



Rewarding Learning

ADVANCED
General Certificate of Education
2025

Centre Number

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Candidate Number

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Economics

StemUp Model Solution

Assessment Unit A2 1

assessing

Business Economics



[AEC11]

AEC11

MONDAY 19 MAY, AFTERNOON

TIME

2 hours.

INSTRUCTIONS TO CANDIDATES

Write your Centre Number and Candidate Number in the spaces provided at the top of this page. Answer **all** questions in Sections **A** and **B**, and **one** question in Section **C**. You are permitted to use a calculator in this paper.

You must answer the questions in the spaces provided.

Do not write outside the boxed area on each page or on blank pages.

Complete in black ink only. **Do not write with a gel pen.**

INFORMATION FOR CANDIDATES

The total mark for this paper is 90.

- Section A: 20 marks
- Section B: 40 marks
- Section C: 30 marks

Figures in brackets printed down the right-hand side of pages indicate the marks awarded to each question or part question. This paper is accompanied by a Case Study Booklet.

ADVICE TO CANDIDATES

You are advised to take account of the marks for each part question in allocating the available examination time. In questions involving calculations, you are advised to show your workings.

Quality of written communication will be assessed in Questions **5**, **6(b)**, **(c)** and **(d)**, **7** and **8**. Quantitative skills will be assessed where appropriate.

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Section A (20 marks)

Answer all questions

- 1 Software company Harness has recently announced plans to open a technology hub in Belfast, creating up to 100 jobs in the technology sector. A spokesperson stated that the investment was part of the company's ambitious expansion plans, which would allow it to benefit from greater management and financial economies. It could also take advantage of the large pool of highly trained labour available in Northern Ireland's fast-growing IT sector.

With reference to the information above, explain the difference between internal and external economies of scale. [4]

Economies of scale are the cost advantages of increased size, which cause long-run average cost (LRAC) to fall as output rises.

Internal economies of scale arise from the growth of the individual firm itself, whatever happens to other firms. Harness expects managerial

economies (e.g. specialist managers running the new Belfast hub) and

financial economies (borrowing more cheaply and easily because it is larger).

External economies of scale arise from the growth of the whole industry or

area, not the firm. Harness benefits from Northern Ireland's fast-growing IT

sector, which has created a large pool of highly trained labour, lowering its recruitment and training costs even if the firm itself did not grow. So

internal economies move the firm down its LRAC curve, while external

economies shift the LRAC curve downwards.



- 2 Two coffee shops, Costly Coffee and Café Nemo, are the only coffee shops which operate in a small town. Both companies are considering engaging in a local radio advertising campaign to increase sales and market share. The payoff matrix below illustrates the expected weekly profit of both firms, depending on whether each firm decides to advertise or not.

		Costly Coffee	
		Don't advertise	Advertise
Café Nemo	Don't advertise	£3,000 / £3,000	£2,000 / £4,000
	Advertise	£4,000 / £2,000	£2,400 / £2,400

Using the profit payoff matrix above, explain whether, in the absence of collusion, Café Nemo and Costly Coffee would be likely to advertise. [4]

Advertising is the dominant strategy for both firms. For Café Nemo: if Costly Coffee does not advertise, advertising earns £4,000 rather than £3,000; if Costly Coffee advertises, advertising earns £2,400 rather than £2,000. So advertising is better whatever its rival does. The payoffs are symmetric, so the same is true for Costly Coffee (£4,000 > £3,000 and £2,400 > £2,000). Without collusion neither firm can trust the other not to advertise, so both will advertise and earn £2,400 each (the Nash equilibrium), even though both would earn more (£3,000 each) if they agreed not to advertise. This is a classic prisoners' dilemma.

[Turn over]



- 3 Barry's Benches makes garden benches from scrap metal and wood. The table below shows how the weekly output of benches varies with the number of employees.

Number of employees	Total weekly bench production
1	20
2	48
3	88
4	148
5	206
6	248
7	278

With reference to the information in the table above, explain what is meant by the law of diminishing marginal returns to the variable factor.

[4]

The law of diminishing marginal returns states that in the short run, as more units of a variable factor (labour) are added to a fixed factor (Barry's workshop and tools), the marginal product (extra output from one more worker) may at first rise but will eventually fall.

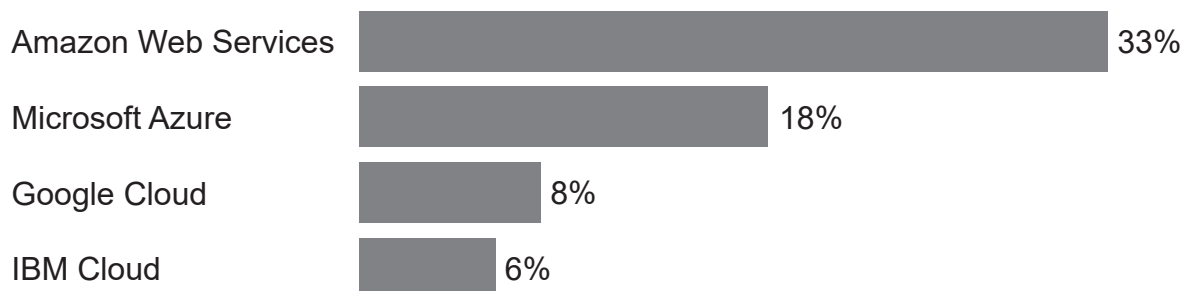
MP = change in total output: 20, 28, 40, 60, 58, 42, 30 benches.

