

MANAGING PRICING REFORM IMPACTS ON CONSUMERS WITH SUBSIDIES

Issues Paper No. 7

Inquiry into the reform of SA Water's drinking water and sewerage prices

August 2013



REQUEST FOR SUBMISSIONS

The Essential Services Commission of SA (**the Commission**) invites written submissions from all members of the community in relation to the issues raised in this Issues Paper. Written comments should be provided by **5.00 p.m., Friday 8 November 2013**. It is highly desirable for an electronic copy of the submission to accompany any written submission.

It is Commission's policy to make all submissions publicly available via its website (www.escosa.sa.gov.au), except where a submission either wholly or partly contains confidential or commercially sensitive information provided on a confidential basis and appropriate prior notice has been given.

The Commission may also exercise its discretion not to exhibit any submission based on their length or content (for example containing material that is defamatory, offensive or in breach of any law).

Responses to this paper should be directed to:

Managing Pricing Reform Impacts on Consumers with Subsidies - Inquiry into the reform of SA Water's drinking water and sewerage prices

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The Essential Services Commission of South Australia is the independent economic regulator of the electricity, gas, ports, rail and water industries in South Australia. The Commission's primary objective is the *protection of the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services*. For more information, please visit www.escosa.sa.gov.au.

THE ISSUE

The Essential Services Commission of South Australia (**Commission**) is considering options for reforming SA Water's prices to achieve greater economic efficiency and better promote the long term interests of consumers.

The potential pricing reforms to be explored in the inquiry may have impacts on certain individuals and customer groups, including consumers who currently receive exemptions and concessions from paying water and sewerage charges. It is important that these impacts can be managed as necessary.

The Commission will, therefore, be examining strategies for delivering prices that are more economically efficient, while providing options to help ensure that customers in need of support receive adequate assistance.

The Commission will not be considering which customers should receive assistance (e.g. through exemptions and concessions). Those decisions are best left to the Government.

In addition, to the extent that assistance is provided through price discounts which may be inefficient, the Commission will examine whether such assistance can be more efficiently provided by other means.

Stakeholders are strongly encouraged to read Issues Paper 1 which describes the context and objectives of this inquiry, accessible [here](#).

BACKGROUND

The granting of exemptions and concessions is an important policy tool for assisting those most in need. Both water and sewerage charges are used to alleviate costs for some types of organisations and individuals.

- ▲ Land used exclusively for charity, public worship or state schooling purposes, is exempt, in part¹ or in full, from paying water and/or sewerage charges.
- ▲ A pensioner concession scheme operates to reduce the strain water bills can have on low and fixed income households.

However, where an exemption or concession is provided, the customer does not pay the true costs of using water or sewerage services. In the absence of pricing signals that reflect true cost, customers have little incentive to consume an 'economically efficient' level of services. For example, a price for water that is 'below cost' can lead to overconsumption, while a price 'above cost' can lead to underconsumption.

The following sections describe some of the main reform options to be considered by the Commission as a part of its inquiry, and how these may relate to concessions and exemptions.

Water Services

Also an issue is the interaction between the existing water 'inclining block tariffs' and water concessions. This system for residential water use sets a first tier of consumption below true cost and, therefore, acts as a form of social tariff.

Having two separate mechanisms aimed at helping low and fixed income customers, without evidence that low income consumers are also low usage consumers, is likely to result in higher prices for customers overall.

The Commission is separately considering broader reforms to promote greater economic efficiency in water tariffs, including the review of inclining block tariffs. (Refer Issues Paper 2 – Water Pricing [here](#))

Sewerage Services

Charges for standard domestic sewerage services are currently based on the capital value of a customer's property. The property value is seen as a proxy of capacity to pay, and property-based charging is therefore considered to be 'fair'.

A flat rate sewerage concession applies on top of property-based charging, for eligible concession holders.

Having two social equity measures operating separately could be affecting the efficiency of the sewerage concession scheme. The Commission is separately exploring options for greater economic efficiency in charging for sewerage services, including the review of property-based charging. (Refer Issues Paper 3 – Sewerage, Trade Waste and Property-based Charging [here](#)).

¹ SA Water fee schedule, Community Concession Water and Sewerage Rates

CURRENT ARRANGEMENTS

While economic principles suggest it is not appropriate to dictate how consumers spend their income (or entitlements), the Commission acknowledges that the South Australian Government considers direct application to water and sewerage bills the most appropriate way to provide assistance to vulnerable consumers.

Exemptions

The water and sewerage exemption schemes are set out under transitional provisions of the recently repealed *Waterworks Act 1932* and *Sewerage Act 1929*. The *Water Industry Act 2012* supersedes both of these Acts, however, an exemption scheme to apply under this new law has not yet been implemented.

