

12 November 2010

Carole Gardner
Urban Water Inquiry
Productivity Commission
LB2 Collins Street East
MELBOURNE VIC 3165

Dear Ms Gardner,

Productivity Commission Urban Water Inquiry

The Consumer Utilities Advocacy Centre Ltd (CUAC) is an independent consumer advocacy organisation. It was established to ensure the representation of Victorian consumers in policy and regulatory debates on electricity, gas and water. In informing these debates, CUAC monitors grass roots consumer utilities issues with particular regard to low income, disadvantaged and rural consumers.

CUAC welcomes the opportunity to comment on the Productivity Commission's Urban Water Inquiry. CUAC's submission approximately follows the structure of the Commission's Issues Paper, focussing specifically on consumer engagement and consumer impacts. As we have a specific mandate to represent Victorian consumers, our submission draws predominantly on evidence and experiences from this state.

Objectives for the urban water sector

Clarifying and articulating objectives is the logical first step in any policy process and CUAC supports the Commission's approach in this regard. In particular, we welcome the Commission's recognition that reform measures are tools that should be used only where they can reasonably be expected to achieve better overall outcomes for consumers.

Consumer objectives

When considering objectives for the urban water sector, it should be remembered that the urban water system exists to serve consumers. The United Nations (UN) Guidelines for Consumer Protection provide a useful starting point for consideration of consumers' interests and requirements. These UN Guidelines have been 'translated' into the following statements of consumer rights by Consumers International:

1. **The right to satisfaction of basic needs** - To have access to basic, essential goods and services: adequate food, clothing, shelter, health care, education, public utilities, water and sanitation.
2. **The right to safety** - To be protected against products, production processes and services which are hazardous to health or life.
3. **The right to be informed** - To be given the facts needed to make an informed choice, and to be protected against dishonest or misleading advertising and labelling.
4. **The right to choose** - To be able to select from a range of products and services, offered at competitive prices with an assurance of satisfactory quality.
5. **The right to be heard** - To have consumer interests represented in the making and execution of government policy, and in the development of products and services.

6. **The right to redress** - To receive a fair settlement of just claims, including compensation for misrepresentation, shoddy goods or unsatisfactory services.
7. **The right to consumer education** - To acquire knowledge and skills needed to make informed, confident choices about goods and services, while being aware of basic consumer rights and responsibilities and how to act on them.
8. **The right to a healthy environment** - To live and work in an environment which is non-threatening to the well-being of present and future generations.¹

The UN Guidelines are general statements, and there needs to be consideration of how they relate to water in particular. For example, with regard to choice in the water sector, retail competition and choice may not be practical or deliver the most cost-effective services to consumers. Nevertheless, these eight rights offer a useful starting point for identifying consumer objectives in relation to urban water reform. Consideration of these objectives should be integrated into urban water reform policy, planning and implementation.

We welcome the Productivity Commission's recognition, in its Issues Paper, that water and wastewater services are essential services and that ensuring universal and affordable access is an important policy objective.² CUAC sees maintaining universal and affordable access as the most important objective in urban water. It is a government responsibility to provide a policy framework which ensures that no Australian is left without access to water – or encouraged to use unsafe levels of water – because of financial hardship.

In discussion of access to water, reference is often made to a 'minimum acceptable' or 'essential' level of access. This distinction recognises that consumers are not entitled to an unlimited or excessive supply of water. CUAC recognises the limits to consumers' entitlement to water, but we also see a need for some caution when distinguishing between essential and discretionary water use. This distinction is not as straightforward as it may first appear. Individuals' different circumstances (such as family size, medical needs, and climate) mean that the amount of water necessary to meet basic needs varies. One implication of this is that it is difficult to specify an 'essential' or minimum volume of water (above which use could be considered discretionary) to apply to all consumers.

Moreover, in a highly developed country like Australia, a level of water use beyond that needed to meet basic survival needs is necessary to social participation and inclusion. CUAC believes that all consumers should have this level of access to water. This means that a minimum universal level of access to water in Australia might include provision for uses that could be considered discretionary in other contexts.

Economic efficiency and consumer interests

The inquiry's Terms of Reference require the Commission to investigate urban water reform options with a primary focus on economic efficiency. CUAC believes that increasing economic efficiency is an important goal of consumer policy. This argument is put well in a 2006 Consumer Affairs Victoria research paper:

[Consumer] policy should in the first instance be directed to an economically efficient allocation of resources. The question to ask of any policy decision is "Will this transaction or change make somebody better off while making no one worse off?"... Economic efficiency maximises the total wealth in our community for distribution which is undeniably a good thing...³

The special characteristics of water (as an essential service, a network-based utility and crucial environmental resource) mean that economic efficiency is not always the overriding objective, nor is it straightforward to

¹ Consumers International, 'How are consumer rights defined?', on the *Consumers International* website <http://www.consumersinternational.org/Templates/Internal.asp?NodeID=95043>.

