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Urban Water Inquiry  
Productivity Commission  
LB2 Collins Street East  
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### **CUAC submission to Productivity Commission Urban Water Inquiry – Draft Report**

The Consumer Utilities Advocacy Centre (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 grassroots consumer utilities issues with particular regard to low income, disadvantaged and rural consumers.

CUAC previously made a submission to the Productivity Commission's Urban Water inquiry. We would like to provide further comment in light of the Commission's Draft Report.

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## **Chapter 3 – Objectives for the urban water sector**

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As noted in our earlier submission, we agree with the Commission's view that clear objectives for the urban water sector are needed. We would like to reiterate our view that the urban water sector exists to serve consumers, and that maintaining universal and affordable access is the most important objective in urban water.

In the main, we agree with the supply security, access, public health, environmental and amenity objectives outlined in the draft report. We would like to add further comment on some of the Commission's draft findings with regard to objectives.

### **Water security and reliability at least expected cost**

In principle, CUAC agrees that "achieving water security at least expected cost" is a key objective for the sector. We also acknowledge the strengths of the "without risk aversion" approach to this. At the same time, CUAC recognises that Australia's political system means that other factors will continue to influence urban water policy decision-making, such that a strict

approach to achieving water security at least expected cost without risk aversion is unlikely to be followed at all times.

### **Universal and affordable access**

CUAC is pleased that the Productivity Commission has recognised that ‘water provision and wastewater provision are essential services important for public health’ and that ‘universal and affordable access... should be a government objective.’ We also recognise that, as the Commission notes, affordability rests not only on water prices, but is also related to social security and taxation systems and other prices in the economy.

While policymakers may decide to address universal and affordable access partly or wholly through mechanisms outside of the sector itself, it remains important that the objective is kept front of mind. The urban water sector needs to maintain awareness of whether affordability and access is being achieved through, for example, the tax and transfer system. If it is not (as is the case currently), affordability will need to be addressed within the sector, even although this may not be optimally efficient. Achieving affordability and access also requires information-sharing across policy areas. We have made further comment on achieving universal and affordable access on pages 12-19 of this submission.

### **Economic efficiency as an overarching objective**

The Commission has argued that, defined broadly to include non-monetary costs and benefits, ‘economic efficiency provides a framework for making ... tradeoffs in a way that produces the best overall outcomes for the community’. CUAC agrees that efficiency is important and that, in theory at least, it can incorporate broader costs and benefits (such as those relating to environmental sustainability).

We also welcome the draft report’s acknowledgement that economic efficiency does not encapsulate social equity objectives, and that the two objectives will conflict at times. When this occurs, and when affordability and other distributional impacts are not adequately addressed in other policy areas, CUAC believes that some efficiency sacrifices in the urban water sector may be necessary.

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## **Chapter 4 – The role of governments**

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In CUAC’s firm view, governments are ultimately responsible for ensuring access to water and must retain accountability for this. We therefore support draft finding 4.1 that:

*It is the role of governments (elected representatives) to:*

- *set objectives for policy development for urban water and relevant objectives for each agency*
- *develop policy frameworks and principles in relation to public health, the environment and service delivery that are consistent with these objectives*
- *define property rights for water*
- *put in place institutional and governance arrangements for:*

- public health, environmental and economic regulation relating to water
- service delivery of potable water, non-potable water, wastewater and stormwater services.

CUAC also believes that governments should remain responsible for water supply augmentation decision-making, as discussed on pages 4-5 of this submission.

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## Chapter 5 – Improving regulation of the urban water sector

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The Commission's draft report examines the costs of regulation and includes draft recommendation that:

*Urban water sector regulators should rigorously apply the six principles of good regulatory practice spelt out by the Regulation Taskforce in 2006.*

These principles are:

- *Governments should not act to address 'problems' until a case for action has been clearly established:*
  - *This should include establishing the nature of the problem and why action additional to existing measures are needed, recognising that not all 'problems' will justify (additional) government action.*
- *A range of feasible policy options — including self-regulatory and co-regulatory approaches — need to be identified and their benefits and costs, including compliance costs, assessed within an appropriate framework.*
- *Only the option that generates the greatest net benefit for the community, taking into account all the impacts, should be adopted.*
- *Effective guidance should be provided to relevant regulators and regulated parties in order to ensure that the policy intent of the regulation is clear, as well as the expected compliance requirements.*
- *Mechanisms are needed to ensure that regulation remains relevant and effective over time.*
- *There needs to be effective consultation with regulated parties at all stages of the regulatory cycle.*

While CUAC broadly supports the aim of minimising the costs of regulation where this can be done without compromising its effectiveness, we view these principles as insufficient. Particularly in the essential services, CUAC sees a need for a strong regulatory framework which includes, importantly, monitoring, enforcement and compliance. The Regulation Taskforce principles make no reference to these functions (except in terms of compliance costs). We also note that while the principles highlight the need for 'effective consultation with regulated parties', they make no mention of consultation with other crucial stakeholders such as consumers.

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## Chapter 6 - Supply of water, wastewater and stormwater services

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### Making better supply augmentation decisions

CUAC sees supply augmentation decision-making as an area of critical importance to water consumers. As the Commission points out in the draft report, poor decision-making in this area can be extremely costly for consumers.

In the main, CUAC supports the Productivity Commission's suggestions for improved supply augmentation decision-making. We agree that supply and demand should be considered together. However, a different view on the costs and benefits of restrictions and on the fair distribution of costs and burdens means that we are less enthusiastic about price-based demand management measures such as scarcity pricing.

However, CUAC strongly supports the Commission's findings and recommendations regarding the need for transparent, rigorous and side-by-side comparison of supply augmentation options, incorporating consultation with the community.

CUAC opposes policy bans on potential supply augmentation options. For instance, CUAC opposes policy bans on rural-urban trade, which has the potential to augment urban water supply at low cost. Such trade would need to be carefully managed, with potential negative effects on regional and rural communities identified, monitored and addressed where appropriate.

Similarly, CUAC does not oppose planned, potable use of recycled water where this is a cost effective option. It must be acknowledged that this does not have the support of the majority of citizens, and certainly, recycling for potable use should not simply be imposed by decision-makers without extensive community consultation and input. Nonetheless, given scientific evidence that recycling for potable use can be done safely (and indeed, is in other countries), outright policy bans are not appropriate. Instead, recycling for potable use is one of a range of options that should be included in a public, transparent process when supply augmentation is being considered.

We therefore strongly support draft recommendation 6.1 that:

*State and Territory Governments should adopt policy settings that allow the costs and benefits of all supply augmentation options to be considered using a real options (or adaptive management) approach.*

*Information on costs, risks and benefits to consumers of all augmentation options should be made publicly available and views of the community sought, especially regarding sensitive options like potable reuse.*

*Bans on particular augmentation options (those explicitly stated and those that are implied by government decisions) should be removed, including those on:*

- *rural-urban trade (to allow water to be allocated to its highest value use)*
- *planned potable reuse (unplanned potable reuse occurs commonly without any apparent ill-effects).*

### ***Role of government***

While governments should ideally compare all options side-by-side, this may not always occur. Although governments will sometimes make less than ideal decisions, CUAC nonetheless sees supply augmentation decision-making as properly the responsibility of governments. CUAC does not support any reform that removes government responsibility and accountability for supply augmentation decision-making.

Few things are more important than maintenance of water supply and because of this, governments must retain responsibility for water supply decision making. Removing or distancing supply augmentation decision-making from governments reduces democratic accountability and community control. Government decisions of supply must be justified to the electorate, and poor decision-making can come at a political cost (as has arguably occurred in Victoria in relation to the Wonthaggi desalination plant). Although the political process can generate inefficiencies, CUAC believes an appropriate response to this is advocacy for transparent and public assessment of options by government, rather than removal of supply augmentation decisions from the political sphere.

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## **Chapter 7 – Pricing of water and wastewater**

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### **Pricing objectives**

The Commission's draft report positions economic efficiency as the only legitimate objective in water pricing, a view that CUAC does not share. We believe that social equity and affordability are also relevant to pricing and tariff design. This position is explained in detail in a recent speech on social equity objectives in urban water pricing, which is included as an appendix to this submission. As we highlighted in our earlier submission, while it may be more efficient to address affordability and social equity through mechanisms other than tariffs, price setting in the urban water sector cannot start from the assumption that this is already occurring.

The failure to acknowledge the legitimacy of access and social equity objectives is also, in CUAC's view, a major flaw in the National Water Initiative Pricing Principles. The pricing principles identified in Victoria's Water Industry Regulatory Order offer, in our view, better and more balanced guidance.

### **Final retail pricing**

CUAC's initial submission to the inquiry covered retail pricing issues in some detail. Without repeating that material, we have further comment to make on some of the Commission's draft findings and recommendations.

