáil, is worth recording:

'*The provision of additional exemptions from taxation measures could give rise to a domino effect. Providing an additional exemption from the charge may seem reasonable in itself but it could give rise to pressure for more exemptions catering for circumstances different, but not wholly dissimilar, from the original one…The broad applicability of the household charge has allowed us to set it at the lowest possible level for 2012 at €100. The inclusion of further exemptions or waivers would require a corresponding increase in the level of the charge and would disadvantage those households liable for the charge.*'[22]

The second notable aspect of the charge related to arrangements for its payment and administration, which were modelled closely on the NPPR charge, introduced in 2009, and which had generated revenue well ahead of expectations and was regarded as a resounding success on that account. The new charge, like the NPPR, was to be collected by the Local Government Management Agency (LGMA) and administered on a self-assessment basis. Owners of residential property were expected to register themselves and pay the charge, the deadline for which was 31 March 2012.

Despite its apparently modest level and the scope of the exemptions (250,000 households), the announcement of the charge prompted a strong negative reaction from opposition parties, and provoked protest amongst the broader population. The most commonly expressed criticisms included the fact that the charge was at a flat rate and hence regressive, and reflected the perception that it was the harbinger of a heavier burden to come. Left-wing politicians threatened to organise a boycott of the tax and undertook not to pay it themselves. A campaign around the slogan 'Don't register, don't pay' gathered some momentum as the 31 March deadline approached.

As of that deadline, the LGMA estimated that 832,000 property owners had registered, representing a compliance rate of just over 50%. The cabinet received a briefing on the situation at its next meeting. That briefing contained a sobering analysis of the low compliance rate. Around this time several government Ministers were reported as having come to the conclusion, in light of the household charge experience, that the Revenue Commissioners would have to be put in charge of collecting and administering the new property tax when it was introduced.[23]

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[22] *Dáil Éireann Debates*, Vol 749 No 4. Available at: https://www.oireachtas.ie/en/debates/debate/dail/2011-12-13/29/

[23] Harry McGee, Olivia Kelly, and Marese McDonagh. "Revenue Should Take Control of Property Tax, Say Ministers." *Irish Times*, 3 April 2012, 1.

The Inter-Departmental Group

Meanwhile, the government had decided to bring forward preparations for transitioning to the new property tax so that it could be introduced with effect from 2013 rather than 2014 as previously planned. That decision was made in December 2011. It was motivated in part by the perceived need to avoid the imposition of two new charges in the same year, as water charges were due to commence in 2014. There was also a growing feeling at cabinet that the sooner the regressive, fixed-rate household charge could be dispensed with, the better.

An Inter-Departmental Group (IDG) was established in early 2012 to assist the government in the design of the new tax. Don Thornhill, a well-respected and experienced public servant, who had spent a substantial portion of his career in the Revenue Commissioners, was chosen to chair the IDG, and its other members were drawn from the Departments of Finance, Public Expenditure and Reform, Environment, Social Protection, Communications, and the Revenue Commissioners. It was to report to Minister Hogan. Its secretariat was drawn from his Department.

The IDG's terms of reference were carefully drafted. It was required that the property tax designed by the Group be 'informed by previous work and international experience'. It was also required that the tax be easily determined and have regard to the information currently available. There was a clear suggestion in this that the government wanted to proceed quickly and avoid the sort of delay likely to be entailed by having to complete a nationwide valuation process. The terms of reference explicitly pointed the Group towards self-assessment as the basis for computing liability. The Group was also mandated to 'consider the appropriate arrangements for a robust audit function and strong enforcement and penalty provisions for non-compliance'.[24]

One of the key tasks facing the IDG was to choose the basis of assessment: Was it to be site value or some other basis? The site value phrase had featured consistently in official policy documents from the time of the Fianna Fáil–Green Party *Renewed Programme for Government* in October 2009 through to the Fine Gael–Labour *Programme for Government* of March 2011 but, while this may have reflected a degree of conviction in the former, it seems likely that it was more the product of inertia in the latter. It had been very much a Green Party idea, and the fact that the phrase endured may be regarded as a Green Party legacy, even if only a linguistic rather than a deeper philosophical one.

Moreover, public servants with knowledge and experience of the tax system were not attracted to the site value idea. A good insight into the official mind in this regard is provided by a report of the *Tax Strategy Group* produced in September 2010.[25] That report, noting that site value tax (SVT) was rarely used in other jurisdictions, identified a number of difficulties with such a tax, including, in particular, its comprehensibility to the public and the requirement for a comprehensive and continuously updated database of property ownership.

This kind of critique placed site value at odds with the IDG's terms of reference. Indeed, it seems that the government had set its face against SVT before the IDG was set up, and that the terms of reference were framed accordingly. In any event, the IDG delivered its own verdict and went

[24] The terms of reference are reproduced as Appendix 1 of the IDG's report.
[25] Tax Strategy Group. *Tax Administration Issues* (TSG 10/10). 2010.

to some trouble to do so. Chapter 3 of its report addressed the issue at length and with some rigour, and came down decisively against site value as the basis of assessment on the grounds of simplicity, transparency, and equity. Its verdict was also informed by international experience and previous work, specifically the recommendations of the Commission on Taxation.

The Inter-Departmental Group's proposed system

Instead, the IDG recommended that market value be the basis of assessment, being widely understood and transparent, coming 'within the ordinary understanding of what is fair', and being the predominant means of assessment internationally. It was also in line with the approach advocated by the Commission on Taxation. Indeed, in most material respects, what the IDG proposed was very close to what the Commission on Taxation had proposed in 2009, including:

- That the tax operate on a self-assessment basis.
- That property owners (and not tenants) be legally responsible for payment.
- That valuation be on the basis of valuation bands rather than point estimates, in order to assist compliance.
- That all revenue collected accrue to the local authorities.
- That there be a system of voluntary deferral arrangements to address inability to pay problems amongst certain categories of householders.

An interesting difference was the IDG's proposal that the tax incorporate a locally determined element, the purpose of which was to allow individual local authorities to vary the rate of tax in their area by a modest margin. However, what especially differentiated the IDG's work was its emphasis on implementation, in particular, the compliance and enforcement elements thereof. Of its 18 key recommendations, no fewer than six related to aspects of compliance and enforcement, including provision for collecting the tax at source from payroll and state payments, and for interest and penalties in respect of late payments and/or evasion.

This attention to the practical aspects of how the tax would operate was also evident in the fact that three out of nine chapters of the report were concerned with payment, collection, enforcement and implementation. The chapter on enforcement ran to 20 pages — in a report the main body of which comprised just 100 pages.

The critical role of the Revenue Commissioners

A recommendation critical to the future of the Local Property Tax was that the Revenue Commissioners be given responsibility for the administration, collection, enforcement, and audit functions. This too, echoed the position taken by the Commission on Taxation, but it was not an inevitable outcome. The IDG was established by the Minister for the Environment and reported to him. Its members were assisted in their work by a secretariat drawn from that department. Revenue generated by the tax, named the Local Property Tax (LPT), was to accrue to the local authorities. Its immediate antecedents, the Household Charge and the NPPR charge, had been collected and administered by the Local Government Management Agency.

It might have seemed obvious to some therefore that the LPT would also be administered and collected within the local government nexus. However, the early experience with the Household Charge suggested otherwise, and served to underline the distinction between a (local authority) charge and a (national) tax. If the LPT was to be a national tax, albeit one whose proceeds were to be distributed amongst the local authorities, requiring the kind of compliance rates that characterise national taxes, it followed that it should be the responsibility of the national tax-gathering authority.

It also followed that the national tax-gathering authority be provided with the resources needed to ensure the successful implementation of the tax. The final chapter of the IDG's report spoke to the issues involved here, detailing the system requirements for the smooth and efficient introduction of the new tax, and making specific recommendations to ensure that those requirements were put in place. These recommendations included:

- A decision by government to be made by July 2012 on the basis and design of the tax.
- The development of a detailed implementation plan.
- A comprehensive public information and communication plan.
- A commitment by Government to provide the resources needed to cover the costs that would arise.

It might seem unusual for an advisory group like the IDG to instruct government in relation to the timing of a decision. However, the point of this recommendation was to signal that the Revenue Commissioners needed a reasonable period of notice to make the necessary preparations for the tax, and also needed that notice to have solid political status. Together with a commitment by government to provide whatever resources were needed, the message to Revenue (and the broader public) would be clear and unambiguous.

The IDG did not propose a particular rate for the LPT, believing that to be a matter for government. However, its report provided yield estimates based on tax rates ranging from 0.1% to 0.25%. The report also explored the consequences for yield of different levels of take-up of the deferral option and of local authorities exercising the modest degree of discretion permitted to them. These computational exercises suggested that a property tax along the lines proposed by the IDG would need to be levied at a rate of about 0.2% if it were to deliver revenue of around €500m.

The Government's decision

The IDG's report was completed in June 2012. In July, at its last meeting before the summer break, the cabinet confirmed that the Revenue Commissioners would collect and administer the property tax. In December, the Minister for Finance announced the details of the new tax in his Budget 2013 speech.

The Local Property Tax as announced by the Minister reflected the fact that the government had accepted most of the proposals put forward by the IDG. The most important additional information contained in his speech related to the rate of tax, which was to be 0.18% up to a market value of €1m and 0.25% on the balance above that threshold. The tax was not to come into effect until 1 July 2013, and would therefore apply for only a half-year initially. This was to provide the Revenue Commissioners with the time required to complete their preparatory work, but it also had the perceived benefit of easing the transition to the new tax for home-owners. At the same time, the Minister announced that the Household Charge would cease with effect from 1 January 2013 (and the NPPR charge from 1 January 2014).

The Minister departed from the recommendations of the IDG in a limited number of respects. Amongst them was his approach to the issue of the local discretionary factor.

What the IDG had proposed in this regard was a range of +5% to +15%, meaning that local authorities could increase the tax rate by an amount within this range (i.e., given a national rate of 0.18%, an individual local authority could set a rate between 0.189% and 0.207%), but could not reduce it. The local discretionary factor announced in the budget was -15% to +15% (i.e., given a national rate of 0.18%, local authorities could set rates in the range 0.153% to 0.207%). The rationale for the wider range favoured by the government was to encourage local government responsibility and accountability.[26]

Another important feature of the tax as introduced, and one which again mirrored what was proposed by the IDG, related to methods of payment. Provision was made for the collection of the tax at source from payroll and from recurring and lump-sum payments made by government departments (including, most obviously, payments from the Department of Social Protection and occupational pensions to former public servants, but also payments to farmers from the Department of Agriculture). The legislation giving statutory effect to the new tax also made provision for other methods of payment, but specified that deduction at source would be the default method in the event that a taxpayer did not select an option.

The IDG had taken a parsimonious approach to exemptions. It rationalised this approach as follows: *'…the Group considered that as a tax, the local property tax should be centred on principles of equity, transparency and simplicity. In terms of these principles, it was also considered that a universal liability should apply to all owners of residential property with a limited number of exemptions'.*[27] What exemptions the Group was prepared to admit were carefully defined and were broadly similar to those proposed by the Commission on Taxation and those that applied in respect of the Household Charge.

The IDG had adopted an even more parsimonious position on waivers, and recommended against providing any on grounds of efficiency and equity. Instead, as noted already, the Group proposed that provision should be made for particular categories of householders to avail of arrangements to defer payment.

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[26] In the period 2015–2018 there have been 43 instances of local authorities availing of this discretionary facility, 32 of which have resulted in the local tax rate being reduced and 11 of which have resulted in the local tax rate being raised. Significantly, in each of these years all four Dublin local authorities have reduced the local rate by the maximum extent possible (15%). They have been the only local authorities to do so consistently throughout the period.
[27] Inter-Departmental Working Group on Property Tax. *Design of a Local Property Tax*. 2012, 30.

Exemptions and waivers were one area where the principles underpinning the tax proposals put forward by a group like the IDG might have been expected to yield some ground subsequently to political pressures. However, the list of exemptions in the first piece of legislation giving statutory effect to the tax, the *Local Property Tax Act 2012,* was not much longer than that suggested by the IDG. Indeed, there were only two significant additions, both of which were to be time-bound and to last only to the end of 2016: (i) property purchased in 2013 by a first-time buyer as a sole or main residence and (ii) new and previously unoccupied properties purchased from a builder or developer between January 2013 and end-2016.

The scale and range of liability

Given the design of the tax, the average bill was set to be around €300. However, most bills would be considerably lower than this. The distribution of property values is heavily concentrated at the bottom of the value spectrum with a long tail stretching into the upper reaches. According to the returns submitted by May 2013, and summarised in Table 3.1, 27% of all residential properties were valued in the €0–100k range, implying a liability of just €90; a further 28% were in the €100–150k range, indicating a liability of €225, and a further 21% were in the range €150–200k, with a liability of €315. Further up the scale, bills became much more substantial: properties in the €450–500k range attracted a liability of €855 and the liability was €1,000 or more for all properties valued in the €550–600k range or higher. However, properties in the latter range accounted for less than 2% of the total. For 80% of properties, the liability would be less than €500.

Table 3.1: Distribution of Properties by Value

Value (€)	Number (000s)	Number (%)
0-100,000	453.4	27.0
100,000-150,000	469.1	27.9
150,000-200,000	355.5	21.2
200,000-250,000	169.0	10.1
250,000-300,000	80.9	4.8
300,000-400,000	78.0	4.6
400,000-500,000	35.0	2.1
500,000-600,000	16.3	1.0
600,000-1,000,000	19.7	1.2
1,000,000+	3.7	0.2
	1,681.0	100.0

Source: Revenue Commissioners (based on May 2013 LPT returns)

Nevertheless, for many people, even those facing a moderate liability, the LPT was going to present an unwelcome extra financial burden, and the tax was not warmly welcomed. The announcements of late 2012 were met with considerable criticism. Some of this criticism was of a general kind and related to the perceived unfairness of taxing the 'family home' or to the hardship that the tax would cause. Another, more specific strand of complaint was that the tax would bear inequitably on Dublin where property values were much higher than elsewhere. Other more pointed concerns were raised, including the fact that the legislation did not provide for any relief to those who had purchased houses at the height of the property boom and had paid large amounts in stamp duty on that account.

Amending legislation was introduced in mid-February — the *Local Property Tax (Amendment) Bill 2012* — but very little ground was conceded to the critics and complainants. The grounds for exemption were widened somewhat, notably to include properties that had been impacted by pyrites. Likewise, there was some broadening of the circumstances in which deferrals could be availed of. But there was no change to the essence of the tax.

Understandably, given the popular reaction to the tax, there was some nervousness at government level about how it was going to play out. Cabinet concerns were focused particularly on compliance, the critical measure of which would be provided by the end-June deadline for responding to a Revenue Commissioners' letter setting out an indicative valuation and options for payment. The fear was that a low response rate would undermine the new tax, severely damaging the government's credibility and putting a sizeable dent in its fiscal consolidation programme.

An appearance by Josephine Feehily, chairperson of the Revenue Commissioners at a meeting of the Economic Management Council in early March did much to assuage these concerns. She persuasively expressed confidence that compliance would not be a significant problem, given the enforcement powers at the disposal of the Revenue Commissioners.[28]

In the event, Ms. Feehily's confidence proved to be well-founded. The deadline for registration for the property tax, initially set for 28 May 2013, was extended by 24 hours, such was the volume of last-minute returns. The following day, the Revenue Commissioners announced that returns had been filed in respect of over 1.5 million properties, representing a compliance rate of over 80%. Compliance rates subsequently increased to the 96–97% range.

The Thornhill Review and its aftermath

The valuations determining the initial liability for the LPT were set with reference to May 2013 and were to apply for the first three and a half years of the tax's operation. Accordingly, a revaluation was scheduled to occur in November 2016. In anticipation of this, cognisant of the strong growth in house prices that was underway, and sensitive to the political implications of a revaluation in

[28] During our interviews, one public official who was present at the meeting recalled that Ms. Feehily expressed incredulity at the suggestion that people would not pay the tax and countered with the assertion that the Revenue would simply take what was owed.

such circumstances, particularly with a general election due in the intervening period, the Minister for Finance commissioned Don Thornhill to conduct a review of the tax in early 2015.

That review noted the 'hugely impressive' performance of the tax from a compliance point of view and went on to assess the operation of the tax, paying particular attention to the scope of exemptions, the conditions for deferral, and the arrangements governing the involvement of local authorities. However, the core question that the review addressed was the question of how the LPT might best be adapted to respond to the big increase in property values that had occurred since its inception. Between May 2013 and May 2015, property prices had increased nationally by 26%.[29] This masked considerable regional variation with prices up by 41% in Dublin but by just 14% on average across the rest of the country. A straightforward revaluation exercise would result, not only in a substantial increase in average liability, but also in a wide distribution around this average by region and, given the construction of the valuation bands, by value.