² Productivity Commission (2010) *Australia's Urban Water Sector: Productivity Commission Issues Paper*, Melbourne: Productivity Commission, 26.

³ Consumer Affairs Victoria (2006) *Consumer Advocacy in Victoria*, Research Paper No. 7, Melbourne: State of Victoria, 7.

achieve. Nevertheless, increased economic efficiency in the urban water sector can be expected to benefit consumers through lower prices and improved service.

Although efficiency improvements are generally in the interests of consumers, efficiency objectives sometimes conflict with other goals. For example, the objective of maintaining universal access to water may conflict with the requirements of allocative efficiency. As defined by the Productivity Commission in its Issues Paper:

Allocative efficiency requires that the set of goods and services produced from the available resources is the set that maximises value to consumers.⁴

We interpret the Commission's reference to 'value' as referring to economic value – in other words, the worth of a good or service as determined by the market. The difficulty here is that when considered in this sense, a high value use of water will not always align with desirable outcomes. To offer a hypothetical example, a person in need of the use of water for life-saving dialysis but on a very low income could, in economic terms, represent a lower value use of water than a wealthy consumer who is willing (and able) to pay a high price to fill their swimming pool. Clearly, though, the former use of water is more 'valuable' in the general sense of the word.

Where economic efficiency and other objectives do not align neatly, value judgements are required. CUAC sees these points as areas where consumer and community engagement are particularly necessary and useful. Consumer engagement in decision-making is discussed in more detail later in this submission.

Supply

Supply augmentation planning and decision making

As discussed above, regardless of the mechanisms in place for the delivery of water and sewerage services, it is government that retains ultimate accountability for ensuring that all consumers have access to safe and sufficient water. In CUAC's view, therefore, governments must continue to play the central role in providing a policy framework for supply augmentation planning and decision making. CUAC also sees a need for government to educate consumers and communities in supply options and engage consumers in decision-making on supply augmentation and water security.

Greater involvement of consumers in this area of government policy has the potential to improve reform outcomes. The potential for participation to improve reform outcomes has been demonstrated in research, with reviews in France, the United Kingdom and the United States finding that including community knowledge, values and preferences helps in identifying issues and formulating policies for water management planning.⁵

Decisions about water supply security are not solely technological or economic questions, but involve 'values, objective-setting processes, and complex trade-offs'.⁶ The impacts of such decisions are varied, difficult to compare, and in many areas, unquantifiable. Because of this, such decisions cannot be made on scientific, engineering or economic grounds alone, but should include deliberative processes that 'elucidate the preferences, values and choices of citizens who are able to have access to information and to engage in questioning of experts and dialogue with each other in a well-facilitated process.'⁷

⁴ Productivity Commission (2010) *Australia's Urban Water Sector: Productivity Commission Issues Paper*, Melbourne: Productivity Commission, 13.

⁵ Mackenzie, John (2008) 'Watered Down: The Role of Public Participation in Australian Water Governance', *Social Alternatives* 27(3) p. 9.

⁶ White, Stuart, Kate Noble and Joanne Chong, 'Reform, Risk and Reality: Challenges and Opportunities for Australian Urban Water Management', *Australian Economic Review* 41 (4) p. 433.

⁷ White, Stuart, Kate Noble and Joanne Chong, 'Reform, Risk and Reality: Challenges and Opportunities for Australian Urban Water Management', *Australian Economic Review* 41 (4) p. 433.

Where such processes are in place, consumers and communities have the capacity to provide high-quality input. Reviewing research into community views on water allocation matters, Syme and Hatfield-Dodds find that there is 'systematic evidence' that communities can apply traditional philosophical, economic and sociological approaches (expressed in lay language) to decision-making. There have also been demonstrations of communities making reasoned preferences and trade-offs in water decision-making.⁸

The Commission's Issues Paper notes that the 'cost of an urban water system that could be guaranteed to always meet water demand without the need for price increases or non-price restrictions during periods of relative scarcity will generally be much higher than one that relies on price increases or restrictions some of the time.' The Commission suggests that while preferences vary, most consumers would choose a lower-cost level of security with some degree of rationing over a 'Rolls Royce' water supply.⁹

CUAC agrees with this assessment. Victorian experience suggests that many supply augmentation decisions are controversial. Victoria has recently seen substantial investment in supply augmentation through the Victorian Desalination Project. This project has encountered considerable community opposition, perhaps indicating that many consumers consider the level of water security that will be provided via the plant to be excessive given the costs. The potential for supply augmentation projects to generate such opposition highlights the importance of comprehensive community engagement.