#### ***Inclining Block Tariffs***

With regard to Inclining Block Tariffs, Draft Finding 7.3 states that:

*The volumetric component of two-part tariffs is currently distorted by inclining block tariffs. Inclining block tariffs lead to inefficiencies and inequities. There are substantial efficiency gains to be achieved from moving to a flat volumetric retail pricing structure.*

As discussed above, in contrast to the Commission, CUAC sees affordability and social equity as legitimate considerations in pricing and tariff design. Nonetheless, the research we have looked at suggests that IBTs are not particularly effective mechanism for addressing these objectives. We support moves to a two-part tariff with a flat volumetric rate, provided that mechanisms

(such as appropriately designed concessions) are in place to ensure affordability for low-income consumers.

### ***Sewerage disposal charges***

CUAC supports the move away from two part sewerage disposal charges, for the same reasons cited by Melbourne water businesses in the draft report. We also agree that residential wastewater metering would be very costly to implement – if it is possible at all – and that these costs would almost certainly outweigh benefits. We are therefore in favour of replacing the two part charge with a single, fixed charge.

### ***Tenants***

Draft Recommendation 7.2 is that:

*Utilities should charge tenants directly for all water charges, both fixed and volumetric, where water is separately metered. Where this does not already occur, State and Territory governments might need to put in place transitional arrangements to ensure that savings to landlords are passed through to tenants.*

The Commission argues that tenants would not be made worse off with such a reform because they pay for water indirectly through rent where they are not responsible for water charges. The Commission suggests that direct charging to tenants would be administratively simpler and that “rents should be reduced to reflect the change”. Where there is separate metering, the Commission argues that tenants will in fact be better off because they will “have the opportunity to benefit from any savings associated with water consumption.”

CUAC does not agree with this assessment. Firstly, we have seen no evidence to suggest that landlords are likely to reduce rents to reflect the change. Secondly, we note that many rental properties are not water efficient and tenancy laws (in Victoria) largely prevent tenants from making changes, even where they have the financial capacity to do so. As the Commission notes in Chapter 8, split incentives will also reduce the likelihood of landlords making such improvements themselves. If this reform is implemented, the government should put in place measures that will assist renters. One possibility is wider adoption the provision in place in Queensland whereby landlords are only able to pass on water consumption charges to tenants if the premises meet certain water efficiency standards.<sup>1</sup>

### ***Tariff options for consumers***

With Draft Recommendation 7.3, the Commission suggests:

*More consumer choice in urban water tariff offerings should be available. This would:*

- *allow customers to express their preferences on security of supply and price stability*

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<sup>1</sup> See: Residential Tenancies Authority (Queensland) (2010) *Fact Sheet: Information on renting a house, caravan or moveable dwelling – Water charging*, RTA: Brisbane.

- *provide an opportunity for water utilities to manage demand better as water availability changes over time.*

*Utilities would be required to provide default two-part tariffs with a single volumetric component.*

CUAC is not opposed to consideration and investigation of the potential for diversified service and tariff options, and recognises that there might be some benefits to this approach. Nonetheless, we are not convinced that the benefits of providing tariff options would outweigh the costs of implementation. We are concerned to see this notion enthusiastically and uncritically adopted in the absence of either:

- compelling evidence that customers want, or are seeking, greater choice in water services or tariffs; or
- analysis or understanding of the practicalities of consumer choice in utilities sectors.

Without these in place, CUAC believes that implementing reform in this area is premature. We would like to comment on each of the above points in greater detail.

At present, there is a lack of evidence to show that water consumers want increased choice. In this regard, it is worth noting that the current push for greater customer choice has not originated with the community or consumer groups, but appears to be driven by water businesses, policymakers and bodies such as the National Water Commission. In our liaison and consultation, we have not found increased choice to be a priority (or indeed, a consideration) expressed by community stakeholders, who tend instead to focus on issues of fairness, distributional impacts, and the appropriateness and transparency of governments' water resource decision-making.

CUAC is aware that some water businesses in Victoria and elsewhere have begun market research to test the interest of customers in a range of tariff and service options. We were recently invited to observe a consumer focus group on this issue, conducted as part of a study commissioned by Yarra Valley Water. We are supportive of such efforts to establish whether there is substantial interest in greater choice among consumers. To date, however, we have not had the opportunity to scrutinise the results of this research. At the same time, to our knowledge, no research has been conducted to establish the extent to which consumers and the community view greater choice as a *priority* in urban water policy or pricing, or where they rank choice as a priority among a range of possible reform priorities.

While market research undoubtedly adds to our knowledge of consumer preferences, we have some methodological concerns about such research where it is used as the sole measure of consumer views and interests. While market research gives a useful snapshot of consumers' first impressions, it does not allow detailed or informed consideration of issues. For instance, in the focus group that CUAC observed, participant requests for background information were not

answered, nor were factual misconceptions<sup>2</sup> corrected by the facilitator (presumably in an effort to avoid affecting responses). Consumers' immediate and often relatively uninformed views, as revealed by such focus groups, offer useful insights and do need to be considered, but alone they are not sufficient.

Ideally, prior to any reform, we would like to see consumers' interest in greater choice in water services, products and tariffs tested in a deliberative process. Deliberative processes have the potential to illuminate community and consumer preferences, values and choices in a more comprehensive and considered way than typical market research. For example, a citizens' panel is a deliberative process which involves a randomly selected group of lay people in a structured, facilitated discussion. Experts such as academics and representatives of interest organisations present their perspectives to the group and answer questions. The citizens' panel considers and discusses the issues among themselves and develops written recommendations, which can then feed into the policy process. Use of a deliberative process such as a citizens' panel would add greatly to our understanding of water consumer and community preferences.

Trials, as suggested by the Commission, may also shed light on consumer interest in and responses to tariff choices. In the meantime, in the absence of research evidence, CUAC is sceptical about the extent to which consumers and the community see increased choice in water services, products and charges as desirable, or as a priority.

When examining the potential benefits and disadvantages of choice in the water sector, policymakers should consider the practicalities of consumer choice and the evidence base, from other sectors, on issues of complexity, information and education, and consumer decision-making.

CUAC has some trepidation about reforms that will increase the complexity facing consumers. Over the past two decades, consumers have seen vastly increased choices across a range of domains, including telecommunications, energy, and financial products. While choice often brings benefits, it also requires people to make increasingly numerous and complex decisions. This can be difficult for consumers, particularly for those consumers with limited knowledge or capacity.

CUAC's work on the consumer experience of the Victorian energy retail market has highlighted these issues of choice and complexity. For example, in 2010, CUAC, with funding from the Department of Primary Industries, consulted with a broad range of community sector and business representatives on electricity smart meters. The aim of the project was to assess knowledge and perceptions of electricity smart meters and to identify approaches to providing information through community and business organisations to members and clients. While the research aim was to gather information about smart meters, the consumer experience of the energy market emerged as a major theme in stakeholders' contributions. Throughout the course

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<sup>2</sup> For example, the incorrect belief of some participants that Victorian water businesses are privately owned.



of our consultations, it became clear that smart meters and time-of-use pricing were viewed by many as adding one more layer of complexity to an already complex and confusing energy retail market. Far from pushing for greater choice, many participants argued for simplicity, indicating that the market was already too difficult for them to understand and navigate.

Increased complexity may be worthwhile or even necessary in some circumstances, but government, regulators and business should avoid creating choices which are out of proportion to both the potential benefits of an individual's optimal choice, and to consumers' motivation, knowledge and resources to navigate such choices. This also suggests that if greater choice is to be introduced to the water sector, it should be done carefully, with a relatively limited number of easy-to-compare options that have clear benefits for different types of consumer.

Should greater choice be made available to consumers, this will need to be accompanied by consumer information and education. Providing, in an effective manner, the information and education needed to underpin informed, meaningful consumer choice is a substantial task, the costs of which need to be considered alongside the potential benefits of increased choice. The research on consumer information and education suggests that to be effective, consumer education needs to:

- go beyond simple provision of print and audio-visual materials;
- integrate various strategies (such as mass media, face-to-face communication, incentives, and integration with existing events, services etc.); and
- use messages designed or customised to meet the needs of different groups.<sup>3</sup>

Importantly, consumer information and education strategies must take into account the particular needs of disadvantaged consumers, including those with low literacy skills and those for whom English is not their first language. For these consumers, the literature suggests that information is often most effectively conveyed interpersonally.<sup>4</sup> CUAC, in the aforementioned research project on electricity smart meter information needs, similarly found that face-to-face communication with community workers (such as financial counsellors) can be an effective and important complement to mass media and print information.<sup>5</sup>

Based on the insights from behavioural economics, as well as experience in other sectors, CUAC expects that the proportion of water consumers actively exercising choices in water products, services and tariffs will be low, should such reforms occur. Given that water is a relatively homogenous and unexciting product, and one which (as the Commission's analysis shows) constitutes a very small proportion of household income for most people, it is not plausible to expect a high level of customer motivation to make choices.

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<sup>3</sup> Flowers, Rick et al (2001) *What is Effective Consumer Education?: A literature review*, Commissioned by the Australian Securities and Investments Commission, Centre for Popular Education, University of Technology Sydney: Sydney, p. 30-38.

<sup>4</sup> *Ibid*, p. 36-7.

