Submission To:

Subject: **Water Pricing Reform – Inquiry into the Reform of South Australia's Drinking Water and Sewerage Prices**

Attn: **Essential Service Commission of SA**

From: **Uniting Communities**

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Comment

Uniting Communities is well aware of the significant cost pressures on households for basic living costs including the costs of housing and utilities. We appreciate the opportunity to make this submission albeit later than is ideal. Unfortunately the business of the organisation and the many issues we try to keep abreast of made it difficult to respond in writing to this enquiry before Christmas this year.
We are disappointed that resourcing to support consumer engagement in this process, for example though our 'peak body' SACOSS has not been available, despite being legislated by the SA Parliament. We also recognise that this situation has been beyond the control of ESCoSA.

Principles

We recognise that there are a number of principles at play in determining (drinking) water and sewerage pricing. The following teases out some of those principles as a basis for our more specific comments relating to details of the inquiry. We consider principles under three headings:

1. Public Policy Principles
2. Regulatory Principles and
3. Water and Sewerage Specific Pricing Principles.

Public Policy Principles

Principle 1. Access to water and sanitation is a 'Human Right"
The UN General Assembly on Wednesday July 28th 2010 recognized access to clean water and sanitation as a human right.
The non-binding text "declares the right to safe and clean drinking water and sanitation as a human right that is essential for the full enjoyment of the right to life."
This means that as a basic human right and as a public good, the provision of water is a fundamental responsibility of government, in this instance state government.

Principle 2. Water is an Essential Service (and has no substitute)
We start with the oft quoted but core principle that water is an essential service and we suggest therefore needs to be treated, in both a policy and a regulatory sense, differently from other standard economic goods, for which there are substitutes and consumer discretion.
Water is essential for the maintenance of human life; it therefore has substantial private value to individuals. Water is also a 'public good' and very much a 'merit good'. For example, the public health benefits of sanitation and appropriate use of water for cleaning and hygiene are crucial elements of both the merit good nature and public good nature of water. At the same time, we recognise that there is economic value to water for example for agriculture, horticulture and most other businesses and there are also luxury elements to water consumption for example; swimming pools, spas etc. (A short background paper on the nature of water as an essential service is given as appendix 1)

This complexity in the nature and use of water does make pricing a complex matter and so some of the following principles seek to put some waiting on how to proceed with water and sewerage pricing.

Principle 3. Best interests of end consumers
Water policy and in particular the pricing of potable water and sewerage must be in the best interest of end consumers. We recognise that this is central to ESCOSA's approach but we reiterate the importance of this principle.

Regulatory Principles

Principle 4. Regulation is the responsibility of the independent Regulator
All aspects of water and sewerage pricing regulation need to be left to the independent regulator, ESCOSA, to determine. As provider of water and sewerage services, the SA Government, through SA water has a crucial, but vested interest in water pricing and service provision. We recognise that leaving full regulatory responsibility with the regulator is difficult for government given that it has significant responsibilities in provision of water and that water provides significant return to the state government. However, leaving the regulator free to regulate is critical. This includes not limiting or specifying any of the variables in pricing formulas, eg through 'pricing orders.'

Principle 5. Up to date, comprehensive data needs to be publicly available
The up to date provision of good quality data made available for public use is an essential responsibility of the regulator, and essential for sound regulation. A precondition for effectively competitive markets is perfect (we'll settle for adequate) information to be freely available to all consumers.

Principle 6. Meaningful Consumer Engagement
Ensuring that there is significant consumer engagement in all elements of water and sewerage pricing and regulation, on an ongoing basis, is also crucial for good public policy and good regulatory approach. Consumer engagement means that the opinions of a range of consumer interests are sought, particularly regarding the larger cost elements of a regulatory price determination. Where consumers are consulted, they need to be given clear information about cost, quality of supply options and related trade-offs.