MP rises up to the 4th worker (60 benches), due to specialisation, but diminishing returns set in with the 5th worker, when MP falls to 58, then 42 and 30, as workers must share the fixed equipment. Total output still rises, but at a decreasing rate.



- 4 The chart below shows the worldwide market share by revenue of the four largest cloud service providers in 2019. The total value of the market was \$96 bn.

Worldwide market share of leading cloud service providers, 2019



Using the information in the chart above, calculate the total revenue earned by Microsoft Azure in 2019.

[2]

$$\text{Revenue} = 18\% \times \$96 \text{ bn}$$

$$= 0.18 \times 96 = \$17.28 \text{ bn}$$

[Turn over]

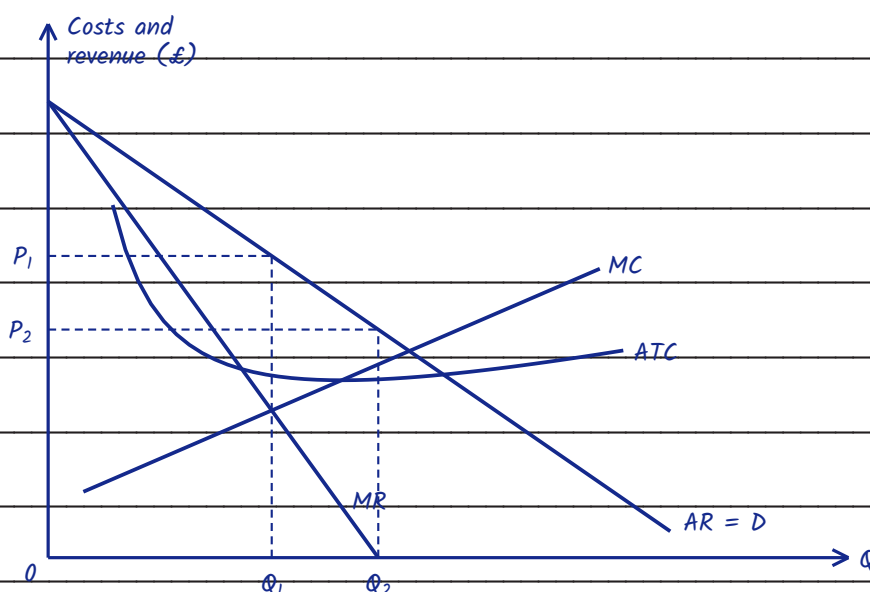


- 5 DJ Vice is a Belfast-based music producer who has recently entered a contract with a local independent record label to release an album of 10 original songs. The contract stipulates that DJ Vice will receive 10% of the total revenue earned from selling the album. The record label is a private limited company, which aims to maximise profits.

With the aid of an appropriate diagram, explain why DJ Vice might disagree with the record company over the best price at which to sell the album. [6]

Quality of written communication will be assessed in this question.

The record label aims to maximise profit, so it will produce where $MC = MR$, where the last album adds as much to revenue as to cost. In the diagram this gives output Q_1 , and the label charges the highest price consumers will pay for Q_1 , read off the AR (demand) curve: P_1 . Here it earns supernormal profit as $P_1 > ATC$.



DJ Vice, however, is paid 10% of total revenue, not a share of profit, so his income is maximised when total revenue is maximised. TR is maximised where $MR = 0$, i.e. where demand is unit elastic ($PED = 1$). This gives the



higher output Q_2 and the lower price P_2 . As long as MR is positive (demand is price elastic, on the upper half of the AR curve), cutting price raises TR, so DJ Vice wants the price cut below P_1 .

The disagreement exists because DJ Vice bears none of the costs of producing, marketing and distributing the album, so he ignores MC. Between Q_1 and Q_2 each extra album still adds to revenue ($MR > 0$), raising his 10% royalty, but adds more to the label's costs than to its revenue ($MC > MR$), so it reduces the label's profit. DJ Vice therefore prefers a lower price and higher sales (P_2, Q_2), which also give him more exposure as an artist, while the label prefers the higher price P_1 .

The size of the disagreement depends on the label's marginal cost: for digital downloads or streams MC is close to zero, so $MC = MR$ would be very near $MR = 0$ and the two preferred prices would be almost the same, whereas for physical CDs or vinyl the gap is larger.

[Turn over



Section B (Case Study) (40 marks)

Answer all questions

Read the information in the Case Study Booklet and answer the questions below.

- 6 (a) Using the information in **Fig. 1**, compare the dividend payments and post-tax profit for Thames Water with that of the other water companies between 2010 and 2020. [4]

Between 2010 and 2020 Thames made £3.20 bn post-tax profit, the 2nd highest after United Utilities (£3.85 bn), and paid £2.65 bn in dividends, the 3rd highest after Anglian (£3.75 bn, about 42% more than Thames) and United Utilities (£2.75 bn).