<sup>5</sup> Consumer Utilities Advocacy Centre (2010) *Consumers and smart meters: Delivering information to non-government organisations*, Report to the Minister for Energy and Resources, the Hon. Peter Batchelor MP. CUAC: Melbourne.

Research in behavioural economics has demonstrated a systematic tendency towards inertia, with consumers tending to stick with the status quo. As choices become more complex, consumers are more likely to use 'rules of thumb' (such as selection of a default option) to make decisions, or to avoid decision-making entirely.<sup>6</sup>

The findings from experimental studies are complemented by research examining the introduction or expansion of choice in a number of sectors, where levels of switching have often been fairly low. For example, in 2005 with 'Super Choice', Australians were given greater choice in superannuation funds. While the expectation was that many consumers would take the opportunity to change fund, the actual numbers were low.<sup>7</sup>

Market research survey responses may overstate the actual willingness and motivation of consumers to make choices on water products, services and tariffs. One recent study surveyed consumers on their willingness to switch supplier for a saving of \$5 per week on various goods and services including banking, electricity and superannuation. Respectively, 28 per cent, 27 per cent and 21 per cent of respondents reported that they would 'definitely' switch under these circumstances, yet actual switching rates are much lower than this: about 3 per cent per year for banks and 3 to 6 percent per year for superannuation.<sup>8</sup>

There are several possible explanations for these discrepancies. A likely factor is that, while answering a question in a survey is simple, active exercise of choice incurs search costs. 'Social desirability bias', where survey respondents inaccurately report behaviours and opinions that are generally considered acceptable or positive,<sup>9</sup> may also play a role.

These issues should be borne in mind when interpreting market research survey results on tariff options. While an individual may indicate during a survey that they would choose a hypothetical tariff or service option, this cannot be taken as meaning that the consumer would, in a real life situation involving search costs, seek out and select that option.

It has been suggested that increased customer choice will help to drive water sector innovation and productivity, as well as revealing opportunities for greater private sector involvement. However, realisation of these gains is dependent not only on the existence of service, product and tariff options, but on the extent to which consumers actively take up the opportunity to choose. In other words, if only a small proportion of consumers actively exercise choice (rather than, for example, staying on a 'default' option), substantial gains in productivity and innovation will not result. For this reason, it is important for policymakers to carefully evaluate the likely levels at which customers will exercise choice before proceeding with this type of reform, the implementation of which will involve substantial costs. We urge the Commission to give more

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<sup>6</sup> Reeson, Andrew and Simon Dunstall (2009) *Behavioural Economics and Complex Decision-Making: Implications for the Australian Tax and Transfer System*, CSIRO: Melbourne.

<sup>7</sup> Fear, Josh and Geraldine Pace (2008) *Choosing not to choose: Making superannuation work by default*, Discussion paper no. 103, The Australia Institute: Canberra, p. 15-17.

<sup>8</sup> Citi Australia (2010) *Evidence versus emotion: How do we really make financial decisions?* The Australia Institute: Canberra, p. 11-12.

<sup>9</sup> Rajenda Nargundkar (2010) *Marketing Research: Text and Cases*, McGraw-Hill: New Delhi, p. 49.

Careful consideration to these issues before including a recommendation for tariff options in its final report recommendations.

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## Chapter 8 – Non-price demand management

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### Restrictions

The Commission's draft report includes discussion of restrictions which, while extensive, in CUAC's view, falls short of the analytical standard that characterises the remainder of the report. Interestingly, in its discussion of restrictions, the Commission gives significant weight and attention to nonfinancial, unquantifiable and intangible costs. For example, it quotes Crase on elderly people afraid to "seek relief" from restrictions because of "fear of the community backlash and a determination to share in the community's 'pain'". The section on restrictions also lists a number of costs incurred including the sacrifice of 'water-based de-stressing activities such as long showers', the inconvenience of watering gardens during prescribed times, and loss of amenity from private gardens.

Similar types of cost could be, but are not, identified in relation to many of the policy options discussed in the report. For instance, the emotional distress experienced by a low-income consumer who decides not to allow their children to play under the sprinkler because of concern about high water prices is not considered a 'cost', nor is the frustration a consumer may feel if they have difficulty deciding on an appropriate water tariff option.

The report is also highly selective in its coverage of nonfinancial effects of restrictions, identifying only potential costs and not benefits. For example, the possibility of injury while carrying buckets of greywater is mentioned, while the beneficial effects of physical activity through the same activity are not. The possibility of reduced 'social cohesion' due to reporting of non-compliant neighbours is mentioned, but the equally likely social cohesion benefits of communities pulling together for a common purpose are not (this is instead identified as an impediment to efficiency gains).

### ***Narrow paradigm***

It may be that the report's coverage of restrictions is a reflection of a narrowly economic conception of price, value, preferences, costs and benefits. While this paradigm is a very useful one, it also has the effect of systematically giving less weight to the experiences and preferences of low-income consumers. For example, under the Commission's paradigm, if a low income consumer chooses to forego gardening because of concern about the cost of water, this is not viewed as a cost, but as an expression of that consumer's preference for another product or service over water. This positive interpretation holds regardless of any distress the individual feels at foregoing gardening.

Essentially, a person with less money has fewer preferences to spread around. The preferences that a low-income person *can afford to express* through consumption choices are only a sub-set

of their *actual* preferences, which may be strongly felt. Moreover, the inability to realise these preferences due to lack of money may have negative consequences for health and wellbeing. In fact, a wealth of research on poverty and financial disadvantage suggests that this is indeed the case. Because it undervalues the preferences of low-income consumers, a classical economic paradigm is not, on its own, sufficient for a full analysis of urban water policy issues.

### ***Altered incentives for water use***

The draft report argues that restrictions create perverse incentives to over-use indoor water in order to generate greywater for gardens, and can lead to compensatory over-watering during allowable watering times. Given that restrictions have, as the Commission acknowledges, ‘been very effective in reducing demand for water’, it would appear that the influence of these incentives has been relatively insignificant.

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## **Chapter 9 – Achieving affordability and consumer protection objectives**

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CUAC is pleased that the Commission’s draft report acknowledges that universal and affordable access should be a government objective, and devotes a chapter to examining how this can be achieved effectively and efficiently. We applaud the Commission for its detailed consideration of these issues. We would also like to add offer further comment on affordability and consumer protection issues.

### **Extent of affordability problems**

The draft report examines the extent of affordability issues in the urban water sector. In doing this, it discusses the incidence of consumers seeking assistance from water utilities for payment difficulties, noting that despite increases, numbers remained very low. CUAC recognises this, and acknowledges that payment difficulties are less of a concern in relation to water than energy.

Nonetheless, it is worth noting that many (if not most) people experiencing payment difficulty do not contact their utility for assistance for reasons of embarrassment, belief that the utility will not offer genuine help, etc. Moreover, the essential nature of water services and the potential for restriction mean that consumers may pay a water bill and go without other important goods and services (such as medicine, or a child’s school excursion). Although paying a water bill contributes to financial hardship (lack of money for other essentials) for such consumers, this hardship will not be visible in business’ performance data. Hence, the rate of requests for payment assistance is not a reliable measure of payment difficulties. For a better understanding of utility hardship issues, we recommend that the Commission review the report of the Committee for Melbourne on the Utility Debt Spiral Project.<sup>10</sup>

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<sup>10</sup> Available at [http://www.ewov.com.au/site/DefaultSite/filesystem/documents/PDF/Reports/Utility-Debt-Spiral-Study\\_April-2005.pdf](http://www.ewov.com.au/site/DefaultSite/filesystem/documents/PDF/Reports/Utility-Debt-Spiral-Study_April-2005.pdf)

We also note that in contrast to discussion on restrictions in Chapter 8, where non-financial costs presumably affecting very small numbers of people are detailed, there is no discussion here of how the experience of payment difficulty impacts on consumers' wellbeing. This has the effect of downplaying the importance of the issue.

The Commission concludes, with Draft Finding 9.2, that:

*Expenditure on water and wastewater services generally represents a small proportion of income, including for low income groups. Price increases in water and wastewater services, although contributing to rising costs of living, are likely to have had less detrimental effect on consumers than price increases of other essential goods and services such as energy and housing, on which expenditure represents a greater share of incomes.*

The chapter finds some evidence that recent price increases have increased the number of households seeking assistance. Nonetheless, missing from the draft finding is any acknowledgement that - although price increases in other goods and services are greater - water price increases *have* had a detrimental impact on some consumers.

### ***Payment/instalment plans***

The Commission's treatment of affordability discusses affordability in terms of water expenditure expressed as a percentage of disposable income. While a valid and useful measure, this bears little relation to a low-income household's actual experience of paying for utilities.

Water charges are typically paid quarterly, rather than being consistently deducted from income over time. Consumers on very low incomes often struggle to find these larger sums in any particular fortnight, or to put aside money over a longer period to meet utility bills when they arrive. As the Commission implies, this situation can be addressed, to some extent, through the provision of instalment plans and similar mechanisms, such as Centrepay, which facilitate smaller and more regular payments. Unfortunately, such mechanisms are not always available or easily accessible. For this reason, in both the water and energy sectors, CUAC advocates for utilities to make instalment plans available to all consumers upon request. We believe that this approach is beneficial to both consumers and businesses, as it helps to prevent accumulation of debt.