Estimates provided by the Department of Finance in the context of the review indicated that a revaluation to reflect price growth over this period would boost the overall yield from the tax (calculated with reference to 2014) from €480m to €620m, and would generate the following results across the valuation spectrum: [30]

- Almost half (50%) of all properties would remain in their original valuation band and hence would not produce any increase in revenue.
- 35% of properties would move up into the next band, producing an increase in liability of €90.
- 10% of properties would move up by two bands (and increase in liability of €180).
- The remaining 7% of properties would move up by between three and six bands, producing an increase in liability ranging from €270 to €540.[31]

These results highlighted an implication of the tax that had not been fully appreciated at the time of its design. Where valuation bands are of uniform absolute width, the same percentage rate of increase in value over time will propel more expensive properties up through the bands more quickly than the more modestly valued properties. As a result, again for a given rate of price appreciation, the sharpest increases in tax liability will be concentrated amongst owners of more highly-valued properties, whereas owners of modest homes may experience no increase in liability at all (as the figures cited above illustrate). Moreover, this effect is exacerbated when prices in Dublin (where property values are well above the national average) are rising more rapidly than prices elsewhere, especially in the more remote rural areas (where there is the greatest concentration of properties of very modest value).

[29] The increases over the period to the scheduled revaluation date were considerably larger, although the differential in rates of increase between Dublin and the rest of the country narrowed appreciably: between May 2013 and November 2016, average house prices nationally increased by 53%. In Dublin the average increase was 58%; In the rest of the country it was 46%.
[30] Don Thornhill. *Review of the Local Property Tax (LPT),* July 2015.
[31] All these calculations assumed that the 0.18% rate of tax would apply. For properties subject to the 0.25% rate, the increase in liability would be greater.

Thus, a revaluation in line with house price growth between May 2013 and May 2015 (or between May 2013 and November 2016) would not only have generated a sharply progressive increase in liabilities across the valuation spectrum but would also have significantly shifted the burden of the tax towards Dublin. As such, it would have aggravated the unpopularity of the tax in the Dublin area, most especially in the capital's more prosperous suburbs.

Thornhill evaluated several options to address the problem, amongst them (i) freezing valuations at the 2013 levels, (ii) using the mid-point between the 2013 and 2016 valuations, and (iii) widening the valuation bands while proceeding with the scheduled November 2016 revaluation. His assessment of the various options was on the basis of the criteria of transparency, fairness, efficiency, and two others (stability of yield and responsiveness to wider economic conditions) to which we will return later.

The option that he judged would best satisfy these criteria was to proceed with the November 2016 revaluation, but to accompany this with a new procedure whereby the tax rate in each local authority area would be determined by government, with local authorities then being given the freedom to adjust that rate upwards by a factor of 15%. In essence, this model would allow the effects of strong price growth to be offset by a reduction in the tax rate in the determination of liability. At the same time, the local dimension of the tax would be strengthened and the element of discretion for the local authorities preserved.

The Thornhill review was completed by July 2015, in good time to inform the government's thinking in advance of Budget 2016. The decision presented in the budget was that the revaluation date for the LPT would be postponed to 2019. Minister Noonan, in announcing the decision, went on to say: 'The postponement of the revaluation date means that home owners will not be faced with significant increases in their LPT in 2017 as a result of increased property values and it gives sufficient time for the other recommendations [of the Thornhill Review] to be considered in full.'

In January 2018, the new Minister for Finance Paschal Donohoe announced that a further review of the tax was to take place, to be completed by August. Launching the latest review, the Minister said that it would be 'informed by the principle of achieving relative stability in the tax payments of those liable to the tax'. This seems like another way of saying that any changes in the tax that emerge from the review will be designed to ensure that increases in liability are small.

Chapter 4: Water Charges – How the Tariff Structure Evolved

The July 2014 charges plan

On 31 July 2014 the Commission for Energy Regulation (CER), whose remit had been extended to include economic regulation of the water sector, set out its proposals for the scheme of water charges that was to apply to domestic consumers for the period from October 2014 through December 2016. Two sets of charges were announced: One in respect of households with water meters installed, the other in respect of unmetered households.

Metered households were to be charged at the rate of €4.88 per 1,000 litres of water supplied and wastewater disposed of per annum over and above the applicable free allowances.[32] These allowances were set at the following levels: 30,000 litres per household and 21,000 litres per child under the age of 18. A household with three children, for example, would have a total free allowance of 93,000 litres. On the other hand, the allowance did not increase with the number of adults: a household with two or more adults would receive the same free allowance as a single-adult household.

Unmetered households were to be charged on an assessed basis, with that charge set at €176 for a single-adult household, rising thereafter by €102 for every additional adult, an adult being defined as any person over the age of 18 years. In the case of unmetered households, the assessed charge did not vary with the number of children.

Two other features of the CER's proposed charging structure are worth noting at this stage. One was that metered households would have their bills capped at the corresponding assessed charge for the first six months after meter installation. So, a two-adult, two-children household would face a certain bill of €144 for the first six months after installation of a meter. The other was that the overall average charge per household (taking metered and unmetered together) was set at €238.

The status of the CER's July announcement is also worth noting. The CER's role as the economic regulator for the water sector had been spelled out in the *Water Services (No 2) Act 2013.* Under that legislation the relationship between the CER and Irish Water, and the process whereby water charges would be determined, were defined. In keeping with the provisions of that legislation, the CER's July announcement was designed to launch a public consultation – its final decision was not scheduled to be made until September.

The 2013 Act also provided for the relevant Minister to directly influence the CER's execution of its regulatory role. Minister Hogan had availed of that provision in early July by issuing to the CER

[32] For households availing of just one of these services the cost was to be €2.44 per 1,000 litres.

a Ministerial Direction that set out certain parameters that were to govern the regulator's proposed tariff structure. Those parameters in turn represented the culmination of a long and tortuous iterative process that had started the previous September and had involved a number of public officials from a range of government departments and state agencies, including the CSO, NewERA, the Departments of Finance, Public Expenditure and Reform, Environment, and the Taoiseach.

The Ministerial Direction specified the levels of the free allowances.[33] It also specified that there was to be no standing charge, and it provided the CER with explicit guidance as to the basis for assessed charges (that they be primarily based on occupancy). A related letter, from the Department of Environment, Community and Local Government (DECLG) to Irish Water, setting out the conditions attaching to government funding for the company, stipulated that the average charge per household should not exceed €240.

In what follows, we first provide some explanatory background in relation to the parameters contained in the Ministerial Direction and then go on to consider the other elements of the tariff structure proposed by the CER.

(i) The average charge

A critical influence on the overall level of tariffs was the objective of passing Eurostat's Market Corporation Test (MCT), thereby securing a statistical classification for Irish Water that would place it outside the general government sector and allow it to borrow on the strength of its own balance sheet. The MCT will be examined in some depth in the next chapter. At this juncture it is enough to know that for an entity to pass the test requires *inter alia* that its total sales amount to the equivalent of at least half its production costs.

In the context of Irish Water this requirement set up an obvious dilemma: the average price had to be high enough to offer the prospect of passing the test, but low enough to be politically acceptable. The €240 limit on the average stipulated in the DECLG's letter to Irish Water emerged from a process that endeavoured to reconcile these two objectives. Indeed, according to at least some of the available official documents that date from this time, €240 was close to the minimum that was then considered consistent with passing the MCT.[34] It is worth noting however that it was considerably lower than the kind of figures that had been circulating earlier in the evolution of the water policy agenda. As recently as September 2013 the average charge per household on which modelling by officials was predicated was €350.

(ii) The household allowance

Two questions arise in relation to the household allowance. The first is why such an allowance was part of the tariff structure at all, and the second is why it was set at the level of 30,000 litres.

[33] The Ministerial Direction had suggested an allowance of 38,000 litres in respect of children. This was on the basis of consumption estimates available when the Direction was being drafted. Subsequent estimates suggested that the typical consumption of a child was just 21,000 litres.
[34] See for example, the July 2014 report for the CER carried out by NERA Economic Consulting entitled *Irish Water Interim Review Assessment.*

As noted in Chapter 2, a household ‘free’ allowance was envisaged as an integral part of the tariff structure from the time the Progressive Democrats embraced water charges in the 1990s. The same idea found its way into the commitment given by the Fianna Fáil–Green Party coalition in relation to water charges in its *Renewed Programme for Government* in 2009.[35] As we have seen, it was subsequently reiterated in the *National Recovery Plan* and the agreement with the Troika. The Fine Gael–Labour *Programme for Government* followed suit. Interestingly though, none of these documents explained its purpose, though it is reasonable to surmise that it was intended to address the issue of affordability by guaranteeing that a certain minimum amount of water would be provided free at the point of use.

But, what should that amount be? In late 2012, the DECLG commissioned the ESRI to do some work on the affordability issue, including an assessment of the costs and benefits of introducing a free allowance at different levels. The authors of the ESRI report argued that universal allowances were a crude and inefficient means of addressing affordability problems as they were available to all, regardless of need.[36] They also pointed out that, the higher the allowance, the higher the volumetric charge required to generate a given level of revenue. They proposed that if an allowance was to be part of the tariff structure, that this be a transitory arrangement to provide a bridge between the *status quo* of zero charges and a charging structure with full cost recovery. They suggested that if, contrary to their advice, an allowance was to be incorporated as a permanent feature, it should be set at a low level of around 15,000 litres per household per year.

The level eventually settled on by government was twice that suggested by the ESRI. It emerged from a process in which affordability was a significant consideration and in which what analysis had been done highlighted one-person households as an at-risk group from an affordability point of view. This would have argued for an allowance that represented a non-trivial proportion of the average water consumption of such households. 30,000 litres would have corresponded to just under half the annual consumption of water for one-person households according to estimates available at the time.

(iii) The child allowance

Another group identified in the ESRI analysis as vulnerable to the introduction of water charges was large families. The child allowance seems to have been conceived as a response to this discovery.

The Ministerial Direction to the CER proposed 38,000 litres per annum as the appropriate level here on the grounds that this reflected the ‘normal consumption’ of a child. That was on the basis of consumption estimates available at the time the Direction was formulated. Subsequent analysis

[35] Then Minister for the Environment, Heritage and Local Government John Gormley proposed an allowance of 40 litres per person per day (just under 15,000 litres annually) in a memo to cabinet in September 2010. In doing so, he cited the case of Flanders where water service providers were required to provide an allowance of 15,000 litres per annum to each person on the basis that this is sufficient to provide for basic daily consumption and hygiene requirements. In the same vein, he also cited a UN Conference of Environment and Development in Rio de Janeiro in 1992.
[36] Paul K. Gorecki, Sean Lyons, and Edgar Morgenroth. *Affordability and the Provision of Water Services in Ireland: Options, Choices and Implications*. 2013.

of metering data by Irish Water produced a significantly lower estimate of 21,000 litres and this was accepted by the CER.

(iv) No standing charge

A common feature of public utility tariff structures generally is a standing charge, that is a fixed component that is invariant with respect to consumption. The rationale for such a component derives from the fact that fixed costs of production for a utility are typically relatively large. The argument is that the tariff structure should reflect this. A related reason for a standing charge is that it ensures an element of stability in the utility's revenue stream.

However, there was no standing charge envisaged in the case of Irish Water and it does not appear that it was ever seriously considered by government, although such a charge featured in some of the early modelling carried out by officials, and was assumed by the ESRI for the purposes of the affordability analysis it carried out.[37] In any event, as noted above, the instruction to design a tariff structure without a standing charge formed an explicit part of Minister Hogan's direction to the CER.

(v) The volumetric rate

Given the parameters set out in the Ministerial Direction and the DECLG's funding letter to Irish Water, the elements of the charging structure that were left to the CER to determine were limited in number. The most significant was the volumetric rate, the price to be charged per unit of consumption over and above the allowance(s). Indeed, even this element had to a large extent been pre-determined before the formal involvement of the CER in the process, given that the government had set a limit for the average household charge (and by extension, Irish Water's total projected revenue from the domestic sector), and given the levels of the allowances.

It is also worth emphasising that there was a trade-off between the allowances and the volumetric rate: the more generous the former, the higher the latter had to be for a given level of revenue from domestic charges. Similarly, the absence of a standing charge had implications for the volumetric rate: its absence meant that the latter had to be higher, again all other things being equal. So, the volumetric rate struck by the CER, at €4.88 per 1,000 litres was higher than it would have been if the tariff structure had incorporated a standing charge or smaller allowances.

(vi) The assessed charges

Assessed charges were required because metering was not going to be complete by the time the charging regime started. Indeed, by that date (1 October 2014), just 32% of all households availing of the public water supply would have meters installed, a proportion that was to rise by 3.7% points per quarter over the duration of the initial charges plan, such that 65% of the relevant household population would be metered by the end of that period (December 2016).

[37] There was some media speculation about a standing charge. The *Irish Independent* of 16 April 2014, for example, reported that the government had 'rejected Irish Water's demands for a large standing charge of €100 a year' but would be imposing one of €50 per annum instead.

Again, the CER did not have much freedom of manoeuvre in relation to the assessed charges. The Ministerial Direction was quite prescriptive, instructing the regulator to ensure that such charges 'should be primarily based on occupancy, but may include such factors as a comparison with metered usage […] to ensure that such charges are as close as possible a proxy for metered usage'.

The obvious way to comply with this instruction was to structure the assessed charges in such a way as to reflect the average estimated consumption of the corresponding household based on the available data from meter readings. So, in the case of a one-person household, the assessed charge was predicated on annual consumption of 66,000 litres (the estimate of average consumption derived from meter readings for such households). Subtracting the 30,000 litre allowance meant a chargeable volume of 36,000 and implied a charge of €176. Using the same data, the incremental consumption per adult was estimated at 21,000 litres implying an incremental charge of €102 per adult.[38]

(vii) The capping arrangements

A feature of the July charges plan that is worth emphasising, because it prefigured subsequent developments, was the capping arrangement whereby metered households would have their bills capped at the corresponding assessed charge for the first six months after meter installation. This measure was designed to ease the transition to a usage-based charging regime and provide a measure of certainty in that period. It would also have provided households with a buffer against the consequences of discovering that their consumption was significantly greater than expected and an opportunity to change consumption behaviour accordingly.

Box 2: Metering

The proposal that water charges be applied on a metered basis, just like the proposal that there be free allowances, dates back to the policy advocated by the PDs in the 1990s, and can be traced through the same sequence of official documents published subsequently. Indeed, the two proposals are inextricably linked: free allowances cannot be implemented without a means of measuring consumption.

Not that the primary purpose of meters was to facilitate the implementation of allowances. Their primary purpose was to facilitate volumetric pricing which was seen as the fairest way of charging. Metering consumption was also seen as a means of encouraging and facilitating conservation of water supply, thereby reducing the pressure on infrastructure and in turn reducing the required level of investment.

Meters can be installed inside or outside the home, in the latter case typically at the boundary of the property. Internal installation has the advantage of being significantly cheaper because the need for boundary boxes and the associated digging of holes and refilling them is dispensed with. Arguably, internal meters engender greater trust on the part of householders because they are perceived to be less susceptible to interference.

[38] The estimates of consumption were obtained from the Irish Water Consumption Research Project, run by Irish Water. This study was carried out in several phases from early 2014.

Meters installed just outside the property boundary offer significant advantages too. Installing them does not require the right of access to the property. They are conducive to more efficient reading: drive-by reading is more readily achieved with external than internal meters. Critically, from a conservation viewpoint, meters placed at the edge of a property will facilitate the identification and location of leaks in external pipework.[39] In the Irish case it seems that it was always envisaged that the meters would be external. In this regard, given the exceptionally high rate of unaccounted for water in the network, the conservation objective was decisive.

From an early stage, estimates of what a meter installation programme would cost were pitched within a narrow range of €500m.[40] It is required that capital projects of this order of magnitude are subject to a cost-benefit analysis (CBA). The DECLG carried out such an analysis in respect of metering. The exercise concluded that the benefits, amongst them the benefit of identifying leaks and thereby relieving pressure on production capacity, would greatly exceed the costs. It is worth noting that the CBA was done in late 2012. By this stage, a very strong political commitment to metering had taken root, with part of the attraction being the employment content of the installation programme.[41] In these circumstances, the outcome of the CBA was unlikely to alter the policy trajectory.

It is also worth noting that this CBA was limited in scope. It evaluated a universal metering programme against the benchmark of the *status quo*. It did not evaluate intermediate solutions such as the opt-in approach adopted in the UK. Moreover, it did not evaluate the costs and benefits of external versus internal metering.

When the *National Recovery Plan* was published in October 2010, the expectation was that a programme of meter installation covering all households supplied by the public water system could be completed within three years, that is, in time to commence charging for water services on a metered basis from 2014. When the Fine Gael–Labour coalition assumed office in March 2011, the expectation that a full metering programme could be completed within this timeframe remained, at least initially.[42]

The timeline that actually transpired was quite different. What became known as Phase One of the metering programme — the phase that covered the 1.05 million properties where it was envisaged that meter installation would encounter no serious technical difficulty — wasn't completed until January 2017. Moreover, the coverage of that programme fell some distance short of universality: by the end of the programme, some 890,000 households out of 1.35 million on the public water system, or 66% of the total, had meters installed. This begs two questions. Why the delay? Why the shortfall in coverage?