However, relative to profit, Thames paid out $2.65 \div 3.20 = 82.8\%$ of post-tax profit as dividends. This is lower than five other firms:

Yorkshire 146.7%, Anglian 125%, Severn Trent 104.2%, Northumbrian 97.2% and Wessex 92.3%; three of these paid out more than they

earned. The other eight firms together paid £15.85 bn from £16.40 bn profit (96.6%), so Thames' payout ratio was about 14 percentage points below the rest. Only United Utilities (71.4%), South West (75.9%) and Southern (54.5%, with dividends of £0.60 bn, less than a quarter of Thames') paid out a lower share.



- (b) With the aid of an appropriate diagram, explain why water and sewage treatment could be considered a natural monopoly. [9]

Quality of written communication will be assessed in this question.

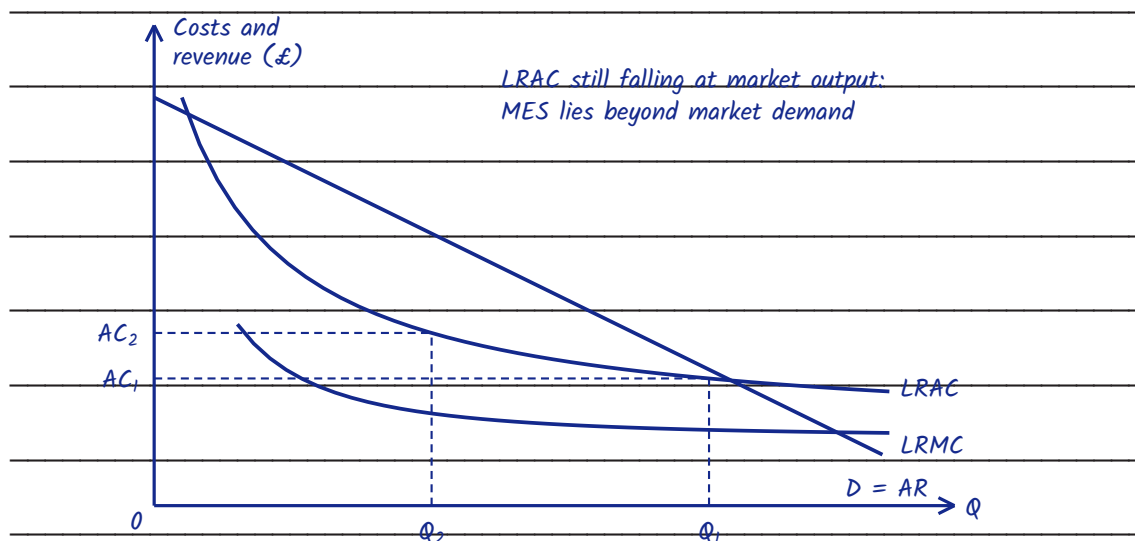
A monopoly is a market with a single supplier (legally, a firm with over 25% market share). A natural monopoly exists where one firm can supply the entire market at a lower long-run average cost than two or more competing firms could, so the most efficient market structure is a single supplier.

Water and sewage treatment has enormous fixed, largely sunk, costs: reservoirs, treatment works, pumping stations and thousands of miles of pipes and sewers must be built and maintained before a single litre is supplied, while the marginal cost of supplying one more household from the existing network is very low. Spreading these huge fixed costs over more output means LRAC falls over the whole range of market output, so economies of scale (especially technical economies of the network) are never exhausted and the minimum efficient scale (MES) lies beyond the level of market demand.

As the diagram below shows, if one firm supplies the whole regional market, Q_1 , its average cost is AC_1 . If two firms competed and split the market, each would produce $Q_2 = \frac{1}{2}Q_1$ at a much higher average cost, AC_2 , because each would have to duplicate the network of pipes and treatment works. Competition would therefore raise costs and prices and waste scarce resources. In fact a second entrant could never cover its

[Turn over]





costs, so competition is not viable.

This is why in England each regional water company, such as Thames Water, is a monopoly in its own region: Source 3 says the companies were 'gifted a regional monopoly' when they were privatised in 1989. It would be wasteful for a rival to lay a second set of water mains and sewers under London's streets. The very high sunk costs also act as a huge barrier to entry, so the monopoly is natural rather than created by law.

Because the firm faces the whole downward-sloping market demand curve and consumers cannot switch supplier, it has strong market power over an essential good with inelastic demand. This is why natural monopolies such as water are either publicly owned or, as in England, regulated by a body such as Ofwat.



- (c) Critically examine the role of regulators such as Ofwat in ensuring private monopolies act in the public interest.

[12]

Quality of written communication will be assessed in this question.