### **The tax and transfer system**

In principle, CUAC supports the notion that distributional and social equity objectives should be pursued at least cost to efficiency. In principle, this may be best achieved via the tax and transfer system.

### ***Concessions and rebates***

The draft report discusses the benefits and disadvantages of concessions as a tool for assisting low-income consumers. To this discussion CUAC would like to add the following points:

- Income thresholds for concessions mean that persons earning an income just over the threshold receive no assistance although they may have a strong need for it. This can be

addressed, to some extent, by designing concessions with different levels of assistance for different income brackets, although this does add to administrative complexity.

- The value of concessions tends to diminish over time. Concessions payments need to be reviewed periodically in relation to the price over the relevant good/service, as well as other prices in the economy, if they are to provide effective assistance.
- Concessions need to be easily accessible to eligible consumers. For example, automatic application of concessions is preferable where possible. Processes that require consumers to register or re-register for concessions reduce access.
- The design and level of water and sewerage concessions need to be considered in concert with the design and level of tariffs. When changes are made to tariff design, any implications for concessions should be considered and addressed *at the same time*. For example, if concessions target one component of water charges (such as the fixed charge), a change in the balance between fixed and volumetric charges will necessitate re-examination of the concession design.

The Commission concludes its discussion of concessions with the finding that:

*Current state and territory concession arrangements for water and wastewater services are inefficient and inequitable. Efficiency gains can be made by replacing or amending water and wastewater concessions with direct payments to targeted households or rebates on the fixed component of water and wastewater service bills.*

CUAC recognises that concessions are an imperfect tool for addressing affordability for low-income and disadvantaged consumers. It is difficult or impossible to design concessions in such a way that all assistance is targeted precisely to those who require it, and in the exact proportions needed. Still, we strongly disagree with the wholesale dismissal of existing concessions as ‘inefficient and inequitable’. While imperfect, concessions serve an important purpose improving affordability for consumers on very low incomes. We are also unconvinced that replacing concessions on bills with direct payments to households would increase overall welfare.

### ***Income support payments***

The draft report suggests that cash transfers through income support payments are a better way of assisting low-income groups. In principle, CUAC agrees with this assessment, and with the Commission’s finding that affordability is most efficiently achieved through non-concessions elements of the tax and transfer payments system.

Unfortunately, however, this is not occurring. The 2009 report of the Pension Review (the Harmer Review) examined the adequacy of the Age Pension, Disability Support Pension and Carer Payment in providing for an acceptable standard of living. It found that the rate of pension

for single people living alone was too low, and that there was a need for reform to the pensions system.<sup>11</sup>

Subsequently, the single rate was increased by around \$30 per week. Other income support payments, already lower than pension payments, were not increased commensurately. In fact, the most recent Organisation for Economic Cooperation and Development (OECD) Economic Survey of Australia notes that Australia's unemployment benefits (i.e. Newstart Allowance) are among the lowest in the OECD, and suggests that payments may be inadequate.<sup>12</sup> Furthermore, because of the different ways in which pensions and unemployment benefits are indexed, this disparity is likely to continue increasing.<sup>13</sup> There is no suggestion from the Australian Government that income support levels will be raised in the short or medium term.

Urban water policy decisions should take account of the actual (rather than the ideal) level of income support payments if low-income and vulnerable consumers are to be protected. Therefore, unless and *until* unemployment benefits are substantially increased, concessions and other affordability measures will remain a necessity for the sector.

With Draft Recommendation 9.1, the Commission recommends that:

*COAG should commission a review of concessions on utility services across all levels of government. The review should assess:*

- *the appropriateness of existing arrangements for providing concessions, including eligibility criteria*
- *the merit of and scope for abolishing concessions and providing relevant assistance to all low income households via other elements of the tax and transfer payments system.*

CUAC is of the view that there is room for improvement in effectiveness and efficiency of concessions, particularly in some jurisdictions other than Victoria. We also note that there are inconsistencies, both within and between jurisdictions, in terms of the impact of concessions on affordability. However, concessions are only one comparatively small component of support provided for people on low incomes, and it is not possible to examine concessions separate from other factors that impact on affordability. Any review of concessions needs to examine all of these aspects together. Such a review should have as its aim *identification of the most effective and efficient way of ensuring that utilities are affordable for low income consumers*. The review should not pre-suppose a particular approach such as abolition of concessions.

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<sup>11</sup> Commonwealth Government Department of Families, Housing, Community Services and Indigenous Affairs, 'Budget 2009-10 – Pension Review Report: 3. Adequacy' at [http://www.fahcsia.gov.au/about/publications/articles/corp/BudgetPAES/budget09\\_10/pension/Documents/Pension\\_Review\\_Report/part3.htm](http://www.fahcsia.gov.au/about/publications/articles/corp/BudgetPAES/budget09_10/pension/Documents/Pension_Review_Report/part3.htm).

<sup>12</sup> Peter Whiteford, 'Why unemployment benefits need to be increased' Inside Story at <http://inside.org.au/why-unemployment-benefits-need-to-be-increased/>

<sup>13</sup> Ibid.

## **Businesses' financial hardship policies & programs**

CUAC welcomes the Commission's findings with regard to the value of water businesses' hardship policies and programs, as well as programs (such as Victoria's Utility Relief Grant Scheme) which provide one-off assistance in exceptional circumstances.

The draft report suggests that flow restrictions are a 'reasonable compromise' when a customer fails to make payments under a payment plan, or to meet other hardship program provisions. On this, we note that consumers sometimes fail to meet payment plan arrangements because the payment plan negotiated between the business and the consumer was not been made with proper regard for what the consumer can afford to pay. Through its liaison with financial counsellors and emergency relief providers, CUAC has heard accounts of vulnerable consumers agreeing to payment plan terms that they know they cannot afford. It is important that, when negotiating payment plans with consumers experiencing financial hardship, utilities be required to have regard for what the customer can afford to pay. At the same time, any utility which finds that a large proportion of hardship program participants are failing to meet the terms of the program should reconsider the design of the program.

### ***Prepayment meters***

CUAC notes that the draft report includes a brief discussion of the potential role of prepayment meters, which are in use in some jurisdictions for electricity. CUAC does not support the use of pre-payment meters for credit management. Prepayment meters are an unsuitable tool for addressing financial hardship and utility stress because they reduce the contact between retailers and customers experiencing hardship, thereby precluding retailers' identification of chronic affordability problems. Prepayment meters allow suppliers to 'disengage' from hardship issues rather than improving their processes for dealing with customers in hardship, without providing any additional benefits over flexible payment arrangements.

## **Consumer policy framework**

### ***Consistent best practice consumer protection***

Again, CUAC welcomes the Productivity Commission's consideration of the consumer policy framework for urban water, and supports Draft Recommendation 9.2 that:

*COAG should develop a set of best practice consumer protection principles for water utilities. These could be included in any new intergovernmental water agreement. At a minimum, the principles should include:*

- *access to an independent dispute resolution process, preferably by a specialist utilities industry ombudsman*
- *the establishment of an industry code defining service standards and provisions to assist consumers facing hardship.*

CUAC particularly welcomes the emphasis on 'best practice': if efforts to develop national principles do not have this 'best practice' focus, some jurisdictions are likely to see a decline in existing protections. We also note that in the development of such a set of principles, it is



critically important that COAG consult with consumer advocates in all jurisdictions. In our view, consumer protection principles cannot be formulated without thorough, meaningful consultation with consumers.

### ***Disadvantage***

The Commission's draft report argues that consumer advocacy focuses heavily on disadvantaged consumers (citing CUAC as an example), and suggests that more 'balanced' representation is desirable.

In our advocacy, CUAC does pay particular attention to the interests of low income and otherwise disadvantaged consumers, particularly in relation to issues of affordability and access. We also acknowledge that, from time to time, the interests of disadvantaged consumers and other consumers may conflict. Nonetheless, we wish to emphasise that our mandate is to represent all Victorian consumers, including both residential and non-residential consumers. To this end, we work with a range of organisations including welfare services, other consumer advocacy groups, industry bodies<sup>14</sup> and local governments. Our positions on issues such as supply augmentation, consumer choice and urban water sector regulation have been developed with regard to what we see as the broad interests of consumers, rather than disadvantaged consumers specifically.

It is also worth noting that there are good reasons for consumer advocacy to pay particular attention to the experiences and interests of disadvantaged consumers. Disadvantaged consumers are more likely to have difficulty maintaining access to essential services. They are less likely to have the knowledge, confidence and resources to ensure their interests and rights are protected, both in interactions with service providers and through input into political, policy and regulatory processes. For these reasons, CUAC believes it is important that consumer policy advocacy continues to pay specific attention to the interests of disadvantaged consumers.