[39] The meters installed by Irish Water are 'semi-smart' meters. They permit drive-by reading. They are also fitted with a leak alarm that is activated when the flow of water exceeds a certain rate. This signal is picked up when the meter is next read. A fully smart meter is designed to permit continuous remote reading. In this case the leak alarm is picked up in continuous time rather than at discrete intervals.

[40] The first time a proposal for a universal metering programme was brought to Cabinet was in December 2009 when the Green Party's John Gormley was Minister for the Environment, Heritage and Local Government. His Memorandum contained an estimate of €500-600m for the cost of installing meters in 1.2 million properties.

[41] For example, Minister Hogan issued a statement on 16 January 2012 in which he said: 'Jobs are at the core of this Government's plan and the water reform programme will form a key element in our job creation strategy. The toll-out of the water metering programme will result in direct employment for approximately 2,000 much-needed good quality jobs for the construction sector.'

[42] In a speech to the Dáil on 6 April 2011, newly appointed Minister of State for the Environment Fergus O'Dowd expressed the view that universal meter installation would take three years and that water charges would not be introduced until that had been done.

Table 4.1: Meter Installation

	(000s)	(%)
31 December 2013	78.9	5.8
30 September 2014	430.3	31.9
31 December 2014	539.0	39.9
31 December 2015	802.3	59.4
31 December 2016	882.8	65.4
31 January 2017	892.7	66.1

Percentages relate to total number of households on the public water network (1.35 million).

Source: Irish Water

The delay in completing the programme is entirely explained by the delay in starting it. Meter installation did not commence until August 2013.[43] The desire to ensure a standardised approach to procurement and installation and to ensure synchronicity of timelines across the country meant that executing the programme on a centralised national basis was the strongly preferred strategy. Some of the preparatory work, including much of the procurement process, could be and was done before Irish Water was incorporated, but installation had to await that date and Irish Water was not incorporated until July 2013.

When metering actually started, it proceeded apace. Over the first 14 months of the programme, that is from August 2013 to end-September 2014, meters were installed at a rate of over 30,000 per month. Over the entire Phase One, the average monthly installation rate was about 22,000. In total, almost 900,000 meters were rolled out in less than three and a half years, a considerable achievement, and one claimed by Irish Water as the most ambitious meter installation programme of its kind ever carried out.

It was also completed within budget. The amount budgeted for Phase One at the outset was €614m; the final cost was €465m (76% of budget). The shortfall reflected the fact that coverage was 160,000 (15%) less than planned.

That coverage was less than planned was officially attributed to ‘a combination of health and safety reasons, service complexity or other technical reasons’.[44] Undoubtedly technical factors explained some of the shortfall, but it is likely that ‘health and safety reasons’, code for the hostility with which installation teams were greeted in certain areas, played a bigger part.

Even if Phase One had been completed as planned, coverage would still have fallen well short of universality: there are a total of 1.35 million households on the public water network. The balance of 300,000, excluded from Phase One, were households where meter installation is either technically infeasible, or could only be achieved within a longer time frame because they had shared service connections or were located in multi-occupancy structures like apartment blocks, or because the main water pipe entered the house through a back garden. It was intended that such households would come within the scope of a Phase Two installation programme.

[43] Interestingly, Minister Gormley’s Memorandum to Government of December 2009 proposed to commence the meter installation programme in Q1 2011.
[44] Dáil statement by Simon Coveney, then Minister with responsibility for water policy on 20 October 2016.

While Phase Two has yet to commence, a recent government decision arising from the *Report of the Joint Committee on the Future Funding of Domestic Water Services*, requires individual meters to be installed in all newly built houses and bulk meters to be installed in all multi-unit residential developments.

Implications of the initial charges plan

For unmetered households, the implications of the charging structure announced by the CER were clear and the bills perfectly predictable. One-adult households were to pay €176 per annum, while two-adult households would pay €278. These charges were not dramatically different from the €238 household average.

For households comprising three adults or more, the unmetered charge was set to be significantly above the average, however. Three-adult households faced a charge of €380 (60% above the average); four-adult households, a charge of €482 (more than twice the average); and so on. If the consumption estimates that these charges were based on accurately reflected usage amongst metered households of equivalent composition, the metered households would have faced comparable bills.

Given the distribution of households by occupancy, this would suggest that, as shown in Table 4.2, some 30% of all households (those containing just one adult) would have faced bills well below the average and another 50% (those containing two adults) would have faced bills modestly above the average. But 20% would have faced bills significantly above the average, ranging from a margin of 60% above to more than twice the average in the case of households containing four adults or more (about 6% of all households).

The CER's charges plan was not well received. Some of the press coverage of the July announcement focused on perceived departures of the proposals from what the government had promised. The *Irish Times*, for example, carried a piece with the headline 'Irish Water reduces free allowance for children', a reference to the fact that the child allowance proposed by the CER (21,000 litres) was lower than that indicated in Minister Hogan's Policy Direction (38,000 litres).[45]

[45] Fiach Kelly. "Irish Water Reduces Free Allowance for Children." *Irish Times*, 1 August 2014.

Table 4.2: Size Distribution of Households

Number of Adults	Households (%)
1	30
2	49
3	14
4	5
5+	2

Source: Census 2011

More damaging was the same paper's front page treatment of the announcement. Under the headline 'Water to cost more than in most EU states', the paper claimed that the CER's proposals would see 'most Irish families paying at least 20 per cent more than the Government claimed less than three months ago'. This claim appears to have been based on a comparison of the €278 assessed charge for a two-adult household contained in the CER plan with the €240 limit on the average household charge imposed by government as a constraint on the charging structure. The comparison was spurious (indeed the average household charge implied by the CER's proposals was slightly less than the €240 limit), but the claim that it prompted set the tone.

Opposition politicians were sharply critical of the charges plan. An important theme that emerged in the criticism related to the distribution of charges around the average and, in particular, the fact that a significant number of households would face bills well above the average.

The package of affordability measures

On 30 September, the CER formally confirmed its decision in relation to the tariff structure. There were some minor amendments to its earlier set of proposals, but the core elements discussed above remained unchanged. Meanwhile, popular opposition to water charges had gathered momentum, and an upcoming by-election in Dublin South West was to prove a potent rallying point for the protesters. That by-election produced a resounding and unexpected victory for Paul Murphy, the Anti-Austerity candidate who had made opposition to water charges a central plank of his campaign. Murphy was a member of the Socialist Party. He won 27% of the first preference votes, 22 percentage points more than the same party's candidate had won in the general election of 2011.

Echoing what had happened in the Dublin West by-election almost 20 years earlier, the Labour vote collapsed. Its candidate obtained just 8.5% of the first preferences, compared with the 36% secured by the party in 2011. The Fine Gael vote also collapsed, from 28% to 9%.[46]

[46] The turn-out in the by-election was just 35%. The turn-out in the same constituency in the 2011 general election was 67%.

Under pressure to retrieve a deteriorating political situation, the government looked for ways of making the proposed water charges regime more palatable. The first attempt to do so was predicated on an unchanged tariff structure, implying that the alleviating measures had to be based on the social welfare system and/or the tax system. As detailed in Box 3, this was ground that had already been explored and had yielded little of value. Now it was being revisited with a degree of urgency. Options that were previously dismissed as unsuitable on grounds of efficiency and cost, now seemed more attractive.

Box 3: Affordability Measures

From an early stage there was concern amongst government ministers about the potential impact of water charges on vulnerable groups, including the elderly, those on low income, and those with chronic medical conditions. The commitment, made in the Programme for Government, to provide a universal free allowance should be seen in this context.

In late 2012, the DECLG commissioned the ESRI to carry out an exercise, the purpose of which was (i) to assess the costs and benefits of introducing a free allowance at different levels in accordance with that commitment, and (ii) to consider options and make recommendations in relation to additional affordability measures that should be introduced.

The conclusions reached by the authors of the ESRI report in relation to the first of these tasks are summarised in the main body of the text.[47] As to the second task, while arguing that it would be far better to use the welfare system to target households with water service affordability problems, the ESRI made little progress in devising specific measures beyond identifying the types of household most likely to be in need of such help. It was a longish list: it included apartment dwellers, younger persons, the working poor, single-parent families, and one-person households. The one strong conclusion reached by the ESRI in relation to specific affordability measures was that the Household Benefits Package and the National Fuel Scheme were 'very badly targeted at those households experiencing water poverty'.

The ESRI report was completed in March 2013. Seven months later, the Cabinet Committee on Economic Infrastructure established a working group — the Inter-Departmental Working Group on Affordability Measures – to consider much the same set of issues. The Group consisted of representatives from a number of departments and was chaired by a senior DECLG official.[48] Its terms of reference directed the Group to address the following questions:

- Which groups of the population would be placed at greatest risk of increased poverty?
- How might any subsidy for water charges be targeted and implemented?
- What cost to the State would arise from any such subsidy?

A serious problem hampering the Group's work, like that of the ESRI before it, was that it was in the dark as to the details of the tariff structure to be adopted. All that was known for sure at the time was that the government intended charges to be based on usage above a free allowance. Even the average level of the charge per household would have been a matter of broad conjecture although some work on this issue had been done at that stage.

[47] Paul K. Gorecki, Sean Lyons, and Edgar Morgenroth. *Affordability and the Provision of Water Services in Ireland: Options, Choices and Implications.* 2013.
[48] The following departments were represented: Environment, Community and Local Government; Social Protection; Finance; Public Expenditure and Reform; and the Taoiseach.

The Group piggy-backed on the earlier ESRI analysis of water poverty, defined as a situation where a household spends more than a certain proportion (3% or 5%) of its disposable income on water. Thus defined, water poverty was projected to characterise 48% (at the 3% threshold) or 26% (at the 5% threshold) of those occupying the lowest decile of the income distribution and a negligible proportion of those in the second lowest decile. In other words, water poverty was projected to apply to, at most, 5% of the population or about 65,000 of the 1.3 million households connected to the public water supply.

These results were derived from a scenario in which it was assumed that there would be no 'free allowance' and the average household charge would be €450-€500.[49] This was clearly a much harsher tariff structure than either of those announced in July and November 2014. Moreover, average water usage per person was assumed to be 145 litres per day, in keeping with the only estimate of water consumption then available, but considerably higher than subsequent estimates based on metered usage.

The Working Group identified the key categories of household that were likely to face affordability challenges as single-occupancy households and large low-income families and examined a range of putative interventions that might be of assistance, amongst them social tariffs. A social tariff is an arrangement whereby certain categories of customer are charged at a special lower rate, which can either be funded by government or through cross-subsidisation by other customers. The Group emphatically recommended against the use of social tariffs on a wide range of grounds, including complexity, administrative difficulty, and inefficiency.

The Group also examined how the social protection system might be used to target the at-risk categories of household, but concluded that there was no existing social protection scheme that they mapped on to. The Group, strongly influenced by the Department of Social Protection (DSP), was also dissuaded from trying to devise a new water-specific welfare scheme by its assessment of the policy and administrative difficulties that would arise. In terms of using an existing scheme as a passport for a water subsidy, the Group repeated the ERSI's verdict, namely that neither the Household Benefits Package nor the Fuel Allowance was particularly useful. In addition, it was pointed out that using the latter would cut across the DSP's policy agenda in relation to labour market activation by creating further disincentives to work.

Not surprisingly, it became clear to the Group as its thinking evolved, 'that the approach to affordability measures cannot be developed in isolation from either the design of water charges or the proposed free allowance, as it is the combined effect [of these] which will impact on particular household circumstances'.[50]

Although the Group's report set out a set of 'next steps' that it would take, including further work on the need for affordability measures in the light of emerging information on the tariff structure, the Group itself did nothing more after the completion of its report in December 2013. Thereafter, what work was done on affordability was done on the political side of the policy-making process.

One such option was to use the Household Benefits Package and the Fuel Allowance as passports for a water subsidy to households. This option was selected and a subsidy of €100 decided on. It was to be payable to over 600,000 households (more than 44% of the total number

[49] This was the baseline scenario so chosen to provide the basis for simulating the effects on water poverty of introducing allowances at different levels and other affordability measures.
[50] *Report of the Inter Departmental Working Group on Affordability Measures*. December 2013, 7.

availing of the public water service) at a gross cost of over €60m. The announcement was first made by the Tánaiste and Minister for Social Protection on 18 September and subsequently confirmed in the 2015 Budget presented on 14 October. Also unveiled in that budget was a tax credit of up to €500, available at the standard rate of 20% and therefore worth up to €100 annually to taxpayers. This was projected to cost €40m in a full year.

This package of affordability measures, costing a total of €100m, had all the appearance of a makeshift arrangement. Passporting the water subsidy on the two social welfare schemes chosen meant that the beneficiaries would have included large numbers of people who were very unlikely to have ability to pay issues (including many beneficiaries of the contributory old age and widow's pensions which are not means-tested). On the other hand, this expedient would have excluded households where ability to pay was likely to be an issue, since neither the Household Benefits Package nor the Fuel allowance are paid to the unemployed. Moreover, the tax credit would have been of benefit only to those paying income tax: those on low pay – the working poor – would have fallen outside its scope.

Not surprisingly therefore, these attempts to ameliorate the effect of the proposed water charges regime were poorly received with the gaps in the coverage of the affordability measures receiving particular attention.[51] The anti-water charges protests gathered further momentum. On 1 November an estimated 100,000 people turned out for a series of nationwide demonstrations signifying that active opposition to water charges had spread well beyond the narrow socio-economic and political boundaries of earlier anti-austerity street protests. Government politicians were unpleasantly surprised to discover that people whom they would never have expected to take to the streets were now doing so.

The November 2014 charges plan

On 19 November, in a further attempt to dispel the gathering political storm clouds, the government scrapped the charges plan confirmed by CER in September and its own subsequent package of affordability measures, and announced a new and radically different tariff structure. At the core of the new regime were two capped charges, to apply equally to both metered and unmetered customers, one at €160 for households containing one adult and the other at €260 for households containing two or more adults. The child allowance of 21,000 litres was retained, but the 30,000 litre household allowance was abolished. The volumetric rate, for metered households, was reduced to €3.70 per 1,000 litres, down from the previous €4.88.

It was proposed that the caps remain in place until 2018, that is spanning a four-year period starting from the new commencement date set for charging which was 1 January 2015 (postponed from the 1 October 2014 date proposed under the previous plan). The legislation giving statutory effect to the new proposals, the *Water Services Act 2014*, contained provision for the indefinite extension of the capping period.

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[51] Typical of the criticism was the reaction of the anti-water charges Right2Water campaign: 'The Government added a new anomaly to its crumbling water tax edifice by introducing a tax credit and extending the household benefits package, leaving hundreds of thousands of low earners who do not earn enough to pay tax, and will not qualify for the households benefit package, empty-handed.'

The November regime also featured an entirely new element, the so-called Water Conservation Grant which was set at €100 per annum and was available to all households who registered certain details with Irish Water, irrespective of whether they were customers of Irish Water or had paid water charges. Although the government claimed that the grant was not connected to water charges, official documentation setting out the features of and rationale for the new regime claimed that the net yearly cost of water would now be 'either €60 for a single adult household or €160 for all other households until the end of 2018'.[52]

The Conservation Grant was designed to replace the affordability package fashioned to accompany the earlier tariff structure, and was set at the same absolute level as each of the components of that package. At one stage it was proposed that it be made conditional on the payment of water charges, but it was felt that such a condition would compromise the objective of passing Eurostat's MCT. It was also felt that it had to be available to all households, including those who were members of private (group) water schemes.

The average (gross) charge per household under the November plan was estimated at €199, about 16% lower than the €238 average generated by the earlier proposals.

An analysis of who stood to gain and lose from the new regime compared with the old provides insights into why the new charges plan was structured as it was. The first thing to say here is that all unmetered households (who were to comprise the vast majority when charging commenced and would still constitute a majority until mid-2016) would face unambiguously lower bills under the new regime than they would have under the earlier one. In the case of households containing one or two adults, the margins were small at €16 and €18 respectively. But for households containing three and more adults, the margin became increasingly large. For five-adult households (say two parents and three children aged over 18), the assessed charge proposed by the CER was €594 whereas the new capped charge was €260.

For metered households the situation was a little more complicated. Here, households at relatively low levels of usage would face higher bills under the new regime than they would have under the earlier proposals. For example, in the case of two-adult households, the November charges plan implied higher bills up to levels of consumption of 83,000 litres annually, if there were no children; 104,000 litres annually, if there was one child; 125,000 annually if there were two children; and so on. At consumption levels above these respective thresholds, metered households would face lower bills under the new plan.

The explanation for this pattern is the fact that the household free allowance was dropped from the revised tariff structure. From this it may be inferred that the purpose of dropping the allowance was to assist in shifting the size distribution of bills. Under the earlier CER proposals, there would have been a very wide dispersion of bills, ranging from the very small to the very large. The cap ensured that the very large bills would be eliminated. The dropping of the household allowance was designed to greatly reduce the number of very small bills.