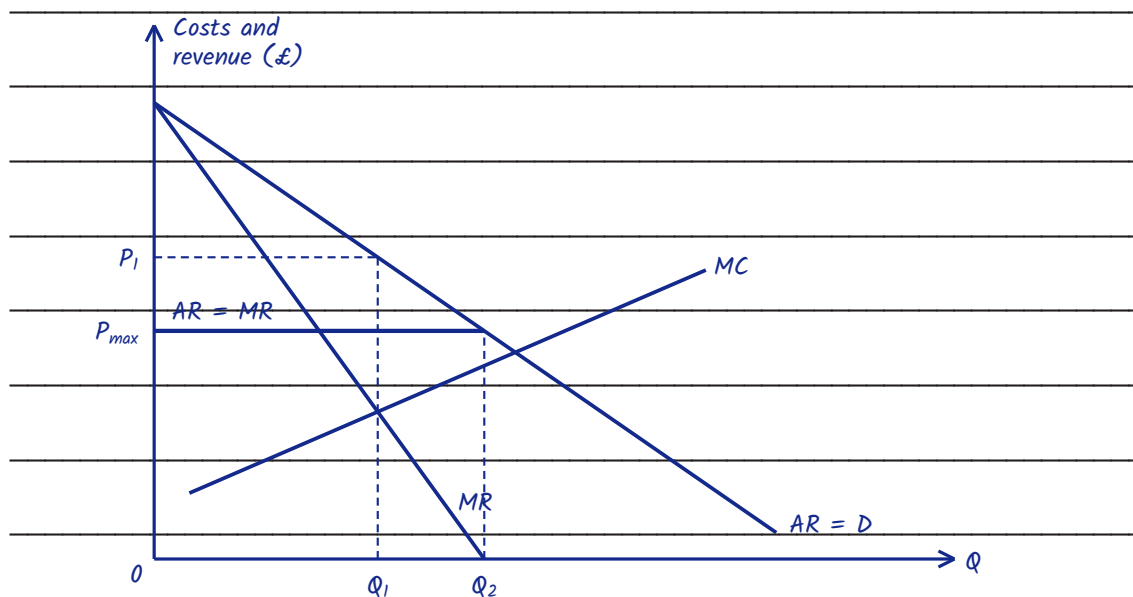
Private monopolies such as the regional water companies face no competition and very inelastic demand for an essential good, so left alone they would restrict output and set price where $MC = MR$, earning supernormal profit and causing allocative inefficiency ($P > MC$). They would also have little incentive to cut costs or to invest. Ofwat is the industry-specific economic regulator created at privatisation in 1989 to act as a surrogate for competition and protect the public interest: keeping bills affordable, ensuring investment in a resilient water and sewage system and maintaining service quality.

Its main tool is a price cap set every five years, which limits how much bills can rise (an 'inflation minus X' type formula), based on each firm's planned investment and expected efficiency gains. The diagram shows how a cap can work.

Without regulation the monopolist produces Q_1 at P_1 . If Ofwat caps the price at P_{max} , the firm's AR and MR become horizontal at P_{max} up to the demand curve, so output rises to Q_2 and price falls, closer to the allocatively efficient outcome, and supernormal profit is transferred back to consumers as consumer surplus. The X factor also gives an incentive for productive efficiency, as the firm keeps any extra profit from cutting costs faster than X. Ofwat can also fine firms, set targets for leakage

[Turn over]





and pollution and compare firms' costs across regions (yardstick competition).

However, the case study suggests regulation has largely failed. Prices have risen by over 40% in real terms (Source 1), so the caps did not keep bills in check. Investment has not been made: three billion litres leak every day and Thames needs over £10 bn just to meet regulatory standards. Meanwhile shareholders have 'stripped £72 bn' and several firms paid out more than they earned (Anglian 125% of profit), loading the companies with debt. Raw sewage discharges show quality was not protected, and the £3.3 million fine on Thames is tiny compared with its £2.65 bn of dividends, so it is no deterrent.

There are reasons for this. Information asymmetry: the firms know their true costs far better than Ofwat, which lacks the funding to investigate



properly (Source 3), so they can overstate costs to obtain lenient caps.

Regulatory capture: with a 'revolving door' and two-thirds of the biggest firms employing ex-Ofwat executives, the regulator may come to serve the industry rather than the public. The 'public interest' is also hard to define and measure, and Ofwat must balance low bills against funding investment, which conflict, so a tight price cap can itself reduce investment.

On the other hand, regulation has had some successes: drinking water and beach quality are far better than before privatisation, and the inefficiency of the old state utilities, where around 40% of jobs were unnecessary (Source 4), has been removed, lowering costs. The failures may reflect how Ofwat has been run rather than regulation itself.

Overall, regulators like Ofwat can in principle make private monopolies act in the public interest, but only if they have enough information, funding, independence and powers. On this evidence Ofwat has been a 'toothless tiger', so its success depends on reforms such as fines linked to turnover, limits on dividends and debt, and stronger independence to prevent capture.

[Turn over



- (d) Evaluate the case for the full renationalisation of the water and sewage system in England. [15]

Quality of written communication will be assessed in this question.

Nationalisation means taking a firm or industry into public (state)

ownership, so the government owns the assets and controls decisions.

Water and sewage were nationalised in the past (Source 2) and

privatised in 1989; campaigners now want full renationalisation.