Further, we disagree with the Commission's assertion that the 'vast majority' of water consumers are not disadvantaged. In fact, research suggests that a substantial proportion of Australians experiences some form of disadvantage, either on an ongoing basis or temporarily. For example:

- Low income

In 2009, just over 2 million people of working age were on income support payments, (excluding age and veteran's pensioners and fulltime students). In October 2010, approximately 557,000 were receiving the Newstart Allowance, which provides a very low level of support. A single unemployed adult receives about \$470 per fortnight (\$33.55 per

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<sup>14</sup> Both the Victorian Employers' Chamber of Commerce and Industry (VECCI), the Victorian Farmers' Federation (VFF) are on CUAC's Reference Group, an advisory body.

day). Private renters are entitled to up to \$115 per fortnight in Rent Assistance if they pay rent of more than \$256 per fortnight, leaving just \$23.50 per day for all other living costs.<sup>15</sup>

- Literacy and numeracy

Results of the most recent ABS Adult Literacy and Life Skills (ALLS) Survey show a fairly high proportion of Australian adults with low literacy and numeracy skills. The ALLS survey groups respondents' scores into five skill levels across different domains, with Level 5 the highest and Level 3 considered the minimum necessary for adults to cope with the demands of everyday life and work. Close to half of Australian adults have literacy and numeracy skills below this level.

**Proportion of adults at Skill Levels 1 and 2**

Domain	%
Prose literacy <i>understand and use information from text including editorials, news stories, poems and fiction</i>	46
Document literacy <i>locate and use information contained in various formats including job applications, payroll forms, transportation schedules, maps, tables and graphics</i>	47
Numeracy <i>effectively manage and respond to the mathematical demands of diverse situations</i>	53

Source: ABS (2006) (Reissue) *Adult Literacy and Life Skills Survey, Summary Results, Australia*, cat. 4228.0

Poor literacy and numeracy can be expected to impact on people as consumers in a range of ways. For instance, consumers with low literacy and numeracy will be less able to interpret charges and bills; understand and choose amongst tariff and service options; and understand written information about their consumer rights.

- Social exclusion

In 2008, the Brotherhood of St Laurence and the Melbourne Institute of Applied Economic and Social Research began development of a new measure of social exclusion (a concept closely related to disadvantage). This multidimensional measure combines 29 indicators across seven domains (material resources; employment; education and skills; health and disability; social connection; community; and personal safety) into a single measure of social exclusion. Based on data from the longitudinal Household Income and Labour Dynamics in Australia (HILDA) survey, their analysis found that:

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<sup>15</sup> Whiteford, Peter (2010) Why unemployment benefits need to be increased' *Inside Story*. Available at <http://inside.org.au/why-unemployment-benefits-need-to-be-increased/>

*over the period 2001–07, the level of marginal exclusion ranged between 26 and 33 per cent of the Australian population aged 15 years and over. Between four and six per cent were ‘deeply excluded’ and less than one per cent were ‘very deeply excluded’.*<sup>16</sup>

In addition to types of disadvantage that tend to endure over time, a further group of consumers will, at some point, experience temporary disadvantage, such as illness or job loss. Policy and regulation limiting restriction powers and setting out hardship obligations, among other things, provide important protection for consumers at such times.

### ***Institutional arrangements for consumer policy advocacy and research***

The draft report argues for greater support for general consumer advocacy and research, with draft recommendation 9.3 that:

*COAG should progress implementation of measures to support consumer advocacy and research consistent with Recommendation 11.3 of the Commission’s 2008 Review of Australia’s Consumer Policy Framework.*

CUAC supports this recommendation. We also see a need for improvements to consultation and advocacy in relation to water specifically, including support for knowledge and capacity building.

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## **Chapter 11 – Institution-centred reform**

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### **Governance of water utilities**

As detailed in our earlier submission, CUAC supports Victoria’s current water utility governance arrangements. We believe that the combination of government ownership and corporatisation in Victoria’s urban water sector strikes an appropriate balance between promoting efficiency and encouraging the fulfilment of public good objectives as determined by government.

#### ***A charter for water utilities***

The Commission’s draft report suggests that governments should create a public charter to guide water utilities. As the Commission would be aware, Victorian water businesses are currently required to develop Customer Charters which are approved by the Essential Services Commission. We favour this process because it requires businesses’ charters to cover specified areas while allowing businesses some flexibility to address local conditions and needs, in consultation with consumers. Approval by the regulator adds a layer of independent oversight. While the Productivity Commission has argued that charters should instead be drawn up by government with advice from the regulator, CUAC is not convinced that this change would produce substantial further benefits for consumers.

Further, while we see value in such charters, CUAC strongly disagrees with the Commission’s suggestion that they will, over time, obviate the need for price regulation.

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<sup>16</sup> Horn, Michael (2010) ‘Monitoring Social Exclusion: findings from a new multidimensional measure for Australia’, Brotherhood Comment, Brotherhood of St Laurence: Melbourne, 4-5.

### ***Supply augmentation decisions***

Draft Recommendation 11.1 suggests that:

*Retail-distribution utilities should be assigned responsibility for meeting security of supply standards and procuring water supply and services.*

As discussed on pages 4-5 of this submission, CUAC believes that governments must remain responsible for supply augmentation decisions.

### ***Further commercialisation of water utilities***

The Commission's draft report argues that water utilities should not be given multiple objectives to balance, and instead should be directed to focus solely on economic efficiency. CUAC strongly disagrees with this argument. Economic efficiency is not the only value held by citizens and communities, particularly with regard to essential services and, reflecting this, elected governments direct water businesses to balance a range of values and objectives.

In criticising the multiple objectives that water GTE's are expected to balance, the Commission quotes Tony Kelly, Managing Director of Yarra Valley Water, describing dealing with competing objectives as 'core business', and acknowledging the complexities of this task. Complex as its work may be, Yarra Valley Water is widely recognised for its comparative success. As the research reviewed by the Commission elsewhere in Chapter 12 demonstrates, Melbourne's Water businesses are recognised internationally for their efficiency. At the same time, Yarra Valley Water's customer hardship program is widely considered to be industry best practice. Energy and Water Ombudsman (Victoria) (EWOV) data suggest that Victoria's water businesses, particularly in metropolitan Melbourne, generate low levels of customer complaints,<sup>17</sup> suggesting comparatively strong customer service.

Far from illustrating the need for a more single-minded focus on economic efficiency, the example of Yarra Valley Water is powerful evidence that water utilities can balance the multiple objectives that elected governments ask them to fulfil.

### **Economic regulation**

CUAC believes that monopoly businesses require price regulation. We see a number of benefits to independent price regulation in the urban water sector, including the promotion of transparency, opportunity for public scrutiny of businesses' proposals, and independent oversight. CUAC strongly opposes the elimination of price regulation of monopoly water businesses, but would support moves to strengthen the independence of regulatory bodies while maintaining their power to regulate prices.

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<sup>17</sup> Particularly striking when compared to customer complaint levels in the energy sector.

## Consumer involvement

CUAC welcomes the Productivity Commission's consideration of consumer involvement in urban water decision-making. The Commission has suggested that the establishment of a representative consumer group or groups may be a mechanism for including consumer preferences in policy and regulatory decision-making, and has requested views on the desirability of this and on the appropriate scope, funding and governance model for such a body.

The Commission suggests that such a body would make representations on matters such as:

- *providing input on cost-benefit analyses conducted by regulators*
- *setting of quality and reliability standards*
- *determination of water related service offerings*
- *identifying and assessing supply augmentations*

Possible models for improved consumer engagement in price and quality negotiations are also canvassed in the draft report.

In a joint project with other advocates, CUAC has recently examined a range of models for consumer advocacy in the energy sector. Based on this work, as well as our experiences advocating on behalf of energy and water consumers in Victorian and national processes, we have identified two alternative models for supporting national consumer advocacy in water. Both models include funding for research activity, which CUAC believes is critical to effective advocacy.

### ***Model A – National consumer advocacy organisation and Consumer Advocacy Panel-administered grants program***

This model involves:

1. Creation of a relatively small National Water Consumer Advocacy Centre (3-4 FTE staff) that would:
  - undertake research, policy development and advocacy; support information sharing, networking and joint advocacy among state and territory consumer advocates; develop an online 'one stop shop' information resource for consumers and organisations; and identify research priorities which would guide a grants program administered by the Consumer Advocacy Panel; and
2. Establishment of a national water consumer research/advocacy grants program that would:
  - fund projects according to research priorities identified with the National Water Consumer Advocacy Centre; and
  - be administered by the existing Consumer Advocacy Panel for energy, an independent body that provides grants for consumer advocacy and research focussed on small and medium users.

Both the National Water Consumer Advocacy Centre and the grants program would be funded initially through consolidated revenue, with a view to funding via a levy on water businesses at a later stage.

### ***Model B – Grants program***

This model involves:

1. Establishment of a national water consumer research/advocacy grants program that would:
  - offer contestable grants for consumer research and advocacy projects, following best practice grant-making guidelines;
  - be administered by the Consumer Advocacy Panel (as above) or, alternatively, through the Department of Sustainability, Environment, Water, Population and Communities; and
  - as with Model A, be funded initially from consolidated revenue.