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[52] Department of the Environment, Community and Local Government. *Water Reforms – Key Elements,* November 2014.

Of course, another consequence of the capping arrangement was that the volumetric element in the tariff structure was much diminished. In fact, it disappeared completely at higher levels of consumption, where the encouragement of conservation made most sense But there was still a volumetric element at the lower consumption levels: It was possible for metered households to 'beat the cap', an objective that they were encouraged to adopt by government spokespersons.[53]

Table 4.3: Consumption by Quartile, Two-Adult Households

Children	Low	Medium	High	Very High	Average	*Cap*
(m^3 per annum)						
0	43	75	104	168	100	*70*
1	51	94	120	171	115	*91*
2	70	112	145	199	131	*112*
3	80	126	155	212	143	*133*
4	109	153	187	252	176	*154*

Source: Water Consumption Research Project, own calculations

The data in Table 4.3 provide an indication of the proportion of two-adult households, for example, that were in a position to beat the cap. Although the volume of consumption corresponding to the capped charge of €260 per annum was significantly below the average consumption for each household type, it is clear from the data on the pattern of consumption that for a significant proportion of households, consumption was low enough that the bills would have been beneath the cap.

In relation to the broad political judgements that underpinned the revised tariff structure it is worth recording what the text of the official announcement had to say about the benefits of the new arrangements.[54] Amongst the claimed benefits listed were:

- *Certainty: All households will know what their maximum bills will be until the end of 2018, which is particularly important for larger households and for those with high usage due to medical need.*
- *Simplicity: There are only two capped charges for primary dwellings – for single and multi-adult charges.*
- *Affordability: The absolute maximum charge is €5 per week (net €3 per week); For single households it will be approximately €3 per week (net €1.15 per week).*

[53] Alan Kelly, the then Minister for the Environment, went so far as to say the following in his Dáil speech on 19 November: 'We estimate that if metered households can reduce their water consumption by between 10 and 15 per cent, then approximately half of Irish households will be able to 'beat the cap'…In fact, some people will be able to get their bills below €100 and when taken with the water conservation grant, they will be slightly better off because of the introduction of water charges and meters'.
[54] Department of the Environment, Community and Local Government. *Water Reforms – Key Elements,* November 2014.

It is interesting that certainty topped the list. Certainty and the introduction of a volumetric charging regime are not easily combined. Likewise, simplicity is difficult to achieve when there are two sets of charges, one for metered and another for unmetered households.

The legislation underpinning the new pricing regime was introduced in the Oireachtas in late November 2014. Despite the government's radical rethink, the opposition was not placated. In the Second Stage debate, Barry Cowen, the Fianna Fáil spokesman on the environment claimed that the conservation principle had been abandoned, noted the absence of the economic regulator from the decision-making process, and warned that Irish Water now risked failing the Eurostat test. Others, to the left of Fianna Fáil, used the occasion to renew their commitment to secure the abolition of water charges altogether. Paul Murphy, the Anti-Austerity Alliance member who had been elected for Dublin South West just a few weeks earlier, promised a boycott of the charges, predicted that the sheer force of people power would bring about the end of charging, and looked forward to a major demonstration against the charges to be held the following week.

Table 4.4: Water Charges Payments

Cycle*	(€m)	(% of target)
1	30.5	44.5
2	38.0	55.5
3	42.3	61.8
4	33.4	48.8
5	20.9	30.5
** Cycle 1: bills in respect of Q1 2015 etc.*		

Source: Irish Water

That demonstration in Dublin city centre took place on 10 December. Estimates of the numbers involved spanned a wide range from 30,000 to 80,000. Differing estimates notwithstanding, it was clear that the water charges issue, despite the new less onerous regime, retained the capacity to bring very large numbers of people out on to the streets.

Of course, what mattered more for the future of water charges was whether people paid. Table 4.4 sets out the relevant data, starting with Cycle 1 which relates to bills in respect of usage in Q1 2015 and ending with Cycle 5 (bills in respect of Q1 2016 usage). The compliance rate started at 44%, increased to almost 62% in Cycle 3 before falling sharply over the final two cycles. This decline, notably the very sharp fall in the final cycle, reflects political developments that amplified the perceived likelihood that charges would be abolished.

The 2016 Election and its aftermath

The water charges regime remained in place through 2015 and into early 2016. In February 2016 a general election took place. The government parties fought that election on a platform that included support for water charges. The left-wing opposition groups in the Dáil, including Sinn Féin, had long expressed their opposition to charges and they campaigned on that basis. Fianna Fáil, which had proposed the introduction of water charges when in government and had refrained from adopting a position of outright opposition to charging at the height of the controversy in 2014, committed in its election manifesto to scrapping water charges (and to abolishing Irish Water).[55]

The Dáil arithmetic after the 2016 election was such that no willing coalition of political parties or groups could command an overall majority. The outcome was a Fine Gael-led minority government with the active support of some independents, sustained in power by a Confidence-and-Supply arrangement with Fianna Fáil. The latter insisted as a condition for agreeing to this arrangement that water charges be suspended for an initial period of nine months, that an Expert Commission be established to make recommendations for a sustainable long-run funding model for Irish Water, and that a Special Oireachtas Committee consider the Commission's findings and make its own recommendations which would then be voted on by the Oireachtas.

The Expert Commission was duly established under the chairmanship of Kevin Duffy, the former Chairperson of the Labour Court, and consisting of people with expertise in different aspects of the water sector.[56] It met on 10 occasions between July and November 2016 when it reported. It was assisted by a secretariat drawn from the staff of the Institute of Public Administration.

Its principal recommendations in relation to the funding model were as follows:

- The funding of water services for normal domestic and personal use should be out of taxation.
- The volume of water necessary to meet the normal domestic and personal needs of citizens should be independently assessed through an open and transparent process.
- Under the proposed arrangement, the national water utility will provide sufficient water to all citizens to cover their domestic and personal needs, and the cost of that water will be recovered from the State, based on tariffs approved by the CER.
- Excessive or wasteful use of water should be paid for directly by the user at tariffs determined by the CER.

The Commission's approach was based on the distinction between the right to water for normal domestic and personal purposes and wasteful usage. It argued that the former could reasonably be regarded as a public service, provided for all citizens and funded out of taxation. On the other hand, it argued that where water usage exceeds normal requirements, the principle of public service can no longer be applied and the user should pay for the excess.

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[55] Fianna Fáil. *An Ireland for All*, Manifesto, 2016.
[56] The members of the Commission are listed in the *Report on the Funding of Domestic Public Water Services in Ireland*. November 2016.

The Commission's recommendations on pricing were broadly endorsed by the Special Oireachtas Committee established to consider them and deliberate on the issues. The Special Committee called for the abolition of water charges and added one notable element of specificity to what had been proposed by the Commission: That the threshold for excessive use be set at 1.7 times the household average, with the household average being determined by the CER. Whether there was to be one universal household average computed or a range of such averages corresponding to households of different size and composition was not stated.

The report of the Special Committee was passed by the Oireachtas, and legislation to give effect to its recommendations, the *Water Services Act 2017*, was subsequently passed. That legislation self-described as 'an Act to provide for discontinuing and extinguishing liabilities in respect of charges imposed by Irish Water for the provision of water services to a dwelling [and] for refund of certain payments made in respect of charges so imposed' was enacted on 17 November 2017. Refunds were paid the following month.

Chapter 5: Irish Water and the Eurostat Test

The decision to set up Irish Water

The introduction of water charges was just one element of a radical transformation of the water sector planned for the 2011–2016 period by the Fine Gael–Labour government. There were in fact four interlocking pieces in what became known as the Water Sector Reform Programme. In addition to charging for water on a volumetric basis and metering its usage, there was the matter of setting up a single water utility and the related matter of putting in place a system of economic regulation.

The overarching vision for the sector was to reach a point where water and waste water services would be provided to the highest standards of reliability and regard for the environment. This required a substantial and sustained volume of investment in water infrastructure. The judgement was that the scale of investment required could only be delivered if a single water utility was established and was able to operate outside the constraints imposed on the general government sector. In other words, water had to be moved ‘off balance sheet’. For that to happen, the water utility would have to be classified by Eurostat as a market corporation. This classification decision, therefore, was seen as critical to the success of the overall strategy.

The first public indication that government thinking was moving in the direction of a single water utility came in the *Memorandum of Understanding* with the Troika in December 2010. That document contained the commitment to undertake ‘an independent assessment of transfer of responsibility for water services provision from local authorities to a water utility’.[57] The Fine Gael–Labour *Programme for Government* of the following March went a step further and committed unambiguously to the establishment of a new state water company to be called Irish Water. This had been the Fine Gael position for some time and dated back to a policy document the party had published in 2009.[58]

When Phil Hogan became Minister for the Environment, Community and Local Government in March 2011, some preparatory work had already been done in relation to the independent assessment provided for in the agreement with the Troika. One of his first tasks as Minister was to commission consultants to undertake that exercise. PwC were chosen for the purpose and started work on the project in June.

The PwC report, completed in November 2011, started with an assessment of the strengths and weaknesses of the *status quo* whereby water services were delivered and the associated

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[57] John Gormley, the then Minister for the Environment, Heritage and Local Government, in a November 2010 memo to cabinet, had proposed to establish a new state agency to fund and manage a meter installation programme with ancillary functions (customer service, billing, revenue collection) outsourced by way of a competitive tendering process, but this arrangement would have fallen well short of the single water utility prefigured in the agreement with the Troika.

[58] Fine Gael. *NewERA*. November 2009.

infrastructure managed by 34 local authorities[59]. Amongst the strengths the consultants attributed to this arrangement were the value of local knowledge in determining operational effectiveness and the benefits of having a local body accountable to the local community. Weaknesses identified included low levels of efficiency, due in part to an inability to achieve economies of scale, fragmented leadership and poor coordination, significant duplication of effort, and an ageing and low quality network (with unaccounted for water being an especially salient issue) due to historical underinvestment.[60] The report came down firmly against retaining the *status quo*.

PwC then went on to assess alternative ways of reorganizing the sector, focusing in particular on two options:

- The public utility model under which Irish Water would become a full Public Utility similar to the ESB, delivering all water services provided by the local authorities under the *status quo*, acting as the single contact point with customers, owning all the infrastructure and employing all water services staff.
- The agency model under which Irish Water would become the single water authority for the country, owning all the assets and taking responsibility for investment, but under which the local authorities, acting as agents for Irish Water, would operate and maintain the services in their areas and perhaps take responsibility for minor capital works. In this model, the staff required for operational and maintenance functions would remain local authority employees. This would have mirrored the way the NRA operates vis-à-vis the local authorities in relation to the road network.

PwC's evaluation of these two options was based on a detailed multi-factorial methodology.[61] The public utility was adjudged by the consultants to be superior under the majority of criteria, especially decisively in relation to those where considerations relating to efficiency, coordination, and accountability were prominent. One notable exception related to implementation, where it was noted that the agency model would likely present fewer challenges from an industrial relations perspective.

The consultants were clear in their conclusions: they recommended the public utility model as the most appropriate model for Irish Water. That recommendation was echoed in a formal cabinet decision in December 2011 to establish Irish Water.

Irish Water becomes a subsidiary of Bord Gáis Éireann

Another question considered by PwC was whether there might be a role for an existing state company in the establishment of Irish Water, but they concluded that the balance of advantage favoured a stand-alone approach. Amongst the arguments they advanced in support of this

[59] PricewaterhouseCoopers. *Irish Water: Phase 1 Report.* November 2011.
[60] Unaccounted for water, largely due to leakage, was estimated at 41% of the total.
[61] The factors used corresponded to the following nine objectives/considerations: (i) financially sustainable water services, (ii) improving the water services infrastructure, (iii) ensuring environmental standards are met, (iv) delivering improved outcomes for customers, (v) strong governance with clear accountabilities, (vi) support other aspects of water reform, (vii) promote efficiency, (viii) implementation considerations, and (ix) impact on the Irish economy.

position were (i) the constraints on integration and sharing imposed by the requirement to ring-fence the water business from other regulated businesses, and (ii) the need for a fully-focused management team to drive the establishment of Irish Water and manage its transition to national water authority. [62]

Despite PwC's views on the matter, there was a predisposition on the part of government to explore this question further. A position paper published by the DECLG in January 2012 revealed that it was engaged with NewERA in a 'detailed review of a number of state agencies to determine whether, and in what manner, the skills within the sector can be harnessed for the successful implementation of the proposed water sector reforms, and particularly the establishment of Irish Water'. [63,64]

In effect, this process reduced to a two-horse race. The only state agencies that registered a serious interest in the proposition were Bord Gáis Éireann (BGÉ) and Bord na Móna. A rigorous evaluation exercise ensued in which the two companies made submissions detailing their capabilities, PwC conducted a 'gaps analysis' to ascertain which of them came closest to fulfilling the requirements, and a group of officials, drawn from DECLG, NewERA and the Department of Communications, Energy and Natural Resources (DCENR), considered the evidence and reached a conclusion.[65] BGÉ emerged as the clear choice. Amongst the considerations that favoured BGÉ was the expertise it had in metering, billing large numbers of customers and operating in a regulated environment, expertise that Bord na Móna lacked.

Several reasons for the decision to embed Irish Water in an existing state company suggest themselves. Probably the most important had to do with timelines: there was a strong perception that setting up Irish Water as a greenfield operation would take much longer.[66] A related consideration was risk: the greenfield option was seen as the riskier one.

Moreover, at least one of the arguments advanced by PwC against the subsidiary route was rendered moot by the selection of BGÉ as parent company, and more particularly by the plan to sell off BGÉ's retail business, Bord Gáis Energy.[67] This disposal was to mean that water would be the only regulated business in the BGÉ Group going forward, thus removing whatever constraints on integration and sharing might be imposed by operating two such businesses. Arguably, that disposal also addressed one of the other PwC arguments in so far as it was likely to result in less competition for senior management attention across different businesses within the Group, and less risk that Irish Water would be denied the management focus it required.

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[62] Clearly the potential 'parent' firm that PwC had in mind in making this point was one that was already operating in a regulated area i.e., the ESB or BGÉ.

[63] This was an entity, prefigured in the November 2009 Fine Gael policy document of the same name, set up by the new government to act as a dedicated source of corporate finance advice to government in relation to state companies.

[64] DECLG. *Reform of the Water Sector in Ireland,* January 2012.

[65] DCENR was involved because the two companies concerned came within its purview.

[66] One official with expertise in the utility sector expressed the view to the author that the process would have taken 18 months longer under the greenfield option.

[67] The decision to sell Bord Gáis Energy was announced in February 2012. In March 2014 the sale for €1.1bn to a consortium headed by Centrica was confirmed. On foot of that deal, BGÉ was renamed Ervia in June 2014. The sale of Bord Gáis Energy came about because of a commitment by the government to sell some state-owned assets under the EU/IMF bail-out programme.

At its meeting of 17 April 2012, the cabinet confirmed its intention to set up Irish Water and announced that the company would be established as a subsidiary of BGÉ. Pending the incorporation of the new company 15 months later, a Programme Management Office was set up in BGÉ and it became the engine that drove the preparatory work, including the establishment of a board, the appointment of a management team, the development of an implementation plan, the design of systems (including payroll and HR, asset management and financial systems, a billing system), and the development of a communications and marketing strategy. Amongst the key appointments made was that of John Tierney, the retiring Dublin City Manager, as Irish Water CEO in January 2013.

The appointment was made by the Board of Irish Water with the consent of the Ministers for the Environment, Communications, and for Public Expenditure and Reform. His background in local government was an important factor in his selection. The expectation was that his presence at the helm of Irish Water would help to achieve a harmonious relationship with the local authorities in what was potentially a fractious and difficult transition.[68] From the outset it had been planned that the local authorities would continue to fulfil a wide range of operational and maintenance functions for a finite period, acting in this regard as agents of Irish Water. One of Tierney's key tasks on becoming CEO was to oversee the negotiation of the agency arrangements.

These arrangements took the form of service level agreements (SLAs) between Irish Water and the individual local authorities and were given statutory underpinning by the *Water Services (No 2) Act 2013.* A notable feature of the SLAs is that they are 12 years in duration, albeit there is provision for review in year 2 and year 7. The close relationship provided for in the SLAs was to play an important part in the Eurostat decision to classify Irish Water within the general government sector two years later.

John Tierney did not enjoy a smooth ride as CEO. A pivotal event was a radio interview broadcast in January 2014 in which he revealed that Irish Water had already spent €50m on external consultants. A firestorm of controversy ensued. Subsequent disclosures about salaries and bonuses deepened the controversy. Irish Water was required to appear before an Oireachtas Committee to explain and defend its start-up budget. Its submission indicated that total planned expenditure on consultancy services in the context of setting up the company was close to €90m. This raised questions about the supposed benefits of making Irish Water a subsidiary of an established utility with experience of billing, metering and operating in a regulated environment.