The main case for it is that the regional water companies are natural

monopolies with inelastic demand. A state-owned firm need not

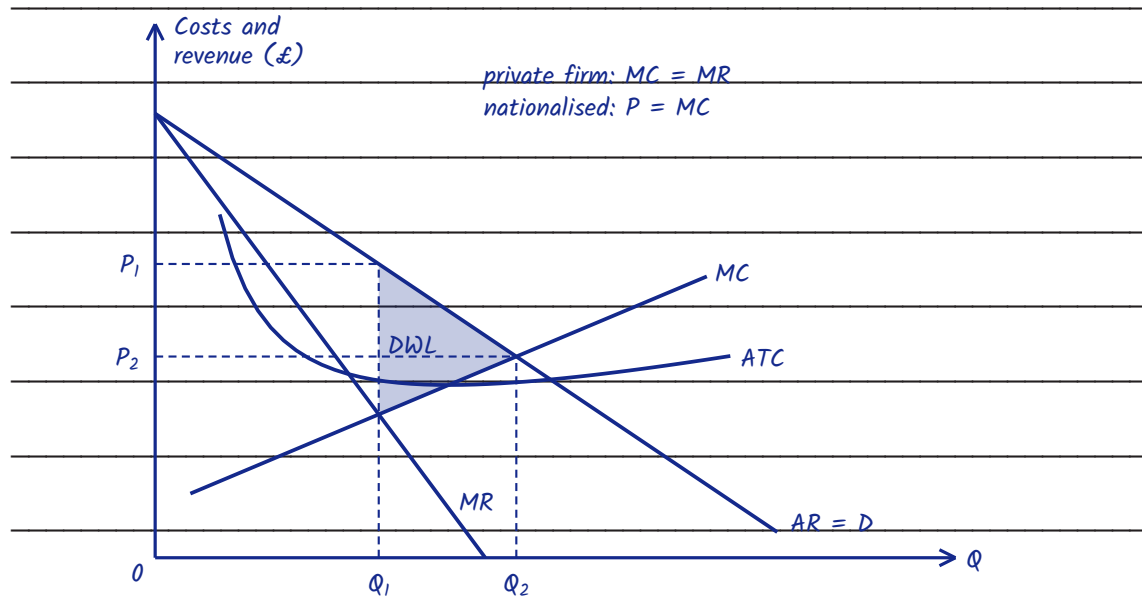
maximise profit, so it could set price where $P = MC$ rather than where

$MC = MR$. As the diagram shows, this lowers price from P_1 to P_2 and

raises output from Q_1 to Q_2 , achieving allocative efficiency, removing the

deadweight loss and increasing consumer surplus. This matters after real

price rises of over 40% (Source 1).



Second, profits could be reinvested instead of paid out. Shareholders have taken £72 bn, and some firms such as Yorkshire (£2.20 bn of dividends from £1.50 bn profit) paid out more than they earned. Under public ownership this surplus could fund fixing leaks (3 billion litres a day) and building reservoirs. Third, the government can borrow far more cheaply than private firms, which matters because water needs huge long-term investment: Thames needs over £10 bn and is struggling to service debts taken on when interest rates were low. Fourth, a state-owned firm could take account of external costs such as sewage discharges that harm rivers, fish and tourism, rather than ignore them to protect profit. Finally, regulation has clearly failed (Source 3), and England is the only country with a fully privatised system: Scottish Water, for example, is publicly owned.

However, there are strong arguments against. Without the profit motive and the threat of takeover or bankruptcy, managers have little incentive to minimise costs, so X-inefficiency and productive inefficiency rise: before privatisation around 40% of jobs were unnecessary (Source 4). Higher average costs mean higher prices or taxpayer subsidies, and in a natural monopoly pricing at $P = MC$ may be below average cost, so the firm would make a loss funded by taxes. There is also less incentive to innovate, reducing dynamic efficiency. Buying the companies could cost £90 bn, which adds to national debt and has an opportunity cost in

[Turn over



spending on the NHS or schools. There is also a risk of political interference: governments may hold prices down before elections or cut investment when public finances are tight, and the pre-1989 water authorities also suffered from underinvestment because of limits on public borrowing.

The strength of the case depends on several factors. It depends on the price paid: if firms are close to collapse, as Thames is, the state could take them into special administration far more cheaply than £90 bn. It depends on whether a public firm can be run efficiently, with clear targets and an independent board, as Scottish Water suggests is possible. It also depends on the time scale: the costs come in the short run, while the gains from cheaper finance and reinvested profits build up over decades. Finally, the alternative of much tougher regulation (limits on dividends and debt, fines that bite) might achieve many of the same gains at far lower cost.

On balance, the case for renationalisation is strong because water is an essential natural monopoly where privatisation and regulation have failed to deliver investment, fair prices or clean rivers. However, full renationalisation at a cost of up to £90 bn is only justified if the state can avoid the inefficiency of the past, so a sensible first step would be to take failing firms like Thames into public ownership while reforming regulation for the rest.



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Section C

Answer **either** question 7 **or** question 8

Quality of written communication will be assessed in these questions.

- 7 A report published recently by the OECD suggested that price discrimination can benefit consumers as well as firms. However, other economists have questioned this conclusion, claiming that all forms of price discrimination are unfair and inefficient, and should be outlawed by government.