Water and Sewerage Pricing Principles

Principle 7. Equity of pricing
Given the essential nature of water and sewerage services, it is crucial that pricing for at least all reasonable household use is equitable. This means that there should not be significant variations in costs as a proportion of household income for an essential quantum of water or sewerage service use, for any household.

Principle 8. Efficiency of pricing

We recognise the value of cost reflective pricing as a principle, but recognise that this is not always easy to apply in practice, compared to the principle. We are also aware of the coming debate about application of Long Run Marginal Pricing for energy, as part of the AEMC's Distribution Network Pricing Arrangements rule change process. There may be implications of this consideration for South Australia's water and sewerage pricing arrangements.
If there is a situation where equity and efficiency of pricing are in conflict, then equity of pricing must take priority.

Principle 9. Reasonable Commercial return only to SA government
The aggregate return to the SA government for all revenue derived from provision of water services are to be through SA Water need to be at a reasonable commercial return no more. By aggregate return, we mean all revenue flowing to the SA government, through SA Water profits, through taxation and through any cost of capital charges. It is unreasonable for a state government to utilise the provision of essential services to double or even triple dip for state revenue purposes. We are aware that there is a tendency for such behaviour to happen for other jurisdictions interstate and overseas with regard to the provision of utilities, in some instances.

Uniting Communities Client Experiences

The experience that is constantly being recounted to a number of Uniting Community services, in particular aged care, disability and financial counselling services, is one of growing budgetary pressure for households through rising costs of housing coupled with rising utility costs. This refers to the rising prices of electricity, gas as well as water.