When considering supply augmentation, and engaging consumers in this process, it is crucially important that all augmentation options are considered alongside each other. In this way, the costs and benefits (economic, social and environmental) of each option can be evaluated comparatively. Such an approach is likely to create a broader support base for the option/s chosen, making reform measures less vulnerable. Greater efforts to build consumers' 'water literacy' and 'bring along' consumers and communities in reform processes might also facilitate broader consideration of supply augmentation options, including increased recycling and stormwater re-use.

Water treatment, transport and distribution and wastewater services

CUAC agrees with the Productivity Commission's suggestion that the inquiry should give considerable attention to examining potential efficiency gains in the water treatment, transport and distribution and wastewater services. In many parts of Victoria, these costs make up a large proportion of average household bills. For example, for a household in Gippsland consuming 165kL in 2010-11, fixed sewerage charges will account for more than half of total charges.¹⁰

Consumption and pricing

Pricing principles and objectives

The Productivity Commission's Issues Paper considers a number of objectives that policymakers may have for pricing:

- Enabling universal access and affordability for consumers
- Encouraging the use of water and wastewater services by users who value them most highly and in uses that are most highly valued (allocative efficiency)

⁸ Syme, Geoffrey J and Steve Hatfield-Dodds (2007) 'The role of communication and attitudes research in the evolution of effective resource management arrangements' in *Managing Water for Australia: the Social and Institutional Challenges*, eds Karen Hussey and Stephen Dovers, Collingwood: CSIRO Publishing, 12-13.

⁹ Productivity Commission (2010) *Australia's Urban Water Sector: Productivity Commission Issues Paper*, Melbourne: Productivity Commission, 18.

¹⁰ Essential Services Commission (2010) *Gippsland Water 2010-11 Tariff Schedule*, Melbourne: ESC.

- Providing appropriate signals for investment in infrastructure that delivers water and wastewater service capacity, reliability and quality (dynamic efficiency)
- Recovering costs and providing water utilities with sufficient revenue to be financially sustainable
- Ensuring that pricing is transparent, flexible and administratively simple.¹¹

CUAC welcomes the Commission's acknowledgement of the multiple objectives that can underpin pricing decisions, particularly its inclusion of the aim of ensuring universal access. We note, however, the omission of a reference to sustainability objectives, important from both an environmental perspective and with a view to intergenerational equity.

In relation to the pricing principles, CUAC recommends to the Commission the Victorian example. The regulatory principles that the ESC must have regard to in relation to pricing are set out in section 14 of the *Water Industry Regulatory Order 2003*. According to the WIRO, prices should:

- provide a sustainable revenue;
- allow recovery of a range of specified costs;
- provide incentives for sustainable water use;
- take into account the interests of customers, including low income and vulnerable customers;
- provide incentives for water businesses to pursue efficiency improvements and promote sustainability; and
- enable customers to readily understand charges, or the manner in which prices are calculated.¹²

In the main, we believe that the WIRO appropriately balances the interests of consumers, including low income and vulnerable consumers, with other objectives. We note, however, that the WIRO principles do not take full account of the economic benefits to consumers of water efficiency improvements.

Water restrictions

Water restrictions, both temporary and permanent, are important demand management tools for water policymakers. As restrictions vary markedly in terms of their severity, duration, recurrence interval, and trigger points, they have differing impacts.

CUAC is aware of strong opposition to the use of restrictions (particularly long-term temporary and permanent restrictions) in parts of the water sector. Many economists argue that water restrictions prevent allocation on the basis of marginal willingness to pay and are therefore inefficient comparative to pricing approaches.¹³ This view is shared by some important stakeholders. For example, in a 2006 report the Business Council of Australia argued that restrictions were mostly 'inappropriate, particularly on a continuing basis' and should be replaced with water markets in which 'prices settle where they will once consumers decide how much they wish to consumer at prices that bring forward various increments of new supply'.¹⁴

It is also a reasonably common view amongst decision-makers that water restrictions are inappropriate and costly, and that they unjustifiably limit flexibility for water consumers. For example, in a 2008 position statement the National Water Commission stated that it 'regards long-term temporary water restrictions as an inequitable and inefficient way of balancing supply and demand'.¹⁵

¹¹ Productivity Commission (2010) *Australia's Urban Water Sector: Productivity Commission Issues Paper*, Melbourne: Productivity Commission, 23.

¹² *Water Industry Regulatory Order 2003 (Victoria)*, as amended as at 25 October 2005.