Critically examine the view that all forms of price discrimination are unfair and inefficient and should be outlawed by government.

[30]

or

- 8 In what has been described as a Golden Age for television, four large companies dominate the TV-based streaming market in the USA and Europe. The big four, Netflix, Amazon Prime Video, HBO Max and Disney+, have been credited with revolutionising the TV industry. However, some argue that the dominance of the big four has led to higher prices, poorer quality output and restricted choice.

Critically examine the view that oligopoly is the least desirable market structure.

[30]



Write the number of the question you have chosen in the box below:

7

Price discrimination occurs when a firm charges different prices to different consumers for the same good or service, where the price differences are not due to differences in the cost of supply. For it to be possible the firm must have price-setting (monopoly) power, be able to separate the market into groups with different price elasticities of demand, and prevent resale (arbitrage) between the groups.

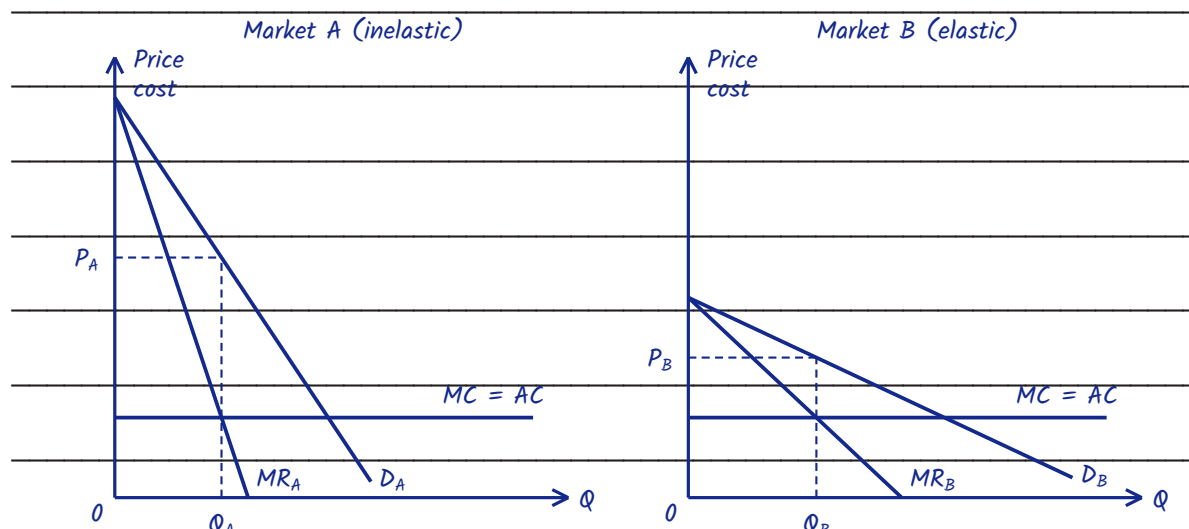
There are three types. First degree: each consumer is charged the maximum they are willing to pay. Second degree: price varies with the quantity bought or the time of use, e.g. bulk discounts, peak and off-peak tariffs. Third degree: the market is split into groups by age, time or location, e.g. student and pensioner rail fares or cinema tickets. Third degree price discrimination is shown in the diagram below.

To maximise profit the firm sets $MC = MR$ in each market. In market A, where demand is price inelastic (e.g. business travellers or business users of software), it charges a high price P_A ; in market B, where demand is price elastic (e.g. students), it charges a low price P_B . Total profit is higher than with a single price, because the firm converts consumer surplus into producer surplus.

There are strong arguments that price discrimination is unfair. Consumers in the inelastic market pay more than they would under a single price simply because they have fewer alternatives or need the good more: commuters who

[Turn over





must travel at peak times, or loyal insurance customers who did not switch and were charged far more than new customers (the 'loyalty penalty'). This redistributes income from consumers to producers, as consumer surplus falls and producer surplus rises, so shareholders gain at consumers' expense. The concern is even greater with first degree discrimination, which firms can increasingly approach using big data and algorithms (personalised and surge pricing), since in theory all consumer surplus is captured by the firm.

It can also be inefficient. In market A price is well above MC, so the firm is allocatively inefficient there, with under-consumption and a deadweight welfare loss. The extra supernormal profit shelters the firm from competitive pressure, so it may become complacent and X-inefficient, with costs above the minimum, leading to higher prices in the long run. Price discrimination can also be used anti-competitively: an incumbent can cut prices in a market where a new entrant appears (predatory pricing) while funding the



losses from high prices in its captive market. This deters entry and reduces competition, which ultimately raises prices for all consumers. On these grounds some argue it should be outlawed.

However, the claim that all forms of price discrimination are unfair and inefficient is too strong. First, consumers with elastic demand, often those on low incomes such as students, children and pensioners, pay a lower price than they would under a single price, and some are priced into the market who would otherwise not consume at all. For example, the high prices paid by business users allow software firms such as Microsoft to offer the same software to schools and students much more cheaply. This could be seen as fairer, not less fair, as it is progressive.