Exempt land can be charged some form of water or sewerage rates if, after consultation with SA Water, the Minister so instructs. For example, exempt landowners are currently billed sewerage rates based on the lower of property value, the minimum charge and a fixed charge per toilet connected to the sewerage system.²

SA Water receives a customer service obligation (CSO) payment from the Treasurer to recognise the rates and revenue it forgoes under the exemption schemes.

Water concessions

The current water concession scheme operates under section 25(1)(o) of the *Water Industry Act 2012*. Eligible pension and concession holders receive a percentage discount (currently 30 per cent) of water charges, subject to a yearly minimum and maximum. This concession is applied as a credit on their bills.³

Tier one water prices apply to the first 30kL of use per quarter for all residential land. It is priced slightly below the true cost to SA Water of providing that water.

Sewerage concessions

A flat rate per annum sewerage concession is applied as a credit to the bill of eligible concession holders. This is in addition to any benefit arising under property-based charging. The double concession of property-based charging, which is supposed to reflect the ability of customers to pay, and the application of sewerage concessions, could be an inefficient way to deliver sewerage bill assistance.

Water and sewerage concessions are funded and administered by the Minister for Communities and Social Inclusion ('the Minister') and applied to customer bills by SA Water.

OPPORTUNITIES FOR CHANGE

There are a number of opportunities to improve the economic efficiency of water and sewerage exemption and concessions. A change would improve economic efficiency if it increases the overall benefit to the state without making customers on the current schemes worse off.

Exemption options

Option 1: Maintain current exemptions (status quo)

The primary benefit of the current approach is the social value associated with helping land users who have less capacity to pay. Other benefits include the promotion and support of charitable and religious works.

The main downside of the current approach is the price distortion that follows from a lack of price signalling to exempt land users. This often leads to an economically inefficient level of use. It also costs SA Water to administer the scheme.

Option 2: Applications for exemptions

SA Water could require land users to apply for exemptions from water or sewerage rates, rather than have them apply automatically to particular land uses. This would place the onus on customers to demonstrate eligibility.

The benefits of this might include the user gaining 'ownership' and appreciation of the costs associated with the exempt activity, which could lead to more efficient behaviours. However, implementing an application process would likely result in costs for the applicant and SA Water.

² The South Australian Government Gazette, *Community Concession Sewerage Rates*, 27 June 2013.

³ Note private tenants receive a payment as their landlord is the water customer.

Option 3: Exemptions as a percentage discount

The current scheme is based on the use of the land, rather than water requirements. It may, therefore, be more efficient for it to operate as a discount (and not a specific set of tariffs), similar to pensioner concessions.

Under this approach, an exempt customer would be charged the full price of the service consumed, but receive a percentage discount as a credit on the bill, reducing the total amount owed.

This type of scheme could benefit the community as it provides more accurate water use price signals to exempt customers. This would also simplify water and sewerage tariffs.

Option 4: Exemptions as rebates

Another approach could involve giving rebates to exempt landowners.

An exempt customer could be charged the full price of using water and sewerage services with a rebate provided on the bill. The rebate could be fixed, comprise more than one fixed value depending on use (like the South Australian Government Water Security Rebate), or means tested in some other way. However, means testing is likely to result in additional costs.

This option provides less complexity and more transparency in water prices. It would also provide certainty for exempt customers about the bill assistance they receive.

Concessions options

Each state operates a pensioner concession scheme for water and/or sewerage charges:

- ▲ Tasmania and NSW (from October 2013) only give concessions on supply charges
- ▲ Victoria and Queensland provide a percentage discount on charges, up to a yearly maximum
- ▲ WA provides 50 per cent concessions on supply charges and water consumption, up to a region-dependent maximum kL usage.

There is no prevailing system.

Option 1: Maintain existing concessions (status quo)

The benefits

The legislative and administrative regimes for the current schemes are already in place.

Concessions as a credit on bills promote some customer understanding of the true cost of consumption (at least for water).

A percentage discount of charges can provide more help in actual dollar terms to larger households. The current sewerage pricing and concession provides certainty to customers regarding the cost of sewerage services for the year.

The schemes are transparently funded by the taxpayer through the Minister.

The downsides

This scheme could be leading to overconsumption of services. There may also be some duplication of effort as administrative costs are incurred by both SA Water and the Department for Communities and Social Inclusion (DCSI).

The scheme still encourages customers having difficulty paying their bills to use less water – despite their needs, at a potential cost to public health and efficiency. High water users can benefit less in proportion due to the application of the maximum concession, while exceptionally low users benefit proportionately more due to the minimum concession.

Asset rich, but income poor pensioners benefit proportionately less under the current flat rate sewerage concessions.

There are also double concessions of tier one pricing plus concessions for water and property-based charging plus concessions for sewerage.

These factors suggest that the current concession scheme may not be the most economically efficient way to achieve the social outcomes sought.

Option 2: Adopt a percentage-based concession for sewerage (and keep status quo water concessions)

A change in legislation and administrative practices would be required, at a cost, if percentage-based sewerage concessions were to be adopted.