¹³ Gerard O'Dea and Jennie Cooper (2008) *Water scarcity: Does it exist and can price help solve the problem?* Water – Working Paper, Sydney: IPART, 10.

¹⁴ Business Council of Australia (2006) *Water Under Pressure: Australia's man-made water scarcity and how to fix it*, Melbourne: BCA, 21.

¹⁵ Australian Government National Water Commission (2008) *Urban Water Pricing: National Water Commission Position, position statement* 2 July 2008, 1.

Despite this opposition, research suggests that restrictions have some important advantages. The Review of Water Restrictions conducted for the National Water Commission in 2007 found that restrictions have been effective in reducing water demand, with estimated savings of between 8 and 33 per cent across different restriction scenarios.¹⁶ Victoria has seen substantial reductions in per capita water use as a result of restrictions combined with consumer education and related behaviour changes. Across Australia, utilities and government agencies responsible for implementing restrictions have emphasised that education, awareness-raising and promotion are central to achieving water savings through restrictions.¹⁷ The report authors suggested that overall, restrictions helped to lower the probability that costly decisions about supply augmentation are needed.

Restrictions also appear to enjoy widespread community support,¹⁸ reflecting positive attitudes towards water conservation more broadly. A recent review of the research literature on community attitudes towards water conservation reveals fairly strong support for conservation across a number of studies. One of the largest, a 2005 survey of 3,500 residents in five Australian cities, investigated attitudes towards water conservation, finding that 93 per cent of respondents agreed that water must be carefully conserved. Interestingly, 94 per cent of respondents believed that water should be saved all the time, not only in times of drought.¹⁹

Community attitude surveys typically show popular acceptance of water restrictions. For example, a survey by IPART in 2003 found that around 63 per cent of people were willing to have water restrictions once each year. A later survey in 2007 found that 80 per cent of participants were in 'total support' of the restrictions in place in Sydney at that time, and nearly 70 per cent 'were in total support of restrictions remaining in place for the foreseeable future'.²⁰

Reviewing the findings of such community attitude surveys, the NWC review of restrictions suggested that while they generally show significant support, carefully designed and applied 'willingness to pay' surveys would provide better evidence on community preferences 'regarding the trade-offs between restrictions and other possible options'.²¹ CUAC agrees with this assessment and supports ongoing work to tease out community views on different types of water restriction as well as alternatives to restrictions.

Given their effectiveness and the community backing they enjoy, CUAC supports the use of restrictions (temporary and permanent) where these are carefully planned and implemented. Recognising that restrictions can impose costs on consumers (residential and non-residential), we believe that temporary and permanent restrictions should be designed taking into account appropriate local community and consumer consultation. The authors of the NWC review of water restrictions argue:

[There] is also emerging evidence that key decisions about resource allocation best reflect society's values when the community themselves are involved in the decision-making processes – such as through deliberative processes. Following the recent, extensive restrictions, there will be a timely opportunity to ensure that there is adequate community engagement in relation to restrictions and also more generally regarding decisions between different drought response and system security options.²²

¹⁶ Chong, Joanne, Jade Herriman, Stuart White and David Campbell, *Review of Water Restrictions*, Volume 1 – Review and Analysis, Final Report for National Water Commission, Sydney: Institute for Sustainable Futures and ACIL Tasman Pty Ltd, vii, viii.

¹⁷ Chong, Joanne, Jade Herriman, Stuart White and David Campbell, *Review of Water Restrictions*, Volume 1 – Review and Analysis, Final Report for National Water Commission, Sydney: Institute for Sustainable Futures and ACIL Tasman Pty Ltd, vi.

¹⁸ Gerard O'Dea and Jennie Cooper (2008) Water scarcity: Does it exist and can price help solve the problem? Water – Working Paper, Sydney: IPART, 10.

¹⁹ Sara Dolnicar and A Hurliman (2010) 'Australians' Water Conservation Behaviours and Attitudes' Australian Journal of Water Resources 14(1): 43-53.

²⁰ Gerard O'Dea and Jennie Cooper (2008) Water scarcity: Does it exist and can price help solve the problem? Water – Working Paper, Sydney: IPART, 11.

²¹ Chong, Joanne, Jade Herriman, Stuart White and David Campbell, *Review of Water Restrictions*, Volume 1 – Review and Analysis, Final Report for National Water Commission, Sydney: Institute for Sustainable Futures and ACIL Tasman Pty Ltd, ix.

²² Chong, Joanne, Jade Herriman, Stuart White and David Campbell, *Review of Water Restrictions*, Volume 1 – Review and Analysis, Final Report for National Water Commission, Sydney: Institute for Sustainable Futures and ACIL Tasman Pty Ltd, xi-xii.