The company's explanation for the large outlay on consultants was that 'while the core capability to define what was required to establish Irish Water existed within Bord Gáis, it would require the use of specialist service providers to help implement this programme'.[69] Put another way, BGÉ knew what systems Irish Water needed to become operational, but didn't know how to set up those systems in the new company.

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[68] In the words of one public official who was closely involved in the development of water policy, John Tierney's mentality was 'always to get the insiders onside'.

[69] Irish Water Submission to the Joint Committee on the Environment, Culture and the Gaeltacht, 11 February 2014.

Irish Water's cost base and the role of the Regulator

As the economic regulator of the water sector, the overarching role of the CER was to protect the interests of water customers.[70] In executing this role, it was given the task of ensuring that Irish Water would operate in an economic and efficient manner. It was to do this by interrogating the company's cost base (including its start-up costs) and capital expenditure plans. This was a key element of the CER's assessment of Irish Water's proposed water charges plan.

The amount that Irish Water was permitted to recover in sales revenue under the regulatory system was called 'total allowed revenue'. This was made up of (i) an appropriate level of operational expenditure, (ii) a level of capital spending that was judged to be adequate, effectively targeted and fully justified, and (iii) an element that allowed the company to achieve a fair return on capital employed, based on an estimate of its Regulatory Asset Base (RAB) and an allowed rate of return.

Table 5.1: Irish Water Allowed Revenue 2014-2016

	Q4 2014	2015	2016	Total
Irish Water Submission (NPV, 2013 Prices, €m)				
Operating Expenditure	205.5	829.5	788.4	1,823.5
Capital Expenditure	186.3	832.8	819.8	1,838.9
Change in RAB				-1,399.1
Total Revenue Required				2,263.2
CER Determination (NPV, 2013 Prices, €m)				
Operating Expenditure	203.8	766.3	716.2	1,686.3
Capital Expenditure	138.3	598.2	571.2	1,307.7
Change in RAB				-915.2
Total Allowed Revenue				2,078.8
Reduction vs. Irish Water				8.20%

Source: CER Water Charges Plan Consultation Paper, 31 July 2014

[70] The CER (Commission for Energy Regulation) had been appointed as economic regulator of the water sector under the *Water Services (No 2) Act 2013*.

In the context of approving Irish Water's proposed charges plan of mid-2014, the CER received a submission from the company that contained details of its cost base and capital spending plans. These were then subjected to rigorous review by the regulator with the assistance of NERA Economic Consulting.[71] The outcome of that review was as follows:

- *Establishment Costs*: the CER found that the costs of establishing the company were for the most part incurred on foot of competitive outsourcing, but disallowed €9m of the €182m total. The amount disallowed mostly related to project management costs which the CER assessed to be higher than expected and for which Irish Water was unable to provide supporting evidence.[72]
- *Operational Expenditure*: Irish Water had proposed to achieve an annual 2.2% efficiency saving in 2015 and 2016. Based on its review of efficiency savings achieved by comparable companies elsewhere, CER judged this to be too low and proposed instead an annual average of 6% for this period.
- *Capital Spending*: Irish Water had submitted a capital spending plan totaling €1.95bn for the period from Q4 2014 to end-2016. The CER disallowed €563m of this, most of which (€475m) reflected what it expected to be a funding constraint, but also reflecting what it described as an 'efficiency challenge'.[73]

On the basis of the above, and taking into account the RAB element, the CER's proposed total allowed revenue figure for the review period (Q4 2014 to end-2016) was about €200m lower than what Irish Water had sought. The details are set out in Table 5.1.

The Eurostat test

As already noted, a central objective of the Water Sector Reform Programme was to take Irish Water off the general government balance sheet. This was seen as having two sets of benefits. First, it would allow the company to borrow on the strength of its own balance sheet. In other words, investment in water infrastructure could proceed on its own terms without having to compete with the demands placed on limited fiscal space by other areas of general government. The obverse of this, and the second, broader benefit was that the demands of the water sector would no longer exert a crowding out effect on those other areas.

To arrive at this happy position, it was necessary that Irish Water pass the so-called 'Eurostat test' or MCT, a statistical classification procedure that is described in detail in Box 4 on the next page.

[71] NERA (not to be confused with NewERA) is a London-based consultancy firm that specialises in the economics of competition and regulation.
[72] The CER had carried out a high-level review of Irish Water's establishment costs in November 2013. The DECLG had approved a budget of €150m for such costs plus a contingency amount of €31m. The CER's conclusion at that time was that 80–85% of the €150m appeared to be reasonable. In the event, the entire budget, including the contingency reserve, was spent.
[73] The figures in the text do not correspond to the figures in Table 5.1 because the latter are expressed in terms of net present value and constant (2013) prices.

Box 4: The 'Eurostat test'

The procedure commonly referred to as the 'Eurostat test' or the 'Market Corporation Test' is more accurately described as a classification process. The object of the exercise is to determine whether a government-controlled producer should properly be classified as part of the general government sector or not. If not, the producer concerned is classified as a market corporation.

There is no statement of the criteria used in this process that is at the same time succinct and complete. It is not simply a matter of applying an algebraic formula. There is a qualitative as well as a quantitative component to the procedure. Applying the procedure is a matter of judgement. It is *a fortiori* the case that trying to anticipate Eurostat's verdict in any one case is a matter of judgement.

There is also a time dimension: the classification rules change over time. ESA 2010, the set of statistical standards on which the current rules are based, replaced ESA 1996 in 2013. Moreover, the interpretation and application of ESA 2010 is something of a work in progress. The manual that provides guidance as to interpreting and applying ESA 2010 to government accounts is revised at regular intervals.

What follows is an attempt to present an authoritative description of the classification procedure by drawing directly from the ultimate source, Eurostat's *Manual on Government Deficit and Debt (2014 Edition).* Even this requires the exercise of some judgement. We have drawn the quotations only from those passages of the *Manual* that we consider relevant to Irish Water. The alternative would be to reproduce several entire pages of the *Manual* resulting in a large measure of redundancy.

Paragraph 28 of the *Manual* makes it clear that the classification procedure contains qualitative as well as quantitative elements. It observes that: '*…public enterprises (…) may be set up for public policy purposes, with various degrees of public support which may influence the price of their output'* and goes on to state in respect of such entities: *'The quantitative test result should not be considered the only relevant criterion determining the classification of the entity. It is also necessary to examine the specific nature of their activity and the specific links they have with government'.*

The passages that follow suggest that the types of specific links that must be interrogated in this context are: (i) links whereby the entity is a dedicated provider of ancillary services to government, (ii) links of a type that mean the entity falls into a category of 'specific public entities' that are treated in a separate section of the *Manual*, or (iii) links that exist by dint of sales of output to government. Of these, it was only links of the type covered by (iii) that were relevant to the Irish Water case. If the type of links covered under (i) and (ii) obtain, the entity is classified in the general government sector without further analysis.

An entity may sell all or some of its output to government. If it sells its output both to government and to other customers (households, corporations) and *'if it is the monopoly (only) supplier of its goods and services in the economy, it is presumed to be a market producer if more than 50% of its output is sold to private units'*.

From this it would appear that a monopoly supplier (a reasonable approximation of Irish Water's position) selling more than 50% of its output to private (non-government) customers meets the criterion for a market corporation. Although 'output' is not defined in this context, it is generally understood to signify 'total sales'. So, the above condition, sometimes confusingly referred to as the 'qualitative criterion', appears to suggest that if more than 50% of total sales are accounted for by sales to private (non-government) customers, the producer is treated as a market producer.

However, one must enter a caveat here. Page 19 of the *Manual* contains a helpful decision tree which clearly implies that the criterion relating to the proportion of output (total sales) accounted for by private sales is not the end of the matter. If passed, the entity is then subject to the question: Are prices economically significant?

The *Manual* indicates two ways of assessing the economic significance of prices. One, set out in paragraph 26, states: '*A price is said to be economically significant when it has a substantial influence on the amounts of products the producers are willing to supply and on the amounts of products the* purchasers wish to acquire'. The other is embedded in paragraph 30, which reads as follows: 'To *determine whether a producer is market, it must sell its products at an economically significant price which, in practice*, would be assessed if the sales of the producer cover a majority of the production costs' (emphasis added). It would appear therefore, that the paragraph 26 definition of economic significance is based on principles, the paragraph 30 definition on praxis.

Turning to the matter of definitions, paragraph 30 of the *Manual* provides the following definition of sales: "Sales" (equal to the market output increased by payments for non*-market output, if any) exclude taxes on products* but include all payments made by general government or the Institutions of the EU'. However, the payments made by government have to take a certain form before they can be included in sales. Specifically, they 'must be directly linked to the volume or value of the output' in which case they are classified as 'subsidies on products'. If, in contrast, they take the form of payments unrelated to output such as a lump sum payment to cover an operating deficit, they are not included in sales.

The definition of production costs is not critical to the Irish Water case but it is worth reproducing for completeness.[74] It is set out in paragraph 32 as follows: '"Production costs…are defined as the sum of *intermediate consumption, compensation of employees, consumption of fixed capital, other taxes on production and the net interest charge. To ensure consistency between the concepts of sales and production costs when applying the 50% criterion, the production costs exclude all imputed costs made for own-account capital f*ormation'.

In summary, assuming the relevant qualitative criteria have been met, an entity which is a monopoly supplier of goods and services to government must satisfy two criteria that are expressed in quantitative terms (although the first of them is sometimes referred to as 'the qualitative test'):

- Its sales to private customers must amount to the equivalent of more than 50% of total sales.
- Its total sales must amount to the equivalent of more than 50% of its production costs.

Finally, there is a time dimension to the market/non-market test, that is the second criterion above. Paragraph 31 indicates that the test should be applied over a period of at least three years.

From the outset, the objective of passing the MCT was an integral part of policy design in relation to the funding model for Irish Water. An early example of this is provided by the PwC *Phase One Report* of November 2011 which contained a detailed analysis of the implications of a range of scenarios for the MCT. In all the scenarios explored, the consultants demonstrated that the MCT criterion was passed by comfortable margins. This outcome reflected the assumptions used by PwC in relation to the average household bill (which ranged from €322 to over €500) and the amount of revenue generated by non-domestic charges (upwards of €400m). Both sets of figures

[74] It is also worth noting that the Eurostat definition of production costs is not the same as the regulatory concept 'allowed revenue'. In particular, the two differ in their measurement of depreciation/consumption of capital.

were pitched at substantially higher levels than in either of the ‘real’ 2014 iterations of the funding model.

When modelling of the tariff structure by officials began in earnest in the autumn of 2013, the imperative of passing the MCT was a constant presence. E-mail exchanges between officials in September and October contain references to a NewERA paper on the impact of Irish Water on the government accounts, and to MCT analyses extracted from Irish Water’s financial models.[75] It is worth noting that the group carrying out this modelling work comprised officials not only from NewERA, DECLG and the Department of Finance, but also officials from the CSO, the agency best placed to interpret the classification process underpinning the MCT.

In November 2013, this group was told that Eurostat was (finally) ready to discuss accounting issues relating to Irish Water with the CSO. In the months that followed, there was occasional contact with Eurostat, but it was almost exclusively the CSO that provided the point of contact.

The statistical/accounting issues that surfaced in discussion amongst the group of officials over this period, mostly in exchanges between CSO officials and others, and that had a bearing (sometimes oblique, sometimes perhaps not fully appreciated at that stage) on the MCT, included the following:

- The relationship between Irish Water and the local authorities, especially regarding transfers of assets and employment contracts.
- The effects of Irish Water’s establishment on non-domestic customers.
- The possibility of expressing the universal free allowance in terms that would allow it to be classified as a product subsidy.

The latter point was relevant to the definition of sales in the market/non-market test and in particular the Eurostat requirement that government payments be directly related to the volume or value of output if they are to be included in sales (see Box 4).[76]

The relevance of the other points to the Eurostat classification procedure may not have been clear at the time but was to emerge later. As already noted, the relationship between Irish Water and the local authorities was a consideration that influenced the eventual Eurostat decision. Another consideration that weighed in that decision was the fact that the setting up of Irish Water did not change the tariff structure faced by non-domestic water consumers or the aggregate revenue derived from such consumers.

‘Eurostat-proofing’ the tariff structure

The group’s early modelling of the tariff structure was based on an average household charge of €350, but by February 2014, reflecting input from the political side, the focus had shifted to an average in the €200–€250 range. A paper circulated that month analysed the implications of

[75] Sourced from material released under FOI legislation.
[76] A connected issue raised around this time was whether a child free allowance might be treated separately from a household allowance on the grounds that it was aimed at a specific social need.

various combinations of (i) opening tariff levels in that range and (ii) subsequent rates of increase in the tariff, on Irish Water's ability to pass the Eurostat test. The results prompted one official to observe at that time that the situation posed a 'trilemma': two of the three desiderata (a low initial tariff, a low rate of increase in the tariff, passing the MCT) could be attained, but not all three.[77]

Table 5.2: CER/NERA Market Corporation Test Analysis

	Q4 2014	2015	2016
	(€m)	(€m)	(€m)
1. Production costs	263	1,067	1,094
2. Customer revenues	132	533	547
- Domestic	*76*	*304*	*307*
- Non-domestic	*56*	*229*	*240*
3. Government purchases	87	346	350
- Household allowance	*59*	*236*	*239*
- Child allowance	*28*	*110*	*112*
Revenues/Production costs (%)*	50	50	*50*
** Excluding government purchases*			

Source: Irish Water Interim Review Assessment, NERA Economic Consulting

It is reasonable to suppose that at this stage there was an understanding amongst officials that an average charge on the €200–€250 range carried the risk of failing the MCT, with that risk obviously increasing towards the lower end of the range. Indeed, some estimates suggested that the €238 average, consistent with the charges plan announced by the CER in July 2014, was just about enough to pass the test. NERA Economic Consultants, engaged by the CER to assist in the assessment of Irish Water's costs, capital spending plans, and proposed tariff structure, computed that sales revenue would amount to just 50% of production costs in each of the years 2014 through 2016 under this charges plan. The NERA computation excluded government purchases (the cost of the universal household and child allowances) from sales. The details are set out in Table 5.2.

Concerns about the November charges plan

The previous chapter provides an account of how the government attempted to defuse the increasing hostility to water charges that prevailed through the autumn of 2014, first by proposing a package of affordability measures, and then by radically recasting the tariff structure itself. Over

[77] Sourced from material released under FOI legislation.

this period, officials modelled and re-modelled a succession of proposals, always with an eye to how these proposals would measure up in terms of the MCT. Amongst the sources of concern that emerged during this process was the idea of paying a €100 compliance grant to households that paid their water bills, on the grounds that the direct linkage between grant and payment would compromise the prospect of passing the test. The compliance condition was removed and the grant morphed into the so-called Water Conservation Grant.

Concerns were also raised about the capping of charges, especially the prospect of the caps being extended for a period of several years, and how this might sit with the Eurostat requirement that prices be economically significant. In a draft note of a meeting on 10 November 2014 between departmental officials and personnel from NewERA and the CSO, the CSO observed that '*it would be difficult to argue that prices are economically significant in a tariff structure in which charges are capped for an extended time period, because customers could consume volumes greater than the volume implied by the cap at no extra charge'* and went on to argue that '*if prices are not economically significant, revenue from customer charges would be considered tax revenue rather than sales revenue'.*[78] This line of argument seems to point clearly towards failing the MCT.

However, the CSO went on to suggest that a distinction could be made between a revised charging structure of this type being proposed by government and such a revised structure being proposed by Irish Water for valid commercial reasons, such as the objective of increasing customer acceptance of charges and thereby increasing customer revenue. From this distinction it could be inferred that the revenue from capped charges proposed by the company for commercial reasons, might be classified as sales revenue by Eurostat and might therefore be consistent with passing the MCT.

Table 5.3: Government MCT Analysis - November Package

	2015	2016	2017	2018
	(€m)	(€m)	(€m)	(€m)
1. Production costs	1,006	1,039	1,055	1,064
2. Customer revenues	500	514	538	564
- Domestic sales	*271*	*274*	*281*	*288*
- Non-domestic sales	*229*	*240*	*257*	*276*
3. Child allowance	89	99	99	99
Sales/Production costs (%)*	49.7	49.5	51.0	53.0
Sales/Production costs (%)**	58.5	59	60.4	62.3
** Excluding child allowance; ** Including child allowance*				

Source: Irish Government Briefing Material, 19 November 2014

[78] Sourced from material released under FOI legislation.

In what appears from the draft note as an attempt to synthesize these two rather different lines of thought, the CSO concluded as follows:

- *'An argument could be made for customer charges to be classified as sales only if the period during which the caps apply is short'.*
- *'As the number of households with meters…increases, it would become increasingly difficult to sustain this argument'.*
- *'If the period during which the caps apply were to be significantly longer than currently proposed, it would be highly unlikely that the argument for customer charges to be classified as sales would be accepted by Eurostat'.*[79]

The computations carried out by officials in relation to the November charges plan at that time showed the MCT being passed: the government subvention was estimated to be less than 50% of overall revenue, and total sales were calculated to be above 50% of production costs. However, the latter outcome was achieved only by counting the cost of the child allowance as part of sales (see Table 5.3). In addition, it is worth noting that Irish Water's production costs had been reduced by an estimated €59m per annum on foot of a government decision to exempt the company from commercial rates.