However, a percentage based concession:

- ▲ should be able to leverage off of the current water concessions legislative and administrative regime
- ▲ is more likely to be adaptable to pricing reforms and changes in the charging regime

- ▲ could better help concession holders because they would receive a greater benefit in dollar terms when facing higher charges.

Option 3: Cap bills for eligible concession holders

Capping bills directly combats affordability issues and removes the chance of bill shock for vulnerable concession holders. It also removes any incentives to under use, which can lead to public health issues and economic inefficiency.

The Watersure program in the UK operates in this way for low-income, metered customers with high essential use, either with medical conditions, or with three or more children.⁴

One view is that such a scheme should only apply to high essential-use customers and that their bills should be capped at either the national or regional average. However, capping bills does not drive efficient consumption behaviours, as customers can keep using, knowing there is a limit to what they will pay. In this way, a bill cap scheme will generally provide greater benefit to those who use more.

It can be difficult to budget for this type of scheme, as the full value of concessions is unknown at the outset. Any change would involve some costs associated with amending legislation and administrative practices.

As with any change from the status quo, an appropriate timeframe may need to be allowed for transitioning to the new arrangements.

Option 4: Give vulnerable customers an allowance of essential volumes of water and charge the appropriate tariff for further 'discretionary' use

There would be initial costs associated with making changes to the legislative and administrative regimes for a change in concession practices. Work would also be required to establish an appropriate 'essential' volume of water, and to establish and keep records on concession holders and household occupancy, in order to apply the concessions appropriately.

An allowance (applied as a credit to the bill) would have the benefit of removing any incentive for vulnerable customers to underconsume on

their essential water use. This could reduce the risk of public health issues, while still encouraging the efficient use of water.

It is relatively simple for Government to budget for a scheme of this type, as the costs are largely fixed in any one year.

Again, an appropriate timeframe may need to be allowed for transitioning to the new arrangements.

Joint operation of exemptions and concessions

Option 1: Exemptions and concessions apply under the same scheme

Exemptions and concessions could operate under the same scheme, while still achieving a social outcome at least equivalent to that under the existing, separate schemes.

The main benefit would be reductions in administrative costs (and removal of duplication) for SA Water, DCSI and the Department of Treasury and Finance. It would also simplify water and sewerage tariffs, and the discounts that are available for exemption and concession customers.

There would be costs to change legislation and administrative practices for the schemes to operate as one.

Funding options

The following funding options apply to all of the options listed above.

Option 1: Government (taxpayer) funded concessions

The pensioner concession is currently funded by the State Government in recognition of the rates and revenue it forgoes and the administrative costs it incurs under the scheme. This type of funding arrangement is usually preferred by both the public and policy makers, where social welfare outcomes are sought.

The benefits are that:

- ▲ the legislative and administrative regimes are already in place
- ▲ the funding and application of CSOs is transparent
- ▲ there is no cross-subsidising between water users.

⁴ Walker, A, The Independent Review of Charging for Household Water and Sewerage Services, December 2009, p 119.

Under this type of arrangement, the eligibility of customers for an exemption or concession is determined and administered within a government department. This information is then communicated to the utility. The utility must then apply the appropriate exemptions and concessions to customer bills.

Once applied within the utility's billing system, the utility must inform the government department of the full value of exemptions and concessions in order to obtain a transfer of funds and settle its accounts. It usually also receives additional funding to compensate it for related administrative costs. There is likely to be some duplication of efforts within this process.

Option 2: Water-user funded (funded and administered by SA Water and its customers)

Customers receiving concessions could have their bills subsidised by other water users, rather than being funded externally by Government. This already happens to some extent with inclining block water tariffs and property-based sewerage tariffs, where high water users, and those living in high value properties, pay relatively higher charges for the same services.

SA Water would administer these cross-subsidies between groups of water users and it would, therefore, incur some costs. Legislative changes would also be required.

Generally cross-subsidies are not favoured by regulators as they introduce distortions that can lead to inefficient consumption.

It is possible, however, that the overall administrative cost, at a state level, would be lower than at present because of the reduction in the number of parties involved. (Government departments would no longer have any direct role in administering concessions).

QUESTIONS

The Commission seeks the views of interested stakeholders on the above matters and, in particular, in relation to the following:

Q: How should a scheme for issuing exemptions or concessions on water or sewerage charges operate?

Q: Who should fund the issuing of water or sewerage exemptions or concessions?

Q: Should water and sewerage exemptions and concessions operate under a single scheme?

Q: Should exemptions be given automatically or should they be applied for?

Q: How can charges or tariffs to exempt customers best be determined?

Q: What is an appropriate timeframe for transitioning to any new concession or exemption scheme?

Q: Are there any other relevant issues, considerations or opportunities for change that should be considered as part of this inquiry?

FURTHER INFORMATION

Any queries relating to this consultation should be directed to:

▲ Brooke Palmer, Analyst

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