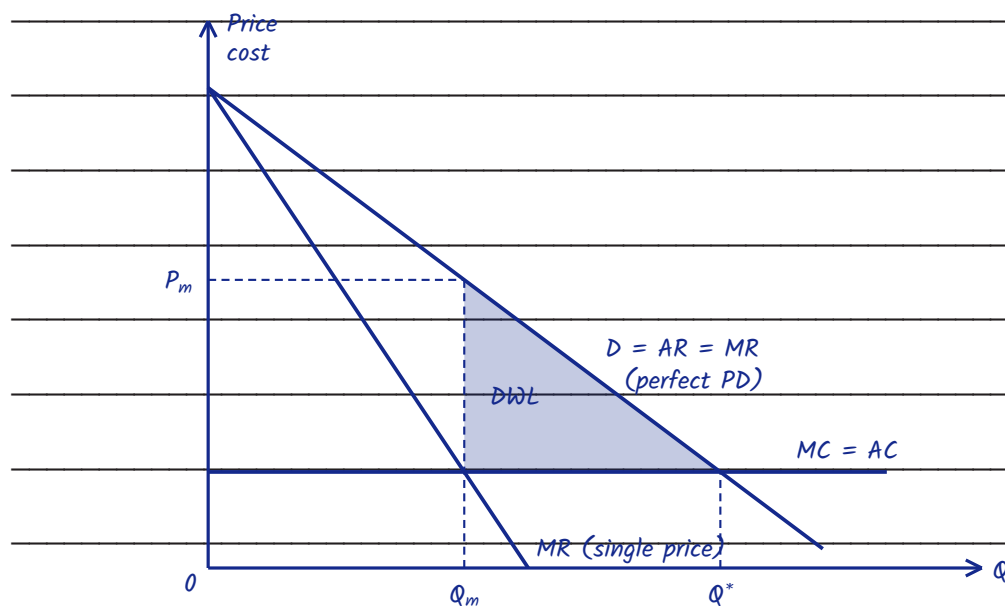
Second, price discrimination can increase output and efficiency. Under first degree price discrimination the firm keeps selling until the price paid by the last consumer equals MC, as shown in the second diagram.

A single-price monopolist would produce Q_m at P_m , with a deadweight loss (shaded). With perfect price discrimination the demand curve becomes the MR curve, so output rises to Q^* where $P = MC$: the outcome is allocatively efficient and the deadweight loss disappears, even though all the surplus goes to the firm. So discrimination is not necessarily inefficient; the issue is how the gains are distributed.

Third, discrimination can make products viable that would not otherwise exist. If no single price covers average cost, e.g. a rural rail service or a new

[Turn over





medicine, the extra revenue from discrimination can cover the high fixed costs. Pharmaceutical firms charge high prices in rich countries and low prices in developing countries, giving poorer patients access to drugs while funding research and development, so the supernormal profit can improve dynamic efficiency through innovation. Higher output also lets firms exploit economies of scale, lowering average costs and possibly prices for all.

Second degree discrimination such as off-peak fares and airline yield management fills seats that would otherwise be empty, spreading demand and making better use of capacity whose marginal cost is close to zero.

Should the government outlaw it? A complete ban would be very difficult to enforce, because it is hard to tell whether price differences reflect costs (e.g. delivery to remote areas or the cost of peak capacity) or discrimination, and firms could disguise discrimination through versioning,



coupons and loyalty schemes. A ban could also harm the very groups it aims to protect: student, child and pensioner concessions and cheap off-peak fares would disappear, and firms would probably set a single price in between, raising prices for elastic groups while giving little help to others. Some services might not be supplied at all.

Whether price discrimination is harmful therefore depends on: the type (first degree may increase output, while the loyalty penalty mainly exploits inertia); whether total output rises compared with single pricing (if it does, welfare usually rises); who pays the higher price (businesses or the poor); how the extra profit is used (R&D or dividends and X-inefficiency); and the degree of market power and contestability. A targeted approach is better than a blanket ban: competition authorities such as the CMA can investigate abuse of a dominant position, including predatory or exclusionary pricing, and regulators can ban specific harmful practices, as the FCA did in 2022 when it banned 'price walking' in home and motor insurance.

In conclusion, the view is only partly valid. Some forms of price discrimination are unfair and inefficient, especially when they exploit loyal or vulnerable consumers or are used to block competition, and these should be regulated. But many forms raise output, widen access for low-income groups, fund innovation and use capacity efficiently, which supports the OECD's conclusion. Price discrimination should therefore be judged case by case rather than outlawed altogether.

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Question Number	Marks
Section A	
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Examiner Number

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Rewarding Learning

ADVANCED
General Certificate of Education
2025

Economics

Assessment Unit A2 1
assessing
Business Economics

[AEC11]

MONDAY 19 MAY, AFTERNOON

CASE STUDY BOOKLET

**For use with
Section B**

Read the following information and answer Question 6 in the question and answer booklet.

The following passages were compiled in August 2023.

Case study: Water – a murky industry

Source 1: Will Thames Water sink?

In June 2023 England's largest water company, Thames Water, entered emergency talks with the regulator Ofwat. Those involved in the discussions have been told that Thames Water would require more than £10 bn to get its infrastructure up to regulatory standards. If it fails to get this cash, it will be forced to cease trading.