Case studies included in the review of restrictions appear to support the contention that consulting residential and business consumers about the types of restrictions to be employed contributes to better outcomes.²³

CUAC acknowledges that restrictions need to be designed carefully as they are, by their nature, a fairly blunt instrument. Restriction design should also draw on the best available evidence on the costs and benefits of specific restriction types (e.g. bans on specific uses, measures promoting water-use efficiency, etc.) CUAC sees a need for ongoing analysis of these costs and benefits to enhance the evidence base for policymaking.

Scarcity pricing

As an alternative to restrictions, it is often suggested that price should be used to manage demand and improve efficiency. Scarcity pricing, where price reflects the scarcity value of water as supply varies, is one such reform often proposed in urban water policy debates. Proponents suggest that scarcity pricing would help to balance supply and demand, obviate the need for restrictions, and potentially encourage new sources of supply.²⁴

CUAC is strongly opposed to the introduction of scarcity pricing for residential water consumers. Given that water restrictions are effective in reducing demand, enjoy wide community acceptance, and can be designed in consultation with consumers to minimise costs, we do not see the avoidance of restrictions as a high priority. That being the case, our concerns about scarcity pricing primarily relate to the distributional effects of scarcity pricing and its potential to undermine universal access.

As acknowledged in the Commission's Issues Paper, while estimates vary somewhat, water is an essential and non-substitutable good and therefore has a low Price Elasticity of Demand (PED).²⁵ PED tends to increase as the percentage of income that the good or service's price represents increases. In other words, elasticity would almost certainly be higher for consumers on low incomes, while the cost of overuse may still be negligible in relation to overall household budgets for consumers on high incomes. Given this, scarcity pricing may shift the burden of reducing demand from all consumers (as is broadly the case under restrictions) to those with less capacity to pay for water.

It should be obvious that price is relevant to the issue of access to water. If the price of water is too high, this will impact on consumers' ability to maintain an appropriate level of access to water. This dynamic is more likely to impact on low-income consumers. High prices for essential services can also impact on low-income households by reducing the money available for other essentials.

Proponents of scarcity pricing and similar reforms often dismiss concerns about equity and social impacts, arguing that they are properly addressed in social policy, not through pricing. This quote from the Business Council of Australia is illustrative:

It is also important to stress that there should be few equity concerns here. First, Governments generally do not specifically subsidise food for low-income earners, instead preferring to rely on general income distribution mechanisms (such as social security). Second, Governments do choose to provide rent subsidies for low-income earners, but they do so in ways that no longer distort the operation of markets... Either of these precedents can be followed with water.²⁶

CUAC sees such statements as a wholly inadequate response to the critical issues of equity and access and their relationship to pricing. While it may be the case that affordability is better addressed through social

²³ Chong, Joanne, Jade Herriman, Stuart White and David Campbell, *Review of Water Restrictions*, Volume 1 – Review and Analysis, Final Report for National Water Commission, Sydney: Institute for Sustainable Futures and ACIL Tasman Pty Ltd.

²⁴ Grafton and Kompas cited in O'Dea, Gerard and Jennie Cooper (2008) *Water scarcity: Does it exist and can price help solve the problem?* Water – Working Paper, Sydney: IPART, 12.

²⁵ Productivity Commission (2010) *Australia's Urban Water Sector: Productivity Commission Issues Paper*, Melbourne: Productivity Commission, 26.

²⁶ Business Council of Australia (2006) *Water Under Pressure: Australia's man-made water scarcity and how to fix it*, Melbourne: BCA, 22.

policy measures (such as concessions, income support, and so on) than through pricing, it cannot simply be assumed that affordability will be ‘taken care of’ somewhere else in the policy process when pricing decisions are made. This approach leaves affordability vulnerable to slipping off the agenda.

Lessons from Victoria’s smart electricity meter roll-out

As discussed, CUAC is opposed to scarcity pricing. If scarcity pricing were to be introduced, however, detailed analysis of the consumer impacts, and the design of measures to address these impacts, must be undertaken *as a part of* the scarcity pricing planning and implementation process. For example, consumer representatives and social welfare agencies would need to be consulted about the likely impacts for different consumer groups. Potential assistance measures such as progressive scarcity pricing (ie. exemptions for some disadvantaged consumers, or an initial allowance at a lower price)²⁷, changes to concessions frameworks, improvements to water businesses’ hardship programs, consumer information and education, water efficiency retrofitting and so on should be identified, evaluated and put in place. Clearly, this process requires a whole-of-government approach to reform.