While Model A is our preferred approach, we believe that either model would offer the crucial support needed to develop strong national consumer advocacy in water.

### **Governance arrangements for regulators**

The Commission's draft report argues that regulators, like utilities, are given multiple objectives by government, resulting in too much discretion in regulator decision-making. Again, CUAC disagrees strongly with this argument. In CUAC's view, it is entirely appropriate for government to direct regulators to balance multiple objectives that it considers important. In contrast to most industries, the water sector has (as the Commission acknowledges) important public health, social equity and environmental dimensions. These matters are of importance to water consumers and it is not feasible to expect that they can be wholly addressed externally to the water sector itself, without regulators and utilities having regard for them.

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## **Chapter 12 – Structural reform options for large urban cities**

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In Chapter 12, the Commission's draft report discusses competition and structural arrangements in general terms, followed by analysis of some specific reform options. We welcome the Commission's recognition that the structural reform options presented in Chapter 12 are not necessarily suitable for particular jurisdictions, and that:

*These options... should be regarded as a starting point for jurisdictions to assess the case for structural reform in Australia's largest urban cities.*

As such, CUAC has not examined each reform option in detail, but would like to make some general comments on some of the structural reform issues covered in Chapter 12.

## **Structural reform, competition and efficiency gains**

### ***Yardstick competition***

The draft report acknowledges the considerable evidence base suggesting that Melbourne water businesses are already highly efficient, but questions both the extent to which this can be attributed to yardstick competition, and the likely ongoing effectiveness of yardstick competition in promoting efficiency.

Conclusively demonstrating causal links is always difficult, particularly so with regard to multifaceted reforms in a complex sector. Nonetheless, CUAC sees the current strong performance of Melbourne businesses as an indication that the policy and regulatory settings already in place are good. While improvement is always possible, we believe that further reform should be done carefully, and only where there is a strong likelihood of substantial benefits. An incautious or hurried approach to further reform risks jeopardising the efficiency and effectiveness already achieved.

Based on our experience as consumer advocates, we see yardstick competition as a useful feature of Victoria's urban water sector, particularly following recent improvements to the timeliness and content of ESC performance reports. The effectiveness of yardstick competition in Victoria should be monitored and evaluated on an ongoing basis. However, while Melbourne water businesses continue to function with comparative efficiency and effectiveness, CUAC does not support major changes to industry structure in Victoria.

### ***Transaction costs and vertical separation***

CUAC supports a case-by-case approach to vertical separation in utilities sectors. The evidence on vertical separation in electricity markets in Australia and Europe is, on our reading, mixed. CUAC therefore acknowledges the potential benefits of this type of structural reform. Likely transaction costs and efficiency improvements should be identified and considered on a case-by-case basis prior to reform.

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## **Chapter 13 – Reform in regional areas**

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Chapter 13 of the Commission's draft report focuses largely on jurisdictions other than Victoria. Based on the history of reform in Victoria, CUAC does see benefits in horizontal aggregation of water utilities in regional areas. The case for such reform should be assessed on a case-by-case basis.

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The Commission's draft report makes a number of references to reforms in the energy sector and their relevance to urban water reform. CUAC is soon to complete a major project looking at energy market design and consumer participation. We would welcome the opportunity to meet with Productivity Commission staff to discuss some of the relevant findings from this research project. Alternatively, we would be pleased to provide a copy of the project's final report when it becomes available. Caitlin Whiteman can be contacted on (03) 9639 7600 to make arrangements or to discuss any aspect of CUAC's submission.

Yours sincerely,

Jo Benvenuti  
**Executive Officer**



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## **Appendix: Presentation - Social equity objectives in urban water pricing**

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### **About CUAC**

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As you have just heard, I am Executive Officer at the Consumer Utilities Advocacy Centre.

CUAC was established in 2002 to provide an independent, proactive, informed advocacy voice for all Victorian energy and water consumers:

- to effectively represent their interest in regulatory and consultation processes with key stakeholders;
- to facilitate and undertake preparation and dissemination of independent research on consumer related utility issues and thereby enable consumers to take full advantage of utility markets; and
- to monitor grassroots consumer utility issues with regard to low income, disadvantaged and rural consumers.

CUAC has a Victorian mandate but nonetheless, we find that we are increasingly called upon for input into national urban water reform processes. Some of you will be aware that we are the sole consumer representative on the Department of Sustainability, Environment, Water, Populations and Communities' National Urban Water Stakeholder Reference Panel. Unfortunately, from our perspective, there is little consumer and community engagement in urban water policy at the national level, and little acknowledgement of its importance.

Because our mandate and expertise is in this state, my presentation today will have a Victorian focus. However, I expect that many of the issues and ideas I cover will be reflected in some way in other jurisdictions. We are very pleased today to have participants from across the country, and we will be glad to hear more from you about the situation and issues in your state.

### **Why this forum?**

A number of developments over the past year prompted CUAC to hold this forum. Early last year we saw the National Water Commission finalise its National Water Initiative Water Pricing Principles. These principles offer guidelines that the states and territories commit to follow in implementing rural and urban pricing. CUAC was disappointed to see that our input, and that of other consumer groups, was not reflected in the Pricing Principles. Perhaps of most concern to us that critical consumer concerns – affordability, access and equity – were largely dismissed as simply not relevant to pricing.

Also in 2010 we saw both the National Water Commission and the Productivity Commission begin substantial urban water policy projects, both of which are examining pricing issues in detail.

For those of us in Victoria, there were a number of other developments. Water businesses began re-considering their tariff structures in preparation for a review by the Victorian regulator, the Essential Services Commission. Notably, some controversy was generated when some of the tariff options being considered by Yarra Valley Water, one of the three major metropolitan water businesses, were made public. We will hear more about that a bit later in the day from Yarra Valley Water Managing Director Tony Kelly. Victoria also saw a change of government in November 2011. The new coalition has signalled its intention to modify water pricing, shifting the emphasis from fixed charges onto variable (usage) charges.

With all of this going on, we at CUAC thought it was important that consumer and community views were given greater and more careful consideration, and that they had the opportunity to be more involved in pricing reform debates and processes. With that in mind, we decided to organise this forum. As we thought more about the day, we also thought that it would be important to involve government, business and regulators in the dialogue. We actually think that, while industry, policymakers and regulators hold most of the technical information, they also stand to gain from discussion with consumer and community representatives who have insights into how policy and regulatory decisions impact on consumers, particularly disadvantaged consumers.

#### **A social equity objective in urban water pricing**

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Today I want to talk about social equity and why I think it is, or should be, an important objective of urban water pricing. Social equity considerations are relevant to distribution of water via the pricing system, and also in the distribution of the burdens and responsibilities associated with urban water, such as the need, at times, to conserve water.

Social equity, even when it is acknowledged as an objective at all, tends to be given pretty short shrift in discussions of urban water and urban water pricing, which at times focus almost exclusively on efficiency. Efficiency is undoubtedly an important objective in urban water. As important as it is, though, I don't believe that efficiency encompasses all that is important in urban water or in pricing.

So why does social equity matter in the context of urban water pricing? Why am I suggesting that it should be given more considered attention?

### ***Water's unique importance***

Well, firstly, and obviously, water has a unique importance. Water is fundamental to life and health: human beings cannot live for more than a few days without water. It is the most essential of all services. I believe that this makes water different in some important ways from other goods and services. At the very least, water's special status obliges us to ensure that all Australians have access to the water needed for drinking, food preparation and hygiene.

Because of water's fundamental importance, there has been a push for recognition of a human right to water. Over the last two decades, there have been more than ten formal UN declarations on the right to water. The right to water is discussed in detail in the UN Committee on Economic, Cultural and Social Rights' General Comment 15, quoted here [slide]. General Comment 15 also points out that water should be accessible to all, including the most vulnerable or marginalised, and that accessibility incorporates both physical and economic accessibility. The importance of access can also be recognised without using the language of rights, as we see here from the Productivity Commission [slide].

Whether we view access to water as a right or not, I think it is safe to assume that everyone in this room today recognises that everyone in Australian society should have access to safe and sufficient water. 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.

### ***Access to water contributes to community wellbeing and social cohesion***

I would also suggest that, beyond meeting these most basic human needs, access to some discretionary water facilitates social inclusion and social cohesion in a highly developed country such as Australia. For example, when maintaining a garden is affordable for people on low incomes, there are social and individual benefits such as leisure and physical activity through gardening and the presence of residential green spaces which contribute to quality of life and wellbeing in our cities.

### ***Fairness and social equity matter to consumers***

Finally, social equity should be taken seriously because it matters to consumers. Consumers react negatively when they feel that distributions are unbalanced, especially if basic needs are not being met, or if there are big discrepancies between people and groups.

The Australian community, particularly following recent experiences of drought and restrictions, feels strongly about the water challenges we face and about the task of addressing them. The emotion that many in the community feel regarding water should not, I believe, be dismissed as irrational or unhelpful. There has been buy-in from consumers who have shifted their thinking on water and achieved large water savings through changed behaviours, appliance replacement, substitution of potable water and adherence to restrictions. In Melbourne, for example, per capita consumer of water has fallen from an average of 500 litres per day in 1981 to 330 in 2005 and further to 148 litres in 2008/9.