Over recent years, the company has come in for significant criticism from environmental groups over its pollution record. In June 2023, the company was fined £3.3 million after it was found guilty of discharging millions of litres of raw untreated sewage into two rivers, killing thousands of fish and damaging local ecosystems. Thames Water, like many other water companies in England, stands accused of years of chronic underinvestment and a failure to upgrade its water and sewage infrastructure. It has also been accused of loading the company with debt while drawing down huge dividends for shareholders. **Fig. 1** below shows the post-tax profits of England's largest water companies and their dividend payments between 2010 and 2020.

Company	Post-tax profit (£ bn)	Dividend payments (£ bn)
United Utilities	3.85	2.75
Thames	3.20	2.65
Anglian	3.0	3.75
Severn Trent	2.40	2.50
Northumbrian	1.80	1.75
Yorkshire	1.50	2.20
South West	1.45	1.10
Wessex	1.30	1.20
Southern	1.10	0.60

Fig 1: Post-tax profits and dividends in selected English water companies, 2010–2020

Environmental campaigner Euan Lappin stated, “Since being privatised in 1989, England's water companies have enriched investors and senior executives, but failed to adequately invest in maintaining and upgrading the water and sewage infrastructure. Consumers have seen prices rise by over 40% in real terms. However, the required investment in fixing leaks and building reservoirs has not been made, while shareholders have stripped £72 bn from the system. In some cases, companies have paid more out in dividends than they have earned in profits, a situation which would be unthinkable in any other industry.”

Source 2: From private to public and back again

The history of drinking water and sewage disposal in England can be traced back to the Romans, who built an extensive network of aqueducts and public wells to supply clean water to their settlements. Rapid population growth and urbanisation during the Industrial Revolution resulted in an increased demand for clean drinking water and an adequate system for dealing with wastewater and sewage. To meet this increased demand, private companies began to emerge with the first water company being established in London in 1743.

By the mid 1800s the government realised the need for state involvement in the provision of clean water and sewage services to prevent the spread of deadly diseases such as typhoid and cholera. The government passed several Acts of Parliament, which ultimately resulted in the full nationalisation of water and sewage services.

When the Conservative Party came to power in 1979, under the leadership of Margaret Thatcher, they set about making plans for the full privatisation of water and sewage services. Their initial plans proved very unpopular and were shelved initially for fear of a public backlash. However, in 1989, the plans were resurrected, and the 10 regional water authorities were sold off to private investors for £7.6 bn, making England the only country in the world with a fully privatised water and sewage system.

To ensure interest from private investors, the government took on the £5 bn debts the companies owed and provided the new private companies with £1.5 bn of public money to kick-start investment, meaning the net gain to the UK exchequer was only £1.1 bn!

Source 3: Ofwat – a toothless tiger?

When the water authorities were privatised in 1989, the new water companies were gifted a regional monopoly. To offset this, the government created a regulator for water, Ofwat, to ensure the new private industry worked in the public interest. However, Ofwat has come in for significant criticism for being asleep at the wheel and allowing the current crisis in water and sewage to develop unopposed. Critics argue that Ofwat is hopelessly “captured” and that there is a revolving door between people working at Ofwat and people working in the private water companies. A recent survey showed that two-thirds of the biggest water companies employ executives who once worked for the regulator!

Critics also point out that Ofwat has limited powers to fine companies for actions which act against the public interest. Sinéad Douglas, a campaigner for reform of the current water system, claimed that “creating regulators to oversee the activities of natural monopolies like the water companies is always doomed to failure. Ofwat is a toothless tiger. It lacks the funding to properly investigate the practices of the water companies and the power to impose fines large enough to act as a deterrent”.

Source 4: Calls for water to be nationalised amid failure of regulation

Activists are putting increasing pressure on the government and opposition parties to support the renationalisation of England's water system after criticism that the industry is not acting in the public interest. Campaigners say that water should be renationalised after 30 years of asset stripping, chronic underinvestment, widespread pollution of rivers and ever-increasing water charges. Sinéad Douglas said, "England's privatised water companies treat our rivers and seas like a sewer and their customers like a cash machine. We live in the wettest part of Europe, yet we face yearly hosepipe bans while allowing three billion litres of water to leak from old and decaying water pipes every day. Perhaps returning this most essential of utilities to public ownership, and removing it from the hands of organisations which put profits first, is the only way to go."

Not surprisingly, however, others dispute the view that nationalisation is the answer. Opponents argue that the state-run utilities that existed before privatisation were ineffective and hugely inefficient, since they had no incentive to reduce costs. They estimate that around 40% of the jobs within these utilities before they were privatised were totally unnecessary!

Opponents also argue that the cost of renationalisation could reach £90 bn and hence place a huge burden on the taxpayer. As one spokesman for the water industry put it, "Privatisation has not been perfect, and there is no doubt that the regulatory framework could be tightened to the benefit of the public, but to renationalise water would be a backward step. It would lower water standards and lead to higher costs, which would ultimately be borne by the consumer, either in the form of higher prices or worse, higher taxes!"

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