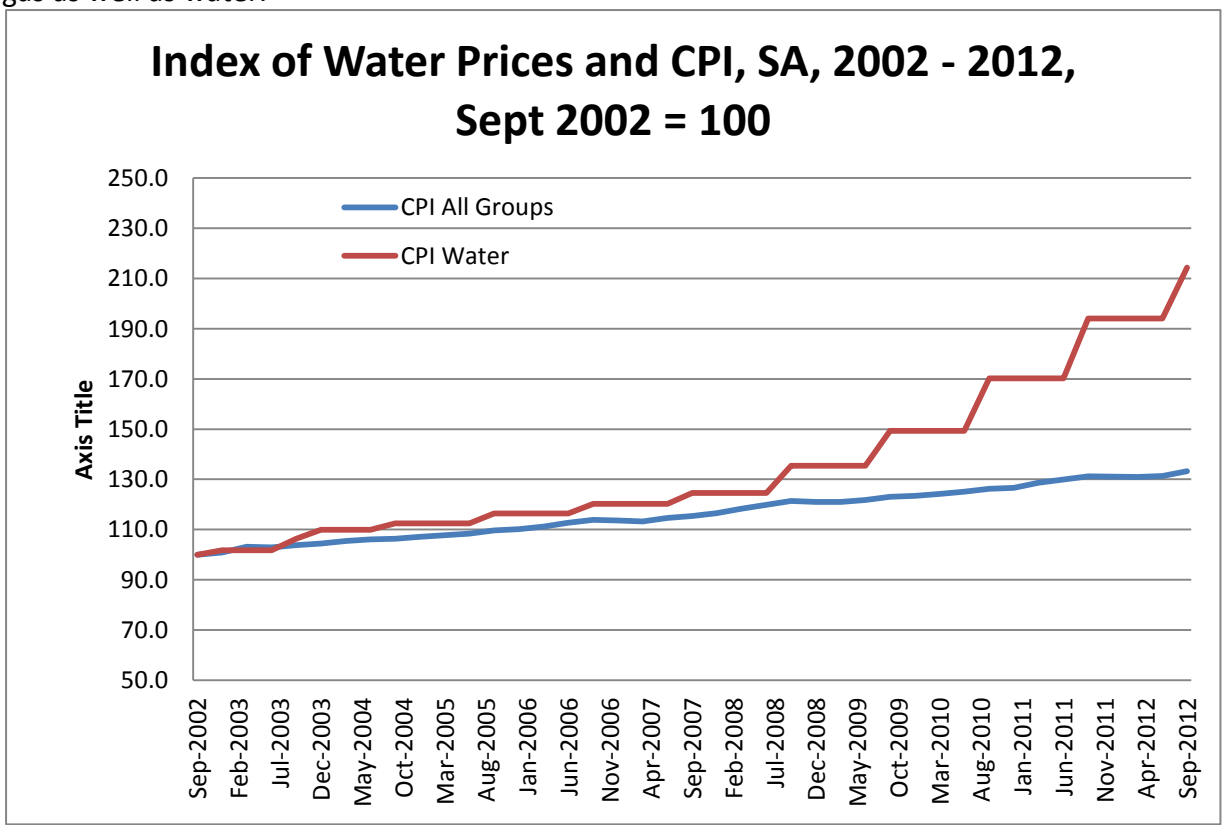

Chart 1. Source ABS, 8 City CPI

Chart 1 shows the rising cost of water for SA end consumers compared to CPI. We note that a majority of low income households both people reliant on government transfer payments and people whose income is tied to minimum wages, have their income linked very closely to CPI rises. The rapidly rising cost of water compared to income rises is having significant adverse impact on growing numbers of SA households. Indeed, some financial counselling clients are now spending up to two thirds of their income on housing plus utility costs; this is indicated in chart 2 where housing plus energy costs as a proportion of household income are graphed by decile and this with a 5 – 95 percentile range within each decile. Water costs are not included in this chart.

Housing + Energy costs as proportion of household disposable income, by Quintile, SA 2010