Recent Victorian experience with the government-mandated roll-out of smart electricity meters and introduction of time-of-use pricing is pertinent to this point. The roll-out of electricity smart meters began in late 2009 following some years of planning led by the Advanced Metering Infrastructure Industry Steering Group (AMIISC). As the sole consumer representative on the AMIISC, CUAC initially found it difficult to have concerns about the roll-out heard or addressed, due in part to the Committee’s limited terms of reference and focus on network operational challenges. Our concerns at that time centered on the lack of clarity about the policy framework and the roles and obligations of the government, regulators and industry in ensuring consumers benefitted from the roll-out. We argued for a comprehensive information and education campaign to prepare consumers for the significant changes ahead. Unfortunately, this did not occur. Consumers began to receive and pay for smart meters without a clear explanation of the purpose and impacts of the roll-out. This led to misinformation, inaccuracy and community fear about meter cost and impacts. Consumers lacked information about the time-of-use pricing that would be facilitated by the roll-out, and the likely impacts of time-of-use pricing for different consumer groups had not been examined in detail.

Concerns mounted and in February 2010, the Victorian government announced a moratorium on the mandatory reassignment of time-of-use pricing while policy and regulatory issues and equity impacts were examined. A new governance structure was developed, providing direct access for consumer advocates to identify policy issues with the Minister. A customer impact study has been commissioned to examine the impacts of time-of-use prices on different customer profiles. This will form the basis for a review of time-of-use tariff options, the concessions framework, the customer protection framework and information and education needs. CUAC has welcomed these initiatives and is heavily engaged in these processes. Clearly, however, a smoother roll-out of smart meters could have been achieved had consideration of consumer impacts begun far earlier in the process. This learning from Victoria’s smart meter roll-out should inform any introduction of water scarcity pricing or similar pricing reforms. CUAC is aware that price mechanisms may contribute to equitable outcomes and behavioural change, and while not supporting the introduction of scarcity pricing we do not necessarily oppose other carefully planned pricing changes.

Postage stamp pricing

CUAC also has some concerns about the social equity implications of removing postage stamp pricing in areas where it currently exists. The difficulty here is that water is often more expensive to supply in areas that also have a concentration of people on low incomes. In Victoria, for example, consumers in non-metropolitan areas and (and in some state’s most socio-economically disadvantaged regions, such as Gippsland) tend to pay

²⁷ Various such scenarios are discussed in the IPART working paper cited elsewhere.

higher prices for water and sewerage services. When postage stamp pricing is removed, measures should be put in place to ensure continuing universal access where prices rise significantly.

Water pricing for tenants

Bringing tenants into ‘a transparent water charging environment’, as was recommended in the 2009 Biennial Assessment of Progress under the NWI,²⁸ may have merit, but decisions on this issue must take consumer impacts into account. Victorian tenants currently pay water usage charges, while property owners remain responsible for service availability charges. Tenants are more likely than owner-occupiers to be on low incomes. At a time of substantial price increases, transferring service charges to tenants could exacerbate many tenants’ financial difficulties in paying their water bills.

In Victoria, transferring these charges to tenants would also impact on Victorian Government concessions. Presently, eligible Victorian consumers are able to access a 50% discount on water and sewerage charges, capped at a maximum of \$245 p.a. in 2010-2011. In 2008-09, 669,000 households (32% of Victorian households) claimed the concession at an average amount of \$155. Were tenants to be liable for all water charges, the average concession amount would increase, and the 50 percent figure would become largely notional (as the maximum concession amount of \$245 would cover less than 50% of annual charges for most households). Examination of impacts such as these must form a part of policy decisions on water pricing.

Tariff structure innovation

Victorian water businesses are currently considering a range of tariff options for water consumers, including “green” tariffs, flexible and capped tariffs, changes to existing inclining block structures and so on. While not opposing innovation in pricing and tariff structures, CUAC notes that consumers and their representatives have not yet had the opportunity to give detailed consideration to these options.

Competition and contestability

CUAC welcomes the Productivity Commission’s recognition that competition or contestability can improve efficiency, but that such reforms also come with associated costs and are not the only reform options for increasing efficiency. We support an approach to competition/contestability reforms that compares the expected costs and benefits (economic, social and environmental) on the basis of the best available evidence. At the same time, the costs and benefits of alternative measures (such as the Victorian reforms discussed below) should also be considered and compared to those of competition-based reforms.

Third party access

With regard to competition and contestability in the urban water sector specifically, CUAC notes that proposed reforms often have few or no precedents either in Australia or internationally. This makes an evidence-based approach particularly difficult. For example, in 2009 the ESC conducted an inquiry into an access regime for water and sewerage infrastructure services. At that time, we highlighted the paucity of evidence about the consumer (and other) impacts of such a regime. Within Australia, the examples are limited to the New South Wales, which to date has not seen any applications for access under its certified regime.²⁹ With such limited examples in Australia (or, indeed, overseas), a full appraisal of consumer impacts is not possible. In accordance with our earlier comments on approaches to urban water reform, we would therefore suggest a gradual and cautious approach to any such reform.