In any event, despite these apparently reassuring computations, there were still reasons to believe that the outcome of the test was seriously in doubt, the price caps being to the forefront amongst them.

The Eurostat verdict

In March 2015 the CSO published a paper on the statistical treatment of Irish Water.[80] This paper set out the CSO's view on how the company should be classified and the reasoning behind that view. The CSO's opinion was that Irish Water should be classified as a market corporation. In arriving at this opinion, the CSO made four critical judgements, including the following:

- That the cost to the government of providing the child allowance should be treated as a social benefit accruing to households and hence as a sale by Irish Water to households. A different treatment would have meant that, all other things equal, the ratio of sales to production costs in both years would have been just below the critical 50% threshold in 2015 and 2016.
- That sales to households be accounted for on an accruals basis, thus overlooking the prospect that actual receipts would fall short of billings, a prospect that seemed especially salient given the intensity of public opposition to charges.

[79] Sourced from material released under FOI legislation.
[80] CSO. *Sector Classification of Irish Water in the Irish National Accounts*. 26 March 2015.

- That the €100 Conservation Grant was unrelated to Irish Water's funding model and, on that account, was not relevant to the assessment of the company's status as a market corporation.

Critically, the CSO also made the implicit assumption that the economic significance of the proposed tariff structure was not an issue, despite the reservations expressed in this regard by CSO officials at the November 2014 meeting discussed above.

The decision arrived at by Eurostat, first announced in summary form in a letter to the CSO dated 1 April 2015, and subsequently confirmed and supported with greater detail in a letter to the CSO dated 24 July 2015, was based on reasoning that differed from that of the CSO on each of these points, most significantly and fundamentally on the issue of the economic significance of the prices.[81] In Eurostat's view, the Irish Water prices could not be regarded as economically significant, in particular because of the caps. One of the consequences of that verdict was to undermine the CSO's argument that the cost of the child allowance be counted as sales to households, since the concept of sales is predicated on economically significant pricing.

Eurostat disputed the CSO's treatment of the €100 grant as a separate measure on the grounds that the intention of the grant was clearly to provide partial compensation to households for the introduction of water charges. As such, it considered that the cost of the grant should be netted off Irish Water's revenues from domestic sales in applying the 50% test. It also disputed the CSO's treatment of the expected non-payment of bills, given the large degree of uncertainty around payment rates.

The CSO had calculated that the sales-to-production ratio would be 54% in both 2015 and 2016. Eurostat suggested a set of alternative values, ranging downwards from 48% to 26%, depending on which and how many of its reservations about the CSO's judgements were factored into the calculations. The main Eurostat calculations are summarised in Table 5.4.

But Eurostat's reasons for reflecting the classification of Irish Water as a market corporation extended beyond the grounds covered above, and included observations that related to the form of the company and the nature of its relationships with central government and the local authorities. In particular, Eurostat noted the 'considerable government control over Irish Water, in particular over board appointments and operations, including broad pricing parameters'. It also opined that Irish Water 'merely reorganises previously non-market activity carried out by local government'.

[81] The Eurostat decision came as an unpleasant surprise to at least some Irish officials, but not to all. Indeed, one of our interviewees professed that it would not have been a surprise if, on balance, the CSO's classification exercise had gone the other way in the first place.

Table 5.4: Eurostat MCT Analysis

	2015	2016
	(€m)	(€m)
Production Costs	1,042	1,068
Customer revenues	500	514
Government purchases	400	479
- Child allowance	*60*	*61*
- Price caps	*129*	*138*
- Product subsidy	*211*	*280*
	(%)	(%)
CSO ratio	*54*	*54*
Alternative ratios		
- Ex. child allowance	48	48
- Ex. child allowance & expected non-payment	43	43
- Ex. child allowance & conservation grant	36	36
- Ex. child allowance, expected non-payment & conservation grant	30	31

Source: Eurostat letter to CSO, 24 July 2015

In this context, the concluding section of the Eurostat decision is worth quoting at length:

'Irish Water merely reorganizes previously non-market activity carried out by local government in a way that does not permit to assess whether there is a genuine commercial basis. A large part of the previous arrangement will continue, most prominently the local authorities' staff and the billing of non-domestic users. No competitive bidding has been carried out and the commercial basis is that of a heavily subsidized public monopoly. Whilst the billing of domestic users is a clear change in the set-up, it is unclear whether it is material enough for it to be considered to be a non-financial corporation, given the non-market character of the activity.

While there might be very good reasons to already classify Irish Water within government on the basis of qualitative criteria, as explained above, Eurostat considers that in any case Irish Water does not meet the 50% test, based on the CSO's own estimates, and should thus be classified in central government in any case'.[82]

[82] Eurostat. *Letter to CSO on Irish Water Classification*, 24th July 2015, p.12.

Of course, the CSO did not mutely accept the Eurostat judgement. A letter to Eurostat dated 17 April 2015 set out a stout defence of its position. A notable element of that defence was the response to Eurostat's points about government control over pricing and the lack of economically significant prices. The CSO's counter-argument, which harked back to an argument put forward at the November 2014 meeting of officials discussed earlier, was that the price caps were not proposed by government but by the company itself, as part of a 'preferred strategy to both raise revenues and build consumer confidence'.[83]

The Eurostat decision was clearly a major blow to the government's plans. However, the reaction of government spokespersons was phlegmatic. Finance Minister Michael Noonan observed that the decision would have no budgetary effects. That was technically true, but only because the official budgetary arithmetic for 2015 and subsequent years had been drawn up on the prudent assumption that Irish Water was part of the general government sector. If the Eurostat decision had gone the other way, it would have resulted in the budgetary numbers changing in a positive direction, with the deficit being reduced by 0.3% of GDP (about €600m) in 2015 and by 0.2% of GDP in 2016 and 2017.

Arguably, it was the Eurostat decision that ensured the abolition of water charges. In the 2016 general election, Fianna Fáil made an unambiguous commitment to scrap the charges and linked this explicitly to the Eurostat ruling. After the election, as a condition for agreeing to a supply and confidence arrangement whereby a minority Fine Gael-led government would be kept in power, Fianna Fáil insisted that water charges be suspended.

[83] CSO. Letter to Eurostat re the classification of Irish Water, 17 April 2015.

Chapter 6: Analysis of the Policy-Making Process

What defines policy success?

What is a successful policy? The obvious answer to this question is that it's a policy that achieves its goals. We might add that it should achieve those goals without having significant negative unintended consequences. But what if the policy goals are contested so that what constitutes success in the eyes of a policy's advocates is an index of failure in the eyes of its opponents? In these circumstances, the policy may be overturned or reversed following a change of government. This leads to a broader definition of policy success, one favoured, for example, by the London-based Institute for Government:

'The most successful policies are ones which achieve or exceed their initial goals in such a way that they become embedded; able to survive a change of government; represent a starting point for subsequent policy development, or remove the issue from the immediate policy agenda.'[84]

In the UK case, examples of policies that meet this definition of success include the introduction of the minimum wage and the privatisation of state companies, policies that were vigorously contested initially, but achieved such a degree of public legitimacy with the passage of time, that they were not reversed following a change of government and so became embedded. Corresponding Irish examples would also include the minimum wage, as well as the introduction of child benefit and of tax credits.

In this chapter, we question whether and to what degree the two policies we have been examining in this report can be considered successes or failures, and we go on to explore what it was about the policy-making process in each case that contributed to that success or failure. Starting with the LPT, we first assess its success in relation to the initial goal(s) of the policy before considering the rather more complicated issue of its 'embeddedness'.

The Local Property Tax: a success to date

The primary goal of the LPT was to generate tax revenue. At the time it was introduced, the target yield in the first full year of its existence was set at €500m. It has fallen a little short of that mark in each of the years 2014 to 2017, but that is a minor quibble.[85] Measured with reference to this goal, it has been a success. This is all the more so when account is taken of the compliance rate, which has been consistently in the range 96–97%, very much in line with what Josephine Feehily, the then Chairperson of the Revenue Commissioners, promised the government in 2012, before the tax was launched.

[84] Jill Rutter et al. *The "S" Factors: Lessons from IFG's Policy Success Reunions*, 2012.
[85] That the yield has fallen a little short has been due in part to the fact that local authorities have been more inclined to use the modest measure of discretion afforded to them under the legislation to lower the tax rate in their area of jurisdiction than to raise it.

What is it about the policy-making process employed in the development of the LPT that contributed to this success? The relevant literature offers several ways of approaching this sort of question.[86] Probably the longest-established of these is the policy cycle approach which conceives of policy-making as a sequence of stages, starting with agenda-setting and the definition of objectives and progressing through policy design, implementation, legitimation, and review. One of the important insights that emerges from this approach is that a strong connection between design and implementation is a critical ingredient of success. Many policies have failed because the problems and challenges of implementation were not anticipated at design stage.

In the case of the LPT, the design process was infused with a keen awareness of the importance of anticipating implementation challenges. This was apparent in the composition of the Inter-Departmental Group and in its terms of reference. It was also demonstrated in the content of the Group's report and in its recommendations. As pointed out in Chapter 3, no fewer than six of those recommendations related to aspects of compliance and enforcement, including provision for collecting the tax at source from payroll and state payments, and for interest and penalties in respect of late payments and evasion, while a section of the report dealt explicitly with the resources required to prepare for the introduction of the tax.

Arguably, the single most important decision in determining the successful implementation of the LPT was one that was intimately connected to compliance and enforcement, namely the decision to give responsibility for the administration and collection of the tax to the Revenue Commissioners. It seems that this was a necessary condition for achieving the outcomes enjoyed by the LPT in relation to yield and compliance. The reason has to do in part with corporate culture: The acceptability threshold for compliance is set at a much higher level by the Revenue than by other state agencies who collect fees and charges. The reason has also to do in part with fear: The arsenal of enforcement powers at the Revenue's disposal (including some new ones that they were conferred within the context of the LPT) is much more intimidating than the enforcement powers of other official bodies that collect revenue.

Was the involvement of the Revenue Commissioners a *sufficient* condition for success? Did the mobilisation of its daunting enforcement powers obviate the need to persuade taxpayers that the LPT was a good idea or, at least, a better idea than the alternatives (to reduce spending or to raise other taxes by an equivalent amount)? We will return to these questions later when we broaden the discussion to include water charges. For now, it is enough to propose that the strong coercive powers of the Revenue would probably not have been enough to make a success of the tax if it were grievously at odds with widespread notions of what is equitable. The likelihood is that a deeply unpopular tax would not have survived a change of government.

This would suggest that another necessary condition for the success of the LPT was that it be reasonably fair. Many, if not most aspects of the tax's design were strongly influenced by this

[86] See for example: Bovens and 't Hart, *Understanding Policy Fiascoes*; Cairney, *Understanding Public Policy — Theories and Issues*; John, *Analyzing Public Policy*; McConnell, *Understanding Policy Success — Rethinking Public Policy*.

requirement including its proportionality, the modest average liability, the banding for valuation purposes, and the availability of a deferral option.

Of course, it's not enough that a tax be fair, it must also be understood to be fair, implying that simplicity and comprehensibility are important features of an acceptable tax. Again, the design of the LPT paid attention to these features. One of the reasons that the Thornhill Group recommended against waivers, for example, was to preserve the simplicity of the tax, while an important reason for coming down against site value was to ensure that the basis for the tax was well understood.

But the future of the LPT is not guaranteed

Returning to the definition of policy success cited earlier, the issue of the LPT's 'embeddedness' has not yet been addressed. Would it be likely to survive a change of government, specifically a government including Fianna Fáil and/or Sinn Féin? The evidence offered by those party's respective manifestos for the 2016 general election is mixed. Fianna Fáil's manifesto signalled acceptance of the tax and simply committed to ensuring that large increases in liability would not occur.[87] In contrast, the Sinn Féin manifesto contained a bald and unambiguous commitment to abolish the tax.[88]

So, has the issue of property taxation been resolved or, in the words of the Institute for Government's definition of policy success, been 'removed from the immediate policy agenda'? The Sinn Féin position would suggest not, even if the apparent absence of willing and viable prospective government partners diminishes Sinn Féin as a threat to the continuation of the LPT.

In any event, there are other reasons to suppose that the property tax issue has not been fully resolved. In particular, as discussed at some length in Chapter 3, the political system has yet to demonstrate its capacity to adapt the LPT to a strong and sustained rise in property values. Revaluation has already been postponed once, and there is reason to suspect that it may be postponed again or, at least, that doing so will be one of the options assessed by the group established in February 2018 to conduct a review of the tax — the second such review.

Moreover, the LPT has yet to fulfil a secondary but potentially important purpose, namely the achievement of a significant rebalancing of the overall tax burden. In this regard it is worth noting that in 2017 the LPT produced receipts equivalent to just 0.9% of the total tax take. It is also worth noting that its share has fallen each year since 2014, the first full year of its application, when it was 1.2%. The political system, it seems, does not have an appetite to significantly raise the yield from the tax. It is notable that the review currently underway is being guided by the objective of ensuring stability in the amount paid by those liable to the tax. This sounds like a recipe for producing little or no change in yield.

[87] The Fianna Fáil manifesto contained the statement: 'We are committed to ensuring that homeowners are not hit with large increases after the next valuation date'.
[88] Sinn Féin's manifesto carried the following commitment: 'We will abolish the Local Property Tax, saving 1.8 million homeowners an average of €244 per year'.

If that is the outcome of the review, the proportion of total tax receipts accounted for by the LPT will fall further, as will its relative importance as a source of revenue. The longer this goes on, the more the opportunity cost of retaining the tax will decline and the temptation to abolish it will increase. The alternative course of action, based on the strategic objective to use property taxation as a means of rebalancing the tax system, is to find a way to significantly raise the yield from the LPT and to use the proceeds to finance reductions in other taxes, notably income tax.

In terms of assessing its embeddedness, we may also ask: Does the LPT represent a starting point for further policy development? Encouragingly, the answer to this question would appear to be yes. Thanks to the work done under the aegis of the Thornhill Review, there is a road map for improving the way in which the tax operates and for making it resilient in the face of pressures from a rising property market. The salient features of the model that emerged from the Thornhill Review were summarised in Chapter 3 and include a mechanism whereby the effects of strong house price growth might be offset (in whole or in part) by a reduction in the rate of tax. Whether that work is significantly drawn on by those undertaking the current review remains to be seen.

Water policy: success or failure?

On the face of it, the attempt to introduce water charges has been a policy failure, if not a policy disaster. It is important to recognise however that charging for water was just one element in a complex multi-faceted programme of reforms planned for the water sector by the Fine Gael–Labour government. The over-arching goal of that programme was to establish a financially self-sustaining national water utility that could source the funding required to make good a creaking infrastructure and develop it to meet future demand. For this to happen required Irish Water to be classified outside the government sector. Secondary goals included the encouragement of efficiency and economy in the use of water. The tariff structure and the deployment of metering in particular were seen as instruments by which these goals could be attained.

To what extent, if at all, seven years after the reform programme was begun, have its goals been achieved? Clearly, the primary objective of establishing Irish Water as a separate self-financing entity has not been fulfilled, because of Eurostat's classification decision. Equally clearly, water charges were short-lived and have been abolished. Not only that, but what money was collected in domestic charges has been refunded to customers.

However, it can be argued that not all has been lost. Irish Water has been established as a national water utility and is arguably well placed to achieve the economies of scale and other efficiencies in the delivery of water services that were beyond the capacity of the 34 local authorities previously responsible. Almost 900,000 households have had meters installed and these can potentially fulfil at least one of their functions, namely assisting in the identification and location of leaks. A regulatory regime has been put in place with a mandate to protect customers' interests by, *inter alia*, ensuring that Irish Water's cost base and capital spending are rigorously interrogated.

Moreover, the principle of charging for excessive water usage has won cross-party acceptance, even if it has yet to be translated into practice.

Policy based on a treacherous foundation

Why was the overarching goal of establishing a financially self-sufficient national water utility not attained? The proximate reason is of course the outcome of the Eurostat classification process. This decision was neither close nor narrowly-based. On the contrary, the criteria that informed it were wide-ranging, and the margin by which the conclusion was arrived at in the case of the quantitative criterion was wide. Failure to achieve the desired outcome here was not due to fine errors of judgement on the part of Irish policy-makers. Instead, it reflected something much more fundamental.

Indeed, the Eurostat judgement was so clear-cut and comprehensive as to suggest that Irish Water would not have achieved off-balance sheet status even on the basis of the CER's original (July 2014) charges plan. Consider the elements of that judgement. In the first instance, it cast doubt on whether Irish Water should be properly classified as a non-financial corporation at all (even before applying the quantitative market/non-market test) because of its relationships with government, including in particular its relationship with the local authorities. Those relationships remained unchanged between the original and revised tariff structures.