### **Social equity – what does it mean?**

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Before continuing I think it is important to clarify some of the terms and concepts I will be using in my discussion of urban water pricing.

‘Equity’ is a word that is used with a range of meanings, and this can create confusion. At the most basic level, equity has to do with fair distribution – both of resources (in this case water) and of burdens and responsibilities.

So what constitutes a fair distribution?

It should be obvious that this is a question about values. The debate about what constitutes fairness in distribution has been a major thread in political philosophy for a long time, and, I think it’s safe to say, it unlikely to ever be settled.

### ***Four principles***

It’s also a debate where people use the same terms with different meanings. There are common ideas about how society can fairly allocate a resource, all of which are relevant to the discussion about urban water pricing. I’ve outlined four of the most common principles on the slide here, using the terms that I’ll be referring back to throughout my presentation:

The first principle that can be applied is ***proportionality***, meaning that the allocation made to an individual is in proportion to their contribution. Applied to urban water, the principle of proportionality suggests that each consumer pays the costs that they, individually, impose on the system. At the same time, consumers who are willing to pay more are able to access more, but everyone is subject to the same processes and rules. This principle, which can also be labelled ‘*economic equity*’, is the most closely aligned with an efficiency focus.

The second principle we might apply is that of **equality**. The principle of equality suggests equal distribution among all. Applied to water, this would mean, for example, that each person would receive an equal amount of water. In the context of pricing, the equality principle could be used to support postage-stamp pricing or the equalization of charges across regions. While such a move would certainly be out of step with current directions in urban water, it's worth remembering that this has not always been the case. For example, in 1977 the UK passed the Water Charges Equalisation Act, the central aim of which was to reduce the disparity in average household bills across regions, with cross-subsidies from urban to rural households.

Thirdly, we might allocate water on the basis of **need**, whereby those who require more of a good receive more of it. In relation to urban water, this would entail universal access to water (as all human beings need water), regardless of capacity to pay, as well as an entitlement for more water for, for example, large households and individuals with special medical needs.

Finally, we might wish to allocate water on the basis of **social utility**, or what we consider to be in the best interests of society as a whole. This relates to my earlier points on social cohesion and societal well-being.

It's probably neither desirable nor achievable to distribute water according to a single one of these principles, and any system is likely to involve a combination of these. However, my argument today is that a greater emphasis should be placed on the latter three than is currently the case, particularly **need** and **social utility**. I'm going to return to these principles in relation to existing and proposed urban water pricing arrangements.

### ***Social equity amongst whom?***

Social equity concerns distribution among individuals and among different groups.

A primary concern is of course fair allocation between individuals from **economically disparate groups**. It's widely accepted in Australia that, regardless of income and capacity to pay, all households should have access to water and water services. This is certainly an absolutely fundamental principle for CUAC. We might also believe that the responsibility for conserving water should be shared fairly among individuals from different socio-economic groups.

We at CUAC are also interested in equity between consumers from **different areas**. In Victoria, there are large geographical differences in urban water prices, and water consumers in metropolitan areas pay substantially less than customers of the regional urban water businesses.

We also need to consider social inequities related to **housing situation**. I'm talking here about the allocation of water costs between tenants and owner occupiers. In Victoria, tenants pay the volumetric usage component of water charges, while landlords are charged the fixed component. This has all kinds of implications which I will get to in more detail later on.

Finally, another concern is about **intergenerational equity**, which ties in with sustainability. This will be a theme explored by the panel session later in the day.

### **Urban water pricing in Victoria**

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I'd like to build on these equity concepts in relation to urban water pricing arrangements in Victoria. I'll then go on to look at some of the urban water pricing reforms that have been proposed in Victoria and at the national level.

Just a brief overview on the Victorian urban water system and pricing for those who are based elsewhere. In Victoria we have 16 urban water businesses, three of which service different parts of Melbourne, and 13 regional urban businesses. All of these are corporatized, but government-owned businesses. The independent economic regulator, the Essential Services Commission, reviews business' price proposals and makes a price determination every 4 to 5 years, setting out how each business' tariffs can be adjusted during the period. There are separate determination processes for the Melbourne-based and the regional urban businesses. The Water Industry Regulatory Order sets out the principles that the ESC must have regard to in relation to price.

#### ***Inclining block tariffs***

Victorian water businesses have some discretion in the way they structure their tariffs. At the moment, most use a two-part structure including a fixed charge for access or service availability, alongside a volumetric charge for consumption. For volumetric charges, most businesses use an Inclining Block Tariff, or IBT. Under an IBT structure, the per-kilolitre cost of water is relatively low up to a certain level of consumption, generally intended to represent essential usage. For consumption above this threshold, which is presumed to be 'discretionary', a higher per kilolitre price applies. The most common IBT structure in Victoria has three blocks. IBTs are also used in a number of other jurisdictions.

Inclining block tariffs can be characterised as 'progressive' insofar as they allow low income households to access an amount of water at relatively low cost. The premise here is that high-income households use more water than low-income households (which indeed they tend to, on average). So the argument goes, the higher rate paid by these high-income households subsidizes the less profligate and presumably lower income users. In this sense, IBTs fit with a principle of equality, serving the aim of equal outcomes by providing cheaper access for those on low incomes.

But inclining block tariffs have also been heavily criticised on the basis of proportionality or *economic equity*. The National Water Commission, for example, in its 2009 biennial assessment argued that inclining block tariffs are inequitable in that they disadvantage larger households, which subsidise smaller users. Linked to this, the Commission's primary objection to inclining block tariffs was on efficiency grounds.

Consumer advocates have also highlighted the disadvantage that inclining block tariffs create for some water users. New South Wales' Public Interest Advocacy Centre, for example, has argued from the principle of **need** that inclining block tariffs discriminate against households that 'would reasonably be expected to consume large quantities of water to secure an adequate standard of living', such as those with special medical needs, large households, and households that accommodate transitory populations, such as some Aboriginal households. It is worth noting here that economies of scale within large households mean often, per capita consumption will actually be fairly low. Nonetheless, the price signal sent to these households under an IBT structure suggests that they are more profligate users. PIAC has argued that these households should be able to access all of their water at the (subsidised) lower first-tier rate.

At CUAC, our view on the social equity merits of Inclining Block Tariffs is mixed. On the whole, they may enable many low-income households to access water at a lower price than they would otherwise, which we see as worthwhile. On the other hand, as PIAC argues, they penalise large water users, some of which will have a strong need for water but less capacity to pay. It seems clear that where inclining block tariffs are used, they may need to be combined with other assistance measures for low-income consumers with special water needs.

### ***Geographical differences***

Looking at water prices in Victoria, perhaps the most striking thing we notice is the difference in average household bills between metropolitan and regional areas.

This graph shows the average annual household bill for owner-occupiers in 2009-10. The metropolitan water businesses – that is, those in Melbourne, are shaded in darker blue, while the regional urbans are in pale blue. You can see that the annual bill was less than \$650 for customers of the Melbourne water businesses. In the regions it's a different story, with average household bills over \$650 for all regional urban businesses. For customers of Goulburn Wimmera Mallee Water, Central Highlands Water and Gippsland Water, average annual bills were up around the \$1,000 mark.

In fact, this data shows that the average household bill for a Gippsland Water consumer, where prices are highest, was nearly double the average for City West water customers, with the lowest prices.

CUAC understands that these differences largely reflect the greater cost of providing water services to regional urban consumers, due to, among other things, the larger geographical area and fewer customers. A pricing arrangement that passes these costs to consumers aligns with a proportionality principle.

Nonetheless, we see this large disparity as quite problematic.

These figures are especially concerning when we consider them alongside ABS data on socio-economic disadvantage. For example, Central Highlands Water customers pay the second

highest water bills in the state, at \$951 per year. Central Highlands Water serves customers in Ballarat, a reasonably well-off area, but also services Victoria's **most disadvantaged** local government area, Central Goldfields shire, as well as Pyrenees shire, the third most disadvantaged of 79 local government areas.

### ***Concessions***

Fortunately, from CUAC's perspective, in Victoria we do have a state government water concession scheme to assist low-income consumers with their water bills.

The Water and Sewerage Concession, administered by the Department of Human Services, entitles eligible concession card holders to a 50% discount on their water and sewerage charges, capped at a maximum of \$245 per annum this financial year.

In 2009-10, the average value of the concession was \$168. The reason the average grant was well below the cap is that in Victoria, renters pay only the volumetric usage charges and not fixed charges, and a large proportion of concession claimants are renters. We think that the Water and Sewerage Concession serves this group – renters with moderate water usage - well. Nonetheless, it's worth acknowledging that while renters don't directly pay fixed charges, rents, which in Victoria are increasing around 5 to 15 percent yearly – above the CPI – may incorporate water price increases. Any fixed costs passed on to renters in this manner do not attract a concession.