²⁸ National Water Commission (2009) *Australian Water Reform 2009: Second biennial assessment of progress in Implementation of the National Water Initiative* Canberra: Commonwealth of Australia, p. 160.

²⁹ Although we note that differences between the New South Wales and Victorian water grids may mean that outcomes are substantially different in Victoria.

Retail competition

CUAC recognises the consumer benefits of competition in most markets. However, it is not certain that retail competition in the urban water sector would deliver benefits that outweigh the substantial costs of establishment. There are a number of issues to consider here, and experience in the energy sector is again relevant.

First, one problem associated with increasing retail competition in the water sector relates to the existing market power of government owned water utilities. Monopoly water businesses have significant market power and, in some cases, brand recognition. It is difficult to design appropriate methods to expose these businesses to competition given the significant market barriers that would confront new entrants trying to displace the established position of existing players. The same issue has confronted the energy industry. Despite efforts to promote competition, the market power of the existing participants at the time of privatisation remains substantial. Efforts to encourage competition have been partially successful, but there is some evidence that the companies formed as a result of privatisation with their large customer bases are once again increasing their market share. This could be a result of potential competitors finding the barriers to entry and to consolidation of their market position to be difficult to surmount.

A further difficulty relates to consumer choice and decision-making. While Victoria's energy market is reputedly the most competitive in the world, CUAC's work with community groups and consumers suggests that many Victorian consumers have difficulty making informed choices in the retail energy market. In many cases, consumers are unaware that choice exists, or do not know how to make a choice and find useful information to support decision-making. Consumers who are aware that they can choose their retailer are often confused by the information and offers available, and therefore incur significant search costs. Our work in this area provides an illustration of how consumers can make poor choices when overwhelmed with choice and information – a contention that is supported by a growing number of studies in the field of behavioural economics and by similar experience in other regulated industries such as banking, telecommunications, insurance and superannuation.

On this basis, CUAC again suggests a cautious approach to competition-based reforms in urban water. The benefits of moving to competitive system would have to be judged to be very large in order to overcome some of the substantial costs associated with creating a competitive market for this basic, homogenous and essential good.

Reform tools, options and implementation

Case for reform

CUAC supports reform measures in the water sector which deliver consumer benefits and where adequate consumer protections are in place. At the same time, we believe that water's unique characteristics and its central importance for public health mean that reform needs to be approached with particular care.

Water reform options should be subject to careful and comprehensive analysis prior to implementation. We recommend an approach to reform which is informed by research, including lessons learnt in other jurisdictions, and analysis of the benefits and potential disadvantages of the different components of reform measures. Given that water differs in some important ways from other network-based utilities, we believe that that examination of costs and benefits of reform proposals should ideally draw primarily on evidence from the water sector itself. When it draws on evidence from other sectors, such as energy, analysis should also address any likely implications of sectoral differences. In general, CUAC supports a gradual, step-by-step approach to reform in the water sector. Such an approach will allow for consumer and other impacts to be anticipated, identified and, where necessary, addressed.

Consumer input into urban water governance at the national level

The Commission's Issues Paper invites comment on the strengths and weaknesses of current urban water governance and institutional arrangements.³⁰ CUAC believes that there are major weaknesses in water governance and institutions at the national level. In particular, we are concerned about the lack of consumer input and engagement and lack of capacity in relation to the social dimensions of urban water reform.

A key mechanism facilitating stakeholder engagement in urban water reform at the national level is the use of four stakeholder panels which provide input on programs and planning, including the Urban Water Stakeholder Reference Panel (UWSRP). CUAC is the sole consumer representative on this panel. This is problematic firstly because of the limited opportunity for consumer input when only one representative is involved. Secondly, as a Victorian organisation, CUAC does not have the mandate (or knowledge of conditions elsewhere) to represent consumers in other jurisdictions on this national panel.

There needs to be thought given to increasing and improving mechanisms for consumer input into national urban water reform processes. An improved model for consumer consultation and engagement would include consumer representatives from different states and representing the range of consumer types (e.g. low-income, regional and small business consumers) so that consumer input reflects the range of circumstances of Australian water consumers.

Professional consumer advocacy

There is an immediate need for a stronger consumer voice in national water reform processes. Effective professional consumer advocacy is an important means through which this can be achieved. Unfortunately, consumer advocacy in this area is currently constrained by a lack of resources. Compared to the energy sector, consumer advocacy in water is less vigorous and under-resourced. For example, consumer advocates in the energy sector can access capacity-building and advocacy funding through the *Consumer Advocacy Panel*, which has no equivalent in the water sector.