Turning to the market/non-market question, as stated in Chapter 5, it had been estimated by the economic consultants engaged by the CER that the original tariff structure just about met the 50% requirement. Bear in mind that in assessing the revised tariff structure from this perspective, Eurostat advanced four grounds for adjusting the CSO's estimated ratio of sales to production costs downwards. These included adjustments in respect of (i) expected non-payment of charges, and (ii) a different cost of capital, both of which would have been equally applicable to a classification decision based on the original tariff structure. Applying these adjustments would have reduced the key ratio below 50%.

The Eurostat judgement provides a lens through which policy decisions inimical to the achievement of the primary goal of the water policy reform programme are highlighted, amongst them decisions around Irish Water's service level agreements with the local authorities and the decision to leave the non-domestic charging regime unchanged. It begs the following question: Had the policy makers arrived at different decisions on these matters, would Eurostat's verdict have been different?

It is impossible to know. Therein lies the rub. Eurostat could not be double-guessed. There was no reliable means of anticipating how it would respond to any particular constellation of data on Irish Water, no way of confidently modelling its reaction function as it were. Significantly, on the matter of Eurostat classification decisions, there is no body of relevant case law, to use a legal analogy. Every case is treated strictly on its own merits without regard to precedent.[89]

[89] Hence, the text of the Eurostat decision makes no reference to other classification decisions. Likewise, the correspondence between it and the CSO.

That being so, one is compelled to observe that a policy that placed the passing of the market corporation test at its heart was a policy that was based on a very treacherous foundation. It was also based on what appears to have been a misunderstanding of how the classification procedure would be conducted.

This, of course, is a judgement that is being offered with the benefit of hindsight. That said, there were enough straws in the wind to suggest that classification would not be the formulaic exercise that many government officials seemed to expect. For one thing, there was the fact that Irish Water was newly established, implying that Eurostat was being asked to classify an entity on the basis of projected future performance rather than a track record, an exercise that it might have been expected to approach with more than usual caution. Secondly, there was the fact that the basic statistical standard had recently been overhauled from ESA 1996 to ESA 2010, carrying with it the extra uncertainty that is characteristic of regime change.

Policy subordinated to Eurostat test

Subordinating policy to the imperative of passing the market corporation test had strong implications for pricing. Simply put, it meant that the revenues generated from domestic customers had to be higher than they might otherwise have been. An interesting thought experiment to carry out as a means of exploring the effect of the MCT imperative is to pose the question: How might thinking about the charging regime have evolved, and what policy mis-steps might have been avoided, had the MCT not been at issue?

In attempting to answer these questions, it is worthwhile distinguishing between the price level (as indicated by the average charge per household), and the tariff structure which comprised the free allowances, the volumetric rate, the price caps, and so on. As regards the former, Chapter 4 told the story of how thinking evolved from figures in the €400–€500 range in the 2011 PwC report through €350 in the early modelling work carried out by officials in 2013, to €238 in the CER's original charges plan of July 2014, before being reduced further to €199 in the revised November plan of that year. This progressive downward adjustment reflected an approach that can be characterised as a quest to discover how low the price could be pushed while still keeping open the prospect of satisfying the MCT. Arguably, if the MCT had not been a key driver of the pricing decision, the process of price discovery would have been more a matter of figuring out what level was sensible given that the starting point was zero.

As regards the tariff structure, it is important to note that there were elements favoured by the policy-makers for reasons that were quite independent of the MCT, including the concept of volumetric pricing and the so-called 'free' allowance for households.[90] Also, the absence of a standing or fixed charge was unconnected with the MCT.

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[90] Volumetric charging *per se* would have commended the charging structure to Eurostat on the grounds of 'economic significance' but it was in any event favoured by the government for reasons to do with fairness, the 'polluter pays' principle, and its perceived capacity to inculcate a culture of conservation. It is also worth recalling that the proposal to charge on a volumetric basis predated the proposal to set up Irish Water (for

So, it is reasonable to suppose that the pricing regime that the government would have favoured in circumstances where passing the MCT was not an objective would not only have produced an average household bill lower than €238, but would still have been volumetric in nature, would still have incorporated some level of free allowance for households, and would not have contained a standing charge.

How much lower the average bill might have been in these circumstances is a matter of conjecture. Perhaps the €199 gross average implied by the November 2014 charges plan is a reasonable figure to use in this respect. All other things equal, this would have produced a volumetric charge of about €4.00 per 1,000 litres, compared with €4.88. This would have meant assessed charges as follows: €144 for one-adult households and an incremental €84 for each additional adult. So, the median two-adult household would have attracted a charge of €228, €50 lower than what was actually announced. The lower volumetric charge in this scheme of things would have generated a less dispersed distribution of bills than was implied by the CER's July plan, but it would still have been the case that a non-trivial proportion of households would have faced bills well above the average. Four- and five-adult households, for example, would have had to pay €396 and €480 respectively under such a regime.

Whether these overall differences would have been sufficient to avert the kind of escalation of protest that took place in autumn 2014, to obviate the kind of affordability package that the government felt compelled to put in place, and to protect the tariff structure from the kind of radical revision that was eventually announced in November is doubtful. It seems likely that it would have taken a significantly lower average tariff to deliver this relatively trouble-free outcome.

Perhaps an average as low as €100 (in line with the average of the November plan net of the conservation grant), would have been required to achieve this, given the structural features that the government was committed to (the free allowances, the volumetric element, the absence of a fixed charge). This kind of scheme would have generated assessed charges starting at €74 for a one-adult household and ranging through €117 for two adults to upwards of €246 for households containing five adults or more.[91] Such a charging scheme would still have been problematical in two ways. First, there would have been significant numbers of households with very low bills: metered households with low consumption relative to their allowances. Second, there would have been some households, albeit a very small minority, with bills large enough to create ability-to-pay issues. But these problems would have been relatively minor.

Aspects of tariff design created dilemmas

This discussion highlights the fact that, quite apart from the influence of the MCT, there were features of the initial charging structure that had undesirable consequences: The free allowances and the absence of a fixed charge. It has already been pointed out, but is worth repeating, that there is an inescapable trade-off between free allowances and the volumetric rate: The bigger the

example, the Progressive Democrats' 1997 manifesto, and the *Renewed Programme for Government* of 2009).

[91] Assuming allowances of 30,000 litres and 21,000 for households and children respectively.

former, the higher the latter must be for a given revenue target. This trade-off is exacerbated if there is no fixed or standing charge. In such circumstances, the volumetric rate must be higher still, again for a given revenue target.

Two sets of implications flow therefore from a tariff structure that incorporates free allowances but no standing charge. One is that the degree of dispersion in bills will be greater than would otherwise be the case, with the average providing a poor guide to the size of the bill that many households will face. This dispersion in turn increases the risk that ability-to-pay problems will arise, again for a given overall revenue target. It also increases the risk that some households will face bills greatly in excess of expectations, particularly where those expectations are formed with reference to a pre-announced average, as was the case with Irish Water.

The other implication is that metered households face greater uncertainty about the size of their bill than would otherwise be the case. The reason is that households typically do not know how much water they have been consuming before meters are installed.

One of the conclusions indicated by this analysis is that the design of the initial charges plan was burdened with too many requirements: To pass the MCT, to incorporate allowances, to exclude a fixed charge, and to be based on volume. Two propositions capture the dilemma that this list of constraints posed:

- For a volumetric pricing structure designed with the MCT in mind to have avoided the problems of excessive dispersion (and greater than expected bills for some households) would have required either that allowances be scrapped or greatly reduced and/or that a standing charge be included.
- For a volumetric pricing structure to have generated an acceptable range of charges, while retaining the free allowance and excluding a standing charge, would have required that the average charge be lower, probably much lower, than would have been considered consistent with passing the MCT.

It is almost (but not quite) a case of: You can set out to pass the MCT or you can have free allowances, but you cannot have both. An interesting thing about this is that the implications of neither of these elements of policy were subjected to rigorous evaluation before being adopted. In the case of passing the MCT, it was embraced as a policy goal from the outset, but there is no evidence to indicate that this followed a formal discussion informed by a thorough assessment of what consequences might flow for other aspects of policy.

Nor is there any evidence to indicate that the objective of passing the MCT was reviewed at any stage during the 2011–14 period, even as the consequences of endeavouring to do so became clearer. That passing the test would be a good thing was, it seems, regarded as axiomatically true. For some of the policy actors involved, particularly on the Labour side of government, the extra fiscal space that would have been created by such an outcome was the reward that made the pain of imposing water charges worthwhile.[92]

As for the universal free allowance, it has already been noted that this was incorporated as part of official policy from an early stage (2009 to be precise, when the then coalition's government programme was renegotiated) and as part of the policy of the Fine Gael–Labour government from the start of its term in 2011. There is no evidence that this was done on the basis of an evaluation of other options or a proper understanding of the implications. It is true that the ESRI was commissioned to assess the costs and benefits of free allowances, but this exercise was not carried out until 2013, and was in any event designed to illuminate the consequences of setting the household allowance at different levels rather than address the question of whether there should be such an allowance in the first place. That there should be an allowance was a given, pre-determined in the political domain.

Two other consequences of the commitment to free allowances are worth highlighting. One is that it had the effect of distorting the discussion about affordability and inhibiting the exploration of other options in this area. The report of the Inter-Departmental Working Group on Affordability Measures, discussed in Chapter 4, makes this very clear. That Group concluded that the level of the free allowance could make a significant contribution to addressing the affordability problem, and that the Group could do only so much useful thinking on the matter before the level of the allowance was determined.

If a universal free allowance had not been on the agenda, the Group would have had to work harder to come up with its own solution, and the Department of Social Protection in particular might have been compelled to engage more constructively with the search for solutions. The ultimate irony was that the very mechanism that was regarded as the main vehicle for addressing affordability problems became a cause of such problems. The ultimate judgement as to its merit was that the universal household allowance was dropped from the November charges plan (although the child allowance was retained).

The second consequence had to do with messaging. What was the free allowance supposed to cover? All the basic water needs of a household or an individual? If not all, then what proportion of those needs? What are basic needs and what needs are not so basic? In endeavouring to answer such questions, journalists unearthed statistics about the volume of water consumed in virtually every basic household activity from washing teeth, to flushing toilets, to taking a shower, to boiling a kettle for tea. The media coverage that ensued brought ridicule on the allowance and the water charges plan more generally.

Scale of regime change not appreciated

The background against which water policy decisions were made in the first half of 2014 was unusually fraught. The government was consumed by a series of controversies involving the

[92] In early 2014 it was expected that the classification of Irish Water as a market corporation and its consequent removal from the government balance sheet would reduce the General Government deficit by about 0.4% of GDP in 2014.

Garda Síochána and the Minister for Justice. Irish Water was mired in a controversy of its own about its pay scales and spending on external consultants. There was wild speculation about the prospective size of water bills which was feeding a growing protest movement. Local elections were looming and with them the threat of serious damage being inflicted on the two government parties.[93] In this febrile atmosphere it is probably fair to say that the government had one shot at getting the charging structure right.

In the event, for the reasons analysed above, they got it wrong. This was partly because the charging structure announced created affordability issues, but it was also partly, because the bills that a significant number of households were facing were well ahead of expectations, expectations that had almost certainly been influenced by the average figure of €240 broadcast by the government before the full charges plan was formally announced. Thinking perhaps that an average pitched at this level, together with the provision of 'generous' allowances for households and children, would be enough to make the package acceptable, the government was taken aback by the hostile reception the announcement received. The misleading coverage of the charges plan in some sections of the media did not help.[94]

There followed another series of policy mis-steps, including the €100 water subsidy passported on the Household Benefits Package and Fuel Allowance schemes, and the water-related tax credit, which were inefficient as affordability measures and poorly targeted, and were derided on that account. The anti-water charges campaign continued to gain momentum, reaching a high point with the Dublin South West by-election success and the big nationwide protests that followed. Soon after that, the government announced the revised tariff structure which, as we have seen, represented a *volte face* in several respects, the most notable of which was that the volumetric component was greatly diminished and the household allowance was dropped.

The proximate cause of this series of policy mis-steps and reversals was of course the original charges plan, but its ultimate source was a failure to appreciate the scale of the regime change that was being contemplated — a shift from zero prices to a volumetric charging system that would generate sufficient revenues to pass the Eurostat test — and to design a set of suitable arrangements at the outset that would have eased and perhaps lengthened the transition. As noted in Chapter 4, the Commission on Taxation had proposed one such set of arrangements which envisaged starting off with a modest fixed charge before moving eventually to a volumetric basis. Of course, it would also have been possible to design a transitional regime with a volumetric element.

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[93] In the local government elections, held at the end of May, the government parties did suffer heavy losses. Fine Gael lost 105 out of 340 council seats and saw its share of the vote fall from 32% to 24%. The Labour Party saw its share of the vote more than halved, to just over 7%, and lost 82 seats. Sinn Féin, the biggest of the parties that had at that stage taken a position opposed to water charges and the only one organised on a nation-wide basis, more than doubled its vote share to over 15% and gained 105 seats.
[94] The *Irish Times* coverage of 1 August 2014, referred to in the discussion in Chapter 4, is an example.

Overly ambitious timescale

A sense of trying to achieve too much too soon is suggested by the approach to the tariff structure. The same is true of the overall water sector reform programme. It is worth restating the principal elements of this programme to provide a reminder of the scale of what it was planned to accomplish:

- The setting up of a new water utility to assume responsibility for the water services functions previously discharged by 34 local authorities, the national scope of the new utility permitting it, *inter alia*, to achieve economies and efficiencies in the delivery of those services that were beyond the capacity of the *status quo.*
- Funding that utility in part by charging domestic customers for water and wastewater services that they had previously enjoyed at a zero price.
- Charging those customers on a volumetric basis (the better to inculcate a conservation mindset, economise on the use of water and thereby reduce the pressure on infrastructure), thus requiring the universal installation of meters.
- The setting up of a regulatory system that would approve the proposed charges and interrogate the utility's cost base and investment plans.
- The achievement by the utility of a classification status that would allow it to operate separately from the government sector in terms of borrowing to finance those investment plans.

There is no doubt that this programme was coherent and underpinned by a powerful logic. On that account it is easy to understand why its architects might have been resistant to efforts to dilute it or modify it in any material way. What is not so clear is whether its designers paid sufficient attention to implementation challenges, not the least of which related to timescale.

The original agreement with the Troika, echoing the *National Recovery Plan*, committed to the introduction of water charges by 2014. The Fine Gael–Labour coalition inherited that commitment when it took office three months later. Its *Programme for Government* also committed to the establishment of Irish Water, a new policy undertaking. In the early months of the new government's term, several statements were issued confirming the timescale for the introduction of charges and indicating that universal metering would be completed by that point. The clear suggestion was that government was so wedded to the volumetric principle on grounds of fairness that charging would not start until all households had meters.

In the event, as described and explained in Chapter 4, the meter installation programme did not commence until August 2013 such that by January 2014 (the original target date for introducing charges) only 80,000 of them (corresponding to 6% of all households on the public supply) were in place. It was January 2017 before Phase One of the programme was complete. This was three years later than implied in the early statements referred to above and, even at that, just two-thirds of all households on the public water supply had been metered.

Two sets of implementation challenges were responsible for this shift in timeline and the reduction in scope. As regards the timeline, the delay is largely explained by the fact that Irish Water had to be established and given statutory definition as a metering authority before meter installation could begin. That process took more than two years, a year of which was taken up with a properly rigorous evaluation of the organisational options, and another year of which was involved in making preparations for the establishment of the new company. It seems reasonable to propose that some appreciable delay in getting to the point where metering could commence because of the setting up of Irish Water was entirely predictable. That being the case, the original timeline was always unrealistic.

Regarding the fact that the scope of the meter installation programme fell well short of universality, there are two explanations. One has to do with the effects of protesters/demonstrators, the scale of which would have been impossible to predict. This factor accounts for at most 150,000 of the 450,000 shortfall. The remaining 300,000 comprises households that could not be metered within a reasonable timeframe because of a variety of technical reasons to do with apartment blocks, shared supply pipes and the like. These technical problems and their likely (if not precise) extent were known to officials from the outset, and this knowledge should have been reflected in the early statements made about metering and charging, but were not.

It should have been perfectly clear to policy-makers at the outset that a volumetric basis for charging was going to be feasible in respect of only a small minority of households when charging commenced if, that is, charging was to commence in accordance with the original timetable. Armed with that knowledge, the over-promising that characterised early government statements in relation to charging and metering could have been avoided, and whatever damage was done by these statements to the credibility of the government’s policy averted.

That knowledge could also have provided the government with the basis for extending the timetable and/or adopting a different approach to pricing, at least in its initial phase. As it transpired, the approach that was actually adopted resulted in a dual tariff structure being announced in the CER’s September 2014 charges plan, which contributed to the confusion and uncertainty that surrounded that plan. Significantly, one of the features of the revised plan of November was that it set out a unified tariff structure.