There are also some social equity issues for low-income homeowners, particularly outside of Melbourne. An average owner-occupier customer of Gippsland Water, for example, might receive a maximum concession amount of \$245, constituting less than a quarter of the average household bill and still leaving around \$800 of charges.

What this means is that the Water and Sewerage Concession does little to remedy the unequal outcomes for regional and metropolitan water consumers in Victoria. We would like to see some thought given to revising the Water and Sewerage Concession to help ease costs for low income regional consumers.

### **Proposed Victorian pricing reforms**

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As I noted at the beginning, part of what prompted CUAC to hold this forum were the various pricing reforms that were being considered in this state.

#### ***Tariff choices for consumers***

One of the possible changes being considered by some water businesses in Victoria is the development of a number of different tariff options for customers to choose from. Yarra Valley Water made headlines last year with news that it was giving thought to options like an "environmental" tariff, (similar to 'green power' plans in the energy sector), where a customer



elects to pay more for water delivered in a more environmentally friendly way. I am sure that Tony Kelly will speak further about these and other ideas in his presentation later today.

Nationally, the idea of 'flexible' tariff options seems to have gained a fair bit of traction with the National Water Commission, which appears to have formed a preliminary view that customers can be 'empowered' and services 'improved' through a move away from 'uniform service offerings'.

We think it's worthwhile to have a discussion to work through the issues around these kinds of reforms. They need careful consideration, particularly around avoiding unintended consequences. Preliminarily, though, I'd like to flag a couple of potential issues we at CUAC think need to be addressed.

One concern is that these kinds of options have the potential to see the burden of demand reduction unequally shouldered by low-income consumers. I will discuss this in more detail when I come to scarcity pricing in a moment.

There is a potential for issues to arise if tariff options are introduced that provide cheaper water but in more limited amounts. Again, there is a parallel in the energy sector, where the introduction of smart meters creates the possibilities of supply capacity control and direct load control. Supply capacity control works by turning off household energy when a customer's consumption exceeds a certain point. This can be a useful capability in some circumstances, but there's concern about the potential for retailers to offer energy plans that encourage consumers to limit their access to electricity for credit management purposes. In Victoria, the ESC has recently prohibited the use of supply capacity control products for the time being. The development of tariff options in water would need to be done carefully to avoid creating similar issues around credit management and access.

We also have some trepidation about increasing the complexity facing consumers. This is informed in part by our experiences of the competitive retail energy market in Victoria, where we see that the complexity of options seems to be out of proportion to the motivation, knowledge and resources that consumers have to navigate the market successfully.

### ***Emphasis on consumption charges***

Secondly, we saw the election of a new coalition government in Victoria, which, during the campaign, flagged its intention to make changes to water pricing. The proposal is to change the balance between fixed and volumetric charges such that around 60% of the average bill comprises usage charges. The idea is that the pricing model will reward households for water-saving efforts and, presumably, give consumers a greater sense of control over costs.

CUAC's preliminary view is that while this has some intuitive appeal, it's important to work through the impact for different types of consumer. Firstly, it's worth considering whether the change would make much material difference to the average consumer's bill.

It is also important to note that the move would disadvantage some consumers, including tenants and large households. Because tenants pay the usage charges but not fixed charges, shifting water costs to usage charges would mean tenants end up paying substantially more. In turn, this could be expected to impact on expenditure for the Water and Sewerage concession, pushing the average concession amount closer to the 50% cap.

Considering that tenants are more likely than homeowners to be on a low income or experiencing disadvantage, a pricing approach which pushes up the amount they pay for water reflects poorly on the equality principle. The move could also have a negative impact for large households and others with legitimate high water needs.

The government has established the *Living Victoria* Ministerial Advisory Council, which is currently thinking about and working through these and other issues.

### **Proposed National pricing reforms**

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Moving to the national arena, there are also a range of major pricing reforms being considered, including in the National Water Commission and Productivity Commission reviews.

#### ***Scarcity pricing***

One proposal that has received a great deal of attention lately is ‘scarcity pricing’, which is also called by some proponents ‘dynamically efficient’ pricing. ‘Scarcity pricing’ is a way of pricing water so that the cost rises and falls to reflect variations in the amount of water available. When water is scarce, it costs more, encouraging lower consumption and creating the revenue needed to fund supply augmentation. The idea is to use price to balance supply and demand, making water restrictions unnecessary and potentially encouraging new sources of supply.

The National Water Commission has previously given some degree of endorsement to the idea of scarcity pricing. In its 2009 Biennial assessment of progress under the National Water Initiative, the Commission recommended that the state and territory governments “consider” “administered scarcity pricing,” while “using more direct instruments than water charges to pursue social equity objectives.”

CUAC has some very strong concerns about the potential use of scarcity pricing.

Our first concern is that a scarcity pricing system would potentially free up prices to go up or down with less control from government and regulators. It should be noted here that proponents sometimes argue that prices would in fact be lower under scarcity pricing, but in our view it is difficult to make that assertion with confidence in today’s uncertain climate and when there is so little experience, in Australia or elsewhere, of scarcity pricing for residential water. In any case, while we can’t assume that prices would increase substantially in a scarcity pricing scenario, they could, and this would not be controlled. Obviously, CUAC thinks it is unacceptable for water to be priced at a level where people on lower incomes cannot afford it. We are concerned about a pricing system that would make the scenario a distinct possibility.

Our second major concern is about fairly sharing the burden of demand reduction. When water restrictions, community education and awareness campaigns and other non-price tools are used to reduce demand for water, reducing consumption is seen as a whole-of-community task. Restrictions place an obligation on all residential water users to conserve water. It's true that some consumers with means can get around restrictions, for example, by using bore water or by purchasing water from third parties. Nonetheless, in theory and, to a significant extent in practice, these non-price demand reduction tools spread the burden of conservation equitably.

In contrast, when price increases are used to dampen demand, we would expect to see the task of reducing consumption falling on lower-income consumers, who are least able to afford higher water charges.

CUAC's assessment is that pricing, as a demand management tool, is less equitable than the other tools at our disposal such as consumer information and education and water restrictions. However, it is worth noting that some commentators argue that it doesn't particularly matter if using price as our principal demand management tool produces unequal outcomes.

It would be inaccurate and unfair to suggest that those who downplay the importance of equity do not see a need to maintain universal access to water for essential needs – they do. As far as I am aware, no-one is suggesting that any consumer should be denied access to water, which is essential for life, due to an inability to pay.

From CUAC's perspective, however, the problem is not so much that people don't agree everyone should have access to water, but that too little attention is paid to considering how universal access is maintained, particularly if and when we proceed with major and often unprecedented reforms, such as scarcity pricing.

Time and again, CUAC sees efficiency-focused commentators arguing that distributional impacts and access issues are not relevant to pricing, and suggesting that our pricing arrangements should be made as efficient as possible, while access and equity concerns are addressed elsewhere, for example, through income support policy or non-distorting concessions.

In principle, this is a good argument, but it ignores the fundamental reality that pricing reform in water is not guaranteed to be – perhaps not even likely to be – accompanied by a corresponding increase in income support, or concessions, or other social policy mechanisms. It is simply not good enough for major pricing reforms to be proposed and pursued on the untested assumption that social and distributional impacts will be addressed by state or local governments, or by the national income support system.

In our view then, any major urban water pricing reforms must integrate consideration of consumer impacts and the specific measures that will be needed to address any detriment. Advocates of, for instance, scarcity pricing, can show that they are serious about social welfare by modelling the impacts of their proposals for different types of low-income consumers, engaging with community sector workers like financial counsellors, and actually considering the

design of government, regulatory and industry assistance mechanisms to complement proposed reforms.

### ***Externality pricing***

Another proposed reform that has been considered is externality pricing. An externality pricing arrangement would incorporate into urban water charges not just the cost of physical infrastructure but other supply costs including impacts on the environment.

Again, the last National Water Commission biennial assessment suggested work on externality pricing, suggesting that ‘well-designed externality pricing can be a powerful and enduring way of dealing with the environmental impacts of water provision and use.’

Such pricing arrangements would contribute to intergenerational fairness by encouraging today’s water consumers to reduce the environmental impact of their usage. Nonetheless, identifying and then monetising externalities is, in practice, difficult.

As with any major pricing reform, careful analysis of the impacts for consumers needs to be an integral consideration for policymakers and regulators.

### **Conclusion**

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The thrust of my presentation today has been that social equity is relevant to water pricing and that social equity issues need to be part of the discussion on urban water pricing and pricing reform. This is, unashamedly, a value position. However, downplaying or dismissing social equity considerations in favour of an exclusive focus on efficiency is also a value position. I hope that my presentation has highlighted some of the social equity principles, issues and impacts that relate to urban water pricing, and that it has shown why they are important.

With these social equity objectives in mind, alongside our efficiency and environmental objectives, it’s time for a broader debate about our urban water pricing options. At CUAC, we think this discussion should include consumers and the community along with water businesses, regulators, and all levels of government. And we think that by bringing those different voices into the discussion, we will increase our capacity to implement urban water pricing that balances all the objectives we set for it. I hope that today’s forum will be a first step in this conversation.