Consumer advocates require detailed and specific knowledge to contribute effectively to policy development processes. As professional consumer advocacy in water is currently under-developed, consumer advocates require financial support to build capacity and expertise. There may also be a need for funding to assist in the facilitation of consumer consultation, as government and regulators sometimes lack the skills base or relationships to consult with consumers directly.

Building knowledge and capacity in the social dimensions of water reform

The Australian Government through its *Water for the Future* strategy has established and provided funding to National Centres of Excellence in Desalination and Water Recycling. These Centres contribute to the knowledge and capacity-building objectives of the National Water Initiative by facilitating and providing leadership in research.³¹

Social considerations and consumer issues need to be given a similarly high profile in the urban water sector. CUAC has therefore advocated for the creation of a National Centre of Excellence in Water and Society. The Centre would provide national and international leadership in research on water consumer rights, experiences and preferences, consumer and community engagement models, and the social dimensions of water policy. As a significant and growing amount of urban water reform activity is taking place at the national level, this needs

³⁰ Productivity Commission (2010) *Australia's Urban Water Sector: Productivity Commission Issues Paper*, Melbourne: Productivity Commission, 33, 34.

³¹ Australian Government Department of Sustainability, Environment, Water, Population and Communities, 'National Centres of Excellence' on the SEWPAC website at <http://www.environment.gov.au/water/policy-programs/urban-water-desalination/centres-of-excellence.html>

to be accompanied by improved knowledge and capacity nationally. Focusing systematically on development of the social research base for water reform, such a Centre could play a major role in reversing the current lack of capacity in this area.

Victorian urban water governance and regulation

In the main, CUAC believes that current governance and regulatory arrangements in Victoria adequately serve urban water consumers.

Prior reforms

Victoria's urban water sector has already undergone substantial reform over a number of years. Vertical disaggregation and corporatisation has driven efficiency improvements, while ownership has remained with the state government.³² Victoria's government-owned water businesses are expected to be economically efficient and commercially viable. Public performance reporting on a range of measures including affordability, assistance to customers experiencing hardship, water supply reliability, restrictions and legal actions helps to promote 'competition by comparison'.³³

Victoria's urban water sector now includes examples of best practice service delivery. Victorian water consumers, particularly within metropolitan Melbourne, currently enjoy good water service delivery as well as relatively strong consumer protections. This is the result of many years of work by government, regulators, water businesses and consumer representatives. In Victoria, the independent regulator, the Essential Services Commission (ESC), has recognised the importance of balancing the interests of consumers and water businesses.

CUAC believes that combination of government ownership and corporatisation in Victoria's urban water sector has facilitated efficiency improvements while also allowing for social and environmental objectives to be pursued. While it is not possible to show a causal link, Energy and Water Ombudsman (Victoria) (EWOV) reporting consistently shows that consumer complaints in relation to water are very low compared to complaint levels in the privatised energy sector.³⁴ Contrastingly, privatisation of the water sector in the UK has coincided with an increase in consumer complaints.³⁵

The Victorian example illustrates the potential for the reform to proceed concurrently with the strengthening of consumer protections and engagement of consumers. It also shows that in other jurisdictions, efficiency improvements may be possible through reforms similar to those made in Victoria (rather than through more radical changes such as, for example, introduction of a third party access regime).

Further improvements

While broadly supportive of Victoria's current governance and regulatory arrangements, CUAC recognises that improvements are needed in some areas. There is scope for, among other things:

- increasing and improving consumer engagement in price determination processes;
- enhancing performance reporting so that it is more timely and easily interpreted (as the ESC is presently attempting);
- lifting the performance of some poorer-performing regional-urban water businesses, particularly in relation to hardship.

³² Martin, Narelle (2004) 'Corporatization as a means of improving water quality: The experience in Victoria, Australia' in *Journal of Toxicology and Environmental Health*, Part A, 67:20.

³³ See Essential Services Commission (2010) *Performance of Urban Water and Sewerage Businesses 2008-09*, Melbourne: ESC.

³⁴ See, for example Energy and Water Ombudsman (Victoria) (2009) 2009 Annual Report, Melbourne: EWOV.

³⁵ BBC 2008, *Record complaints to water firms*, <http://news.bbc.co.uk/2/hi/business/7604644.stm>

CUAC believes that such improvements can be pursued within current regulatory and governance arrangements, while drastic governance or regulatory change may actually hinder this process.

CUAC would welcome the opportunity to present to a public hearing in Melbourne should the Commission wish to discuss any of the issues raised in this submission.

Yours sincerely

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