The role of the Troika

What role did the Troika play in shaping water policy and influencing the reform programme’s timelines? In answering this question, we repeat what we have already said: The proposal to introduce water charges (and the proposal to introduce a property tax) did not originate with the Troika. Their introduction had been the subject of a government commitment, initially in late 2009, a full year before the Troika came to Dublin. The other key elements of water policy in the 2011–2016 period, in particular the establishment of Irish Water, were also domestic in origin.

However, the commitments to introduce water charges and establish Irish Water were incorporated into the government’s agreement with the Troika. As such, progress towards their achievement came within the Troika’s invigilation process in the same way as all other elements of that agreement, including property tax. That implied that they were subject to detailed implementation plans in which deliverables and their delivery dates were specified, and to a quarterly review process that interrogated those plans and assessed progress.

Conversations with senior public officials involved suggest that this process had the effect of forcing the pace. Officials who were responsible for particular elements of the Troika agreement profess to having been keenly aware that the risk of failure to deliver in their area might prejudice the flow of funding to Ireland. In these circumstances, there was a reluctance to re-open issues on which commitments had been made.

It can be argued, therefore, that the fact that the plan to introduce water charges was incorporated into the agreement with the Troika had the effect of making aspects of that plan, including timescales, more rigid than they might otherwise have been.

However, reluctance to re-open commitments did not necessarily reflect an unyielding attitude on the part of the Troika. There was a working assumption amongst Irish officials that the Troika was prepared to renegotiate, provided there was a good case for doing so, and provided that the net result left the key parameters of the fiscal consolidation programme unchanged. There were elements of the Troika agreement revisited and revised, amongst them the target date for introducing water charges, which was first postponed from January to October 2014 (before being subsequently put back to January 2015)

Interestingly, the Troika's departure may have exerted as much influence on water policy as their presence. Ireland exited the bail-out at the end of 2013. On the one hand, this may have encouraged the anti-water charges campaign to believe that the government's attachment to water charges had been weakened. On the other hand, it was used as an argument by the more committed advocates of the policy within government to persist with the policy. The argument was that dropping water charges would send out a signal to international investors that the Irish government could no longer be relied upon to pursue fiscally responsible policies now that the Troika had left, and that this would have harmful consequences for the cost of borrowing.

Chapter 7: Conclusions

Water charges: undone by political arithmetic?

There are several summary explanations for the failed introduction of water charges that, on the face of it, deflect attention from the policy-making process. Even though we regard these explanations as somewhat facile, it is worth considering them to demonstrate that issues relating to the policy-making process lurk under the surface in each case.

The first of these has it that the demise of charges was due to what might be described as 'a series of unfortunate events'. The argument is this: Were it not for the outcome of the 2016 general election, the subsequent confidence and supply agreement put in place to sustain the Fine Gael-led minority government, and Fianna Fáil's insistence that water charges be suspended as part of that agreement, water charges would still be in place, despite everything.

This is an interesting perspective which suggests that success and failure were separated by a thin line drawn in political space. However, it begs a number of obvious questions. Why did the 2016 election produce the outcome that it did: a combined loss of 52 seats and 23.4% of the first preference vote by the two government parties, compared with the outcome of the 2011 election, and the virtual decimation of the Labour Party. What role did water charges play in that outcome? Why did Fianna Fáil adopt the position it did after the election?

Detailed consideration of these questions is beyond the scope of this report. What is clear is that the vast majority of TDs returned to the Dáil in March 2016 represented parties or groups that were explicitly opposed to water charges, a distinct reversal of the result of the election held in 2011.[95] It can only be supposed that the substantial hardening of public attitudes that occurred over this period was caused at least in part by the government's handling of water charges and the broader water policy agenda.

Fianna Fáil, the pivotal element in the Dáil arithmetic, just five years earlier had committed to the introduction of water charges when in government, and its election manifesto emphasised the part played by Irish Water and the outcome of the Eurostat test in changing its position. The relevant section is worth quoting in full:

'Irish Water has been a complete failure on the part of government. Since it failed the Eurostat test, the very reason it was set up, it is incapable of delivering major investment in our water network. Instead, it is imposing a water charges regime where families are paying for a service

[95] The 2011 election saw Fine Gael and Fianna Fáil, both of which supported the introduction of water charges, win 95 out of 166 seats in the Dáil. In 2016, Fine Gael and Labour, the only parties to campaign for the retention of water charges, won just 57 out of 158 seats.

that does not deliver, operated by a quango that is not working. People should not be expected to pay for a service that is not up to standard.'[96]

Why did the Local Property Tax not suffer the same post-election fate as water charges? It scarcely seems necessary to pose the question, but it is worth doing so if only to highlight the issue of opportunity cost. In 2016, the LPT was generating almost €500m in annual revenue, the loss of which would have required a non-trivial effort to make good. The net cost to the Exchequer of abolishing water charges in 2016, allowing for the fact that compliance was running at not much more than 50% and for the resultant saving from abolishing the Water Conservation Grant, was no more than €80m.

This in turn draws attention to the fact that, notwithstanding their evidently much greater unpopularity, water charges were significantly less onerous on average than the LPT. The average bill for water services across the 1.35 million households liable was €199 (or just €99 when the Conservation Grant is taken into account); the average liability for the LPT across the 1.7 million properties in scope was almost €300. Of course, this bald comparison obscures distributional differences between the two, in particular the fact that water charges were regressive while the LPT is a proportional tax with progressive features. Undoubtedly, these differences played some role in shaping public attitudes.

It also draws attention to the fact that the water regime in place at the time of the 2016 election was a pale shadow of what had been envisaged five years earlier. Not only were charges significantly lower than had been originally planned, but the volumetric element in the tariff structure had been greatly diluted and effectively robbed of its potency as a pro-conservation measure and meters had been installed in less than two-thirds of all households.

Doomed from the outset?

Another candidate explanation, if it can be called such, is that the attempt to introduce water charges was never going to succeed, that it was doomed from the outset. A version of this is that, for reasons unspecified, Irish people simply will not pay for water. The failed attempts to charge for water in the 1980s and 1990s are marshalled as supporting evidence. This proposition, however, ignores the fact that in late 2015, some 61% of those liable for the water charges then in place did pay and it fails to explain what it is that differentiates Irish people from the populations of virtually every other EU member state, who pay for the water they consume.

The notion that water charges were doomed from the outset is too bald and fatalistic to be of much explanatory value, but there is a more refined variant of this verdict that may hold more than a little truth. It is this: The approach adopted by the Fine Gael–Labour government incorporated elements that sowed the seeds of the strategy's destruction, albeit that they were designed to make the proposed new regime more politically palatable.

One of them was the universal free allowance. It was conceived of as a measure that would address affordability concerns and signal a degree of recognition of water's status as a necessity,

[96] Fianna Fáil. *An Ireland for All*, *Manifesto*. 2016, 38.

and was an important element in reconciling the Labour Party to the introduction of charges. However, it became a key driver of the excessive dispersion of household bills implied by the initial July 2014 tariff structure, a feature of that tariff structure that contributed to its undoing. It also became an object of unhelpful (if not derisory) attention in its own right, because of the questions it prompted about what basic household acts of water usage it was intended to cover.

Another example of a wholly understandable element of policy that arguably contributed to the strategy's demise was the commitment to universal metering as a precondition for introducing charges. The grounds for making such a commitment were clear and were rooted in the notion of fairness and the objective of cultivating a conservation culture. The point can also be made that choosing a volumetric basis for charging drew on the lessons of history, an important one being that charges unrelated to use are especially unpopular.

However, the commitment on metering set policy up to fail on its own terms. The timescale involved was utterly unrealistic and so when charges finally commenced in January 2015, only 40% of households had meters installed.[97] It is likely that the government paid some price for this in terms of credibility.

A third example of a policy element where intent and effect diverged with detrimental consequences was the determination that Irish Water would pass the Eurostat test. At one level of abstraction, this aim crowned the strategic purpose of the water sector reform programme; At another, it held out the promise of a significant reward for taking the political risks associated with imposing water charges — the promise of a non-trivial expansion of precious fiscal space. However, the pursuit of this objective meant that the average tariff was set at a higher level than it might otherwise have been and, as we have argued, provided a treacherous basis for policy.

An austerity measure too far?

Another, very common take on the failed attempt to introduce water charges is that it was an austerity measure too far, 'the straw that broke the camel's back'. As such, it is portrayed as a policy that became the focal point for the pent-up anger and frustration of a population that had been suffering the brunt of austerity measures for the previous five years.

This line or argument draws attention to the issue of timing and suggests that if water charges had been introduced at the start of the fiscal consolidation rather than at the end, the policy might have stood a better chance of succeeding. There are two points to be made in response to this proposition. The first is that, given that the approach adopted by the government required the setting up of Irish Water and the installation of (at least some) meters before charging commenced, charges could not have been introduced before 2014.

The second point is that an earlier attempt at implementation (assuming a different policy approach) would not have averted protest. The household charge, introduced in 2012, provoked

[97] 539,000 households had been metered by end-December 2014 out of a total of 1.35 million on the public water network.

vigorous protest and a moderately successful campaign of non-payment, which was effectively ended when it was succeeded by the Local Property Tax, responsibility for the enforcement of which was given to the Revenue Commissioners.

Given their respective socio-economic footprints (the household charge applied only to property-owners; water charges applied to all consumers of publicly-supplied water services) and the resonance of the respective rallying calls (there is nothing in the lexicon of opposition to property tax that has quite the same emotional charge as the ‘right to water’), it is reasonable to propose that water charges were always likely to generate a greater volume of protest than the household charge, irrespective of timing.

However, the point here is not that water charges excited protest, but that the scale of protest increased so sharply in the latter part of 2014 after the initial charges plan was announced. This strongly suggests that the level and structure of the charges set out in that plan, reflecting choices made in the policy-making process, as distinct from the fact of water charges *per se*, played an important part in fomenting public opposition. It is also likely that the disposition to protest against charges was strengthened by other factors that were not directly related to charges, such as the suspicion that Irish Water was a vehicle for privatising water and the controversy surrounding the company’s start-up costs.

Conclusions on the policy making process

The discussion in Chapter 6 pointed to aspects of the policy-making process that were instrumental in the successful introduction of the local property tax and aspects that were at least unhelpful to the attempt to introduce water charges. It is worth setting out a succinct summary of the main conclusions that emerged from that discussion.

In our judgement, critical to the success of the LPT was the close attention paid to implementation issues in the design phase. The corresponding lack of attention to implementation issues was a weakness in the approach to water charges, and especially to metering. We have described how perfectly foreseeable events delayed the start of the meter installation programme and how well-known technical complications reduced its scope, such that the initial promise on which policy was based, namely that charging would not start until metering was complete, was undermined.

Another issue around metering that highlights a disconnect between policy design and implementation is that a programme of universal meter installation necessarily implies putting meters where they are not wanted and where, if feelings are running high enough, their installation will be resisted. Given the history of water charges in Ireland, the risk that meter installation would be disrupted or prevented by protest should have been obvious, but there is no evidence that it was taken into account when policy decisions were made, or that measures for mitigating the associated risks were put in place.

This in turn highlights another requirement of good policy-making: The rigorous and open-minded evaluation of different options. Amongst the alternatives to universal metering was an approach whereby meters would be installed at the request of the householder, the so-called optant system that had been used in England and Wales. While the DECLG's Position Paper of January 2012 contained a brief discussion of this option (and others), it was never rigorously assessed.[98] As already noted, the cost-benefit analysis of metering carried out in late 2012 was confined to an evaluation of the universal metering approach relative to the *status quo*, and was silent on intermediate solutions. Besides, it was delivered after the decision to proceed with universal metering had been made by government.

In truth, the commitment to universal metering was made in the political sphere, predated the Fine Gael–Labour government, and was shared by the parties to the previous administration (Fianna Fáil, the Green Party, and the Progressive Democrats). There does not appear to have been a willingness to re-open the question when the new government took power in March 2011. It is worth contrasting this with the position adopted on the valuation base for property tax. Here, site value had been the direction favoured by the political system and the property tax commitments made in the 2009 *Renewed Programme for Government,* the *National Recovery Plan* of 2010, and the 2011 *Programme for Government* were all expressed in such terms, but the question was kept open until the practical implications of such a valuation base had been thoroughly examined and found to be off-putting, and a different base was selected.

There was at least one other element of policy in relation to water charges where a decision made in the political sphere was passed down from one government to the next without being rigorously evaluated against the alternatives, and its implications being fully understood until it was too late. We are referring to the universal free allowance, which became a core part of the approach from 2009 before it was dropped from the November 2014 tariff structure. As noted, the commitment to free allowances had several unhelpful consequences, one of which was that it pre-empted a productive assessment of ways in which the affordability problem might be effectively and efficiently tackled.

There is of course a limit to the comparability of how the policy-making process dealt with property tax and water charges. The latter, being but one element in an ambitious, integrated, multi-faceted reform programme, was considerably wider in scope and presented a much more complex challenge. But the scope and complexity of the water sector reform agenda were features that were themselves the outcome of policy choices. A plan to introduce water charges *per se* could have been narrowly defined and made relatively simple. This is not to say that such a plan would necessarily have succeeded but that it would have offered fewer opportunities for error and fewer targets for protest.[99]

There are several examples of how the ambition of water policy collided with the harsh reality of implementation, especially in relation to timescale. The most obvious is meter installation. Another is the notion that a newly created public utility would achieve market corporation status and be in a position to come off the government balance sheet before establishing a commercial track record.

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[98] DECLG. *Reform of the Water Sector in Ireland, Position Paper*, January 2012.
[99] As one public official involved in the process pithily observed during our interviews: 'The more you take on to do, the more likely it is that you'll make mistakes'.

Probably the most salient such example, however, was the ambition to move seamlessly from zero user costs to a regime of substantial, volumetric-based prices, with all the uncertainty that entailed, particularly at a time when the legacy of hardship created by the financial crisis and its aftermath was a reality for many households.

All in all, in examining policy on water one is left with the impression that it was driven by a vision that would have been more appropriate for a 7–10 year timeframe than a 3–5 year period, and was based on an approach in which the perfect became the enemy of the good.

By comparison with water policy, policy in relation to property tax was tightly focused. It was a comparatively straightforward revenue-raising exercise. It was guided by the time-honoured principles of good tax design: in particular, simplicity and transparency. Hence the decision to reject a site value basis and to favour self-assessment rather than await the construction of a centralised valuation system. The LPT was not an element in an integrated, multi-faceted reform of local government, although it might have been designed as such. It was not an integral part of a policy programme with multiple objectives.

To that extent, the LPT emerged from a deliberative process that was narrow in scope and could be characterised as lacking in intellectual purity, but it was a process that produced a workable solution. It might have been otherwise. As one senior official, closely involved in that process, remarked in our interview: *'Property tax could have become bogged down in the search for a perfect model of local government funding'*.

The case for strategic incrementalism

Water charges were never going to be popular. It was inevitable that any attempt to introduce them would meet with opposition and generate protest, all the more so given the fiscal and economic context. It was not inevitable, however, that any such attempt would end in failure, any more than it was inevitable that any attempt to introduce property tax would fail. Our reading of the situation is that in the case of water charges, the policy approach adopted was decisive in producing failure.

In our judgement, the overarching weakness of the policy position was that it sought to achieve too much too soon. We would argue, therefore, that a more incrementalist approach, albeit one guided by a clear strategic purpose, would have offered a much better chance of success. Such an approach had been proposed and detailed in the 2009 report of the Commission on Taxation. The Commission's proposals distinguished between measures to be introduced in the short term (an initial relatively low fixed charge) and the tariff system to be achieved in the long term (based on full cost recovery and volumetric charging where meters were in place), and proposed that the level of charges would be raised gradually in the intervening period.

The Commission favoured optant rather than mandatory metering, but envisaged consumers being incentivised to install meters through temporary rebates and the prospect of more permanent savings on their water bills. In relation to addressing affordability problems, the Commission came down decisively against the idea of universal free allowances and proposed instead that a number of free units of water be provided where the household income is below a certain threshold, similar to the scheme operated in respect of electricity. This sort of approach to pricing and metering could have been combined with the establishment of Irish Water, but with the adoption of a less demanding timetable in relation to achieving the company's classification as a market corporation separate from the general government sector.

It is a curious fact that, while the Commission's proposals in relation to property taxation provided the blueprint for the Local Property Tax, its proposals on water charges were ignored and were in several essential respects the antithesis of what government chose to do.

Finally, it is worth noting that the last of the Commission on Taxation's proposals in relation to water charges highlighted the critical role of good communications in policy success. That proposal, entitled 'Public Information' is worth quoting on full:

'For the re-introduction of water charges for domestic users to gain public acceptance it will be necessary for local authorities, and for central government, to make it clear to all water consumers through public information campaigns, the need for a water conservation mindset and what is being charged for and why it is necessary to charge.' [100]

It draws attention to an aspect of the water charges debacle that is outside the scope of this report, but is nonetheless important and probably worthy of study in its own right: The battle for the hearts and minds of the people. This was a battle that the government decisively lost.

[100] Commission on Taxation. *Report.* 2009, 451.

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