



Joanna Bale

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## How did our rivers and seas get polluted by sewage?

*Clean water and effective sanitation are essential to human life. Yet every water and waste water company in England and Wales is under criminal investigation – amid allegations of widespread, illegal sewage dumping. Some have already paid out millions of pounds in fines. And the biggest, Thames Water, is on the brink of financial collapse. In this excerpt from an LSE IQ podcast episode, Joanna Bale interviews Gwyn Bevan and Kate Bayliss about how we arrived at this mess.*

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**Joanna Bale:** The story begins with Margaret Thatcher back in 1989 insisting to a rowdy House of Commons that privatising water will be a success. How well was the state-owned water system operating before Mrs Thatcher’s radical programme of privatisation.

**Kate Bayliss:** These regional water authorities were facing financial problems. There was a huge need for investment in the sector...there was considerable pollution.... we needed investment in the water sector, but the government was reluctant to commit more government borrowing or to increase taxes... privatization was happening in other sectors. And so privatization of water came to the fore as a suitable policy. It was supposed to make companies more efficient because of the profit motive, and private companies would then borrow to invest and take the debt off the government’s books. There was a political agenda to create anew class of Conservative voters that would be share owners, because some of the shares were reserved for water company customers. So, water privatization was a deeper cultural shift in the economy.



**Joanna Bale:** Gwyn, you talk about this in your book, about neoliberalism and the radical changes made to public services. Privatisation was supposed to make companies more efficient because of the profit motive, and private companies would then borrow to invest and take the debt off the government's books.

**Gwyn Bevan :** The key idea of neoliberalism at the heart of Margaret Thatcher's governments is that the best form of organising things is private ownership in markets. And she firmly believed that state run enterprises and public services, they lack the incentives for efficiency.

The confidence trick that neoliberalism performed is to persuade people that markets and private ownership are the solution. But there are very stringent conditions where markets work – which is what my book explains...they work really well for simple commodities like bread. We buy it often, it's cheap. You don't write a contract. If quality's terrible, you stop buying it. Failing providers exit the market. And the key thing that makes markets work is competition so failing providers exit. ... the water and sewage companies are classically the exemplar of where markets won't work because you've got a natural monopoly ... vital for life and health.

**Joanna Bale:** Can you just explain "natural monopoly"?

**Gwyn Bevan:** Water comes from one set of reservoirs, through one set of pipes. And if you wanted to have competition, another company would have to develop new reservoirs and a new set of pipes, which would be hugely expensive. That is a natural monopoly. It's unlike say in private markets where a firm manages to achieve a monopolistic position, but actually there are other firms that could easily enter the market.

**Kate Bayliss:** Plus the fact it's water and it's homogenous as water's water. Other than having good quality water, it's not much to define different types of water.

**Joanna Bale:** We all need water and sanitation in our homes. But there is only one company in each region that can provide it. So it's a monopoly business with captive customers. This means there is

no competition – so less incentive to invest in infrastructure and provide the best service. It seems obvious now that this might create problems but did privatization work at first?

**Gwyn Bevan:** In the early 1990s I was working for a firm of economic consultants that was doing really well on the back of consulting for privatization. And they described Ian Byatt, the regulator of Ofwat, as “Chief Executive UK Water PLC”. And it’s felt he had this iron grip on those companies. There were these ground rules for financial probity of those companies – that then disappeared through private equity.

**Joanna Bale:** Can you explain what changed and why?

**Kate Bayliss:** Initially there was a lot of investment...But since privatization, we’ve seen a major change in ownership structures... we have 10 regional water and sewage companies in England and Wales. (we’re not talking about Scotland and Northern Ireland). They had their own separate public companies, initially all listed on the London Stock Exchange, with a dispersed set of shareholders.

**Joanna Bale:** So ordinary people could own shares?

**Kate Bayliss:** Anyone could buy a share...Initially, there was a golden share held by the government until 1994, which was specifically to guard against hostile takeovers.

**Joanna Bale:** What does “golden share” mean?

**Kate Bayliss:** It’s not a controlling share in terms of value, I think it was 15 per cent, but it has properties, which protected against hostile takeovers... that was in place for the first five years. But after that was sold, there was quite a quick process of consolidation ... with shares in some companies all bought by one investor or a consortium of investors.

**Joanna Bale:** The government had prepared the water industry for privatisation by cancelling its debts and injecting cash into it. So, even though it was sold for £7.6 billion, the net proceeds to the Treasury were roughly zero. As small investors sold their shares to cash in their big profits, the water companies were bought up by global enterprises. Who are these big players today?

**BAYLISS:** Now there are 10 big water and sewage companies. Three are still listed on the London Stock Exchange: Severn Trent, United Utilities, and South West Water. Two that are owned by what I call Asian conglomerates. Wessex Water is owned by a Malaysian company called YTL, a sort of family controlled big company with a global portfolio in utilities. And Northumbrian Water is owned by CKI, which is owned by a Hong Kong family-based company, but a huge global company.

Four water and sewage companies are owned by consortia of financial investors. ... pension funds, private equity funds, sovereign wealth funds. This type of investors came together for the specific purposes of buying those companies and have led to financialisation of the water sector. They set up what’s called a special purpose vehicle, SPV. Three are registered in Jersey.

**Joanna Bale:** At the beginning, ordinary people bought shares and then it all changed. So was that always going to happen, do you think? Is that what normally happens with these things? Has that happened with other privatizations?

**Gwyn Bevan:** Yes...that's the trend that happens...The criticism made of Ofwat as a regulator is they assumed that these companies would be looking after their financial balance sheets, therefore they would only pay out dividends if they could afford to do so. And they would also make prudent capital investments. So they would be run the way a normal trading company would. And the point about the securitisation, specialist purpose vehicles is these enterprises are not interested in supplying clean water and doing a good job on sewage in Britain. Their sole purpose is to make as much money as possible for the investors. And you can do that by paying out dividends and running up debt and not investing in pipes or sewage. And so sewage is everywhere in our rivers and seas. From the outside it looks if nothing's changed, but this securitization and financialization has fundamentally undermined regulation.

**BALE:** But why don't the regulators do something about it? What's going on with Ofwat and the Environment Agency?

**BAYLISS:** Companies have financed all investment pretty much through borrowing, pretty much all surplus funds has gone to shareholders. Huge increase in debt. Debt for the whole sector is now over 60 billion, 78 billion has been paid to shareholders since privatization and not enough investment in sewage infrastructure.

But the failings in the environmental side I think are slightly different in that we didn't know. The Environment Agency wasn't doing the audits it should have been, and companies were not reporting. So now we have this criminal investigation that's been going on for two years. So Ofwat and the Environment Agency is looking to see if companies have been deliberately misreporting what they've been doing.

It's been ongoing for some time, because the sewage only really came to light through environmental campaigners and people checking to see.

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## About the author



Joanna Bale is Senior Media Relations Manager at LSE and producer/presenter of the award-winning LSE iQ podcast. She is a former Staff Journalist on The Times and an LSE alumna.



**Gwyn Bevan**

Gwyn Bevan is Emeritus Professor of Policy Analysis in the Department of Management at LSE and author of *How did Britain come to this? A century of systemic failures of governance*. He was Director of the Office for Health Care Performance at the Commission for Health Improvement, which regulated quality of care in the NHS in England and Wales from 2000 to 2004.



**Kate Bayliss**

Kate Bayliss is a Research Associate at SOAS University of London. She has been working on the political economy of essential service provision for over two decades, in the UK and the global South.

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