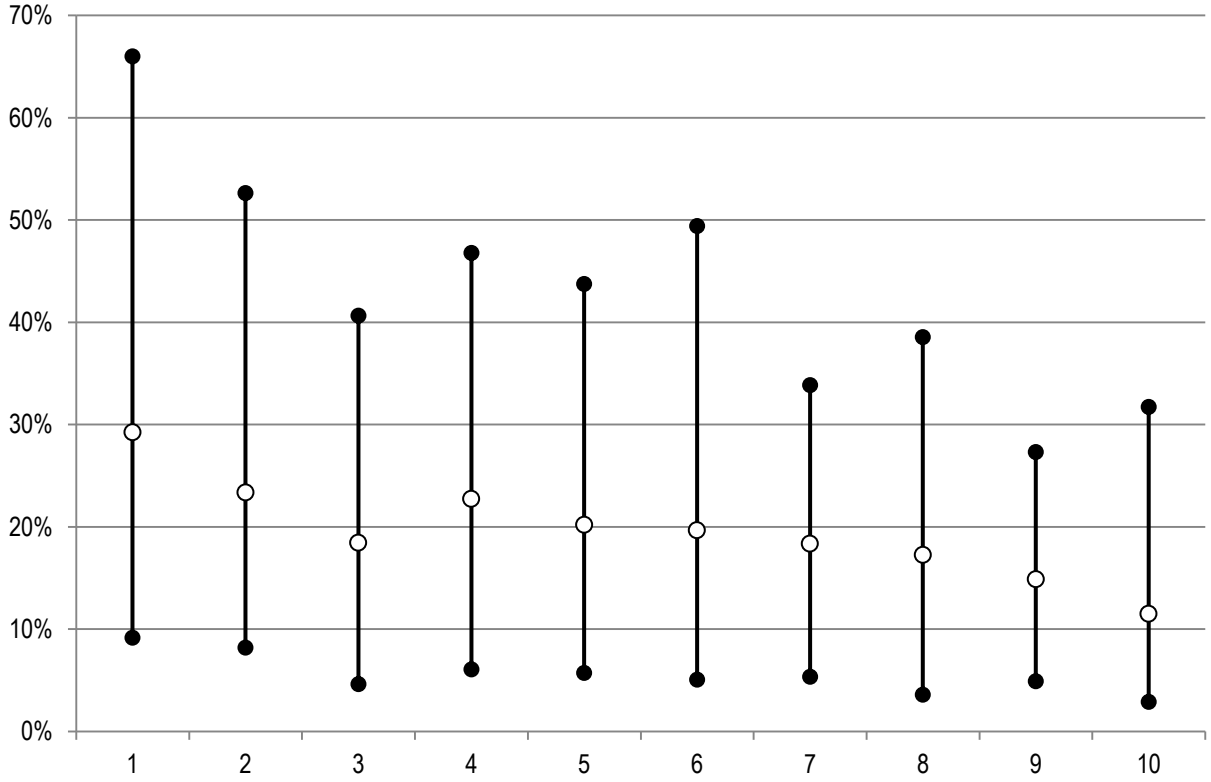

Chart 2. Source ABS Household Expenditure Survey, CURF files, unpublished

These high housing + utilities costs clearly leave very little room for food, health services, education, transport and a myriad of other normal household expenditures. We are not saying that water is the sole, or even a major contributor to these cost pressures, however the rapidly rising cost of water along with rising housing and energy costs is creating a substantial burden for a growing number of households.

Specific Issues Arising from the Enquiry into SA Waters Drinking Water and Sewerage Prices

The following brief comments refer to specific aspects/ questions posed in the various discussion papers.

The Structure of Drinking Water Tariffs including Supply Charges

We recognise that there are different categories of SA Water customers and state our view that the priority customer category must be 'residential consumers', with regard to meeting essential, human right water services, and the lowest efficient cost of supply that is possible. Higher prices are acceptable for 'luxury' water use by households, eg for swimming pools, spas, large gardens etc.

Water for economic activity can be sold according to market principles where price allocates efficiently between competing commercial uses.

We also recognise that water is essential for environmental purposes, but do not consider this important allocation to be directly related to drinking water pricing.

Our main concern is for affordable and adequate drinking water to be available for all households, to meet essential purposes – drinking, cooking, washing and hygiene, including sanitation. In particular, lower and modest income households need to be able to afford the water that they need.

For pricing, a key question is how to fairly meet fixed, network costs and usage charges. For lower income residential households, in particular, the fixed supply charge should be as low as practical, both for affordability purposes, but also to strengthen price signals for use.

Regarding 'use' charges, we support a rapidly rising inclining block that starts with modest use charges for a reasonable quantity of 'essential use water'. Re recognise that this level of 'essential use water' will need to change with household size, and maybe some other variables. Further discussion is needed to determine reasonable annual consumption amounts for households. The current arrangement of two additional charges for higher use is supported, though some more discussion would be useful about the use levels at which different charges would apply. WE are comfortable with the third level, high use being a high charge per kilolitre, to reflect 'luxury' use of water.

Comments about some other aspects of water pricing are given later in this submission.

Options for Pricing Sewerage Services including the Removal of Property Based Charging

Uniting Communities is very interested in the question of how best to charge for sewerage services, noting that it is not a metered service, but it is a service with significant public health, public wellbeing and implications for general benefit across the community. We are also acutely aware that rising utility costs burden is having significant detrimental impact on a growing number of low income households.
The equitable and efficient way of charging for sewerage prices is a vexed question. We are well aware of the complexity of this policy/regulatory question and the difficulty in coming up with an ideal approach, particularly with reference to the various principles (unweighted) that we have listed earlier in this submission.

We however wish to emphasise that of the five options given in the discussion paper number 3, Uniting Communities continues to believe that sewerage charges based on residential and commercial property value are still the best option, in both equity and efficiency terms, for charging for sewerage costs.

We recognise the argument that prices for sewerage services bare little cost in relation to actual cost where a property value based charging process is used. However we do not believe that there are other pricing options which deal with this issue without imposing considerable extra household costs for measuring (sewerage) system use. We are also strongly opposed to a fixed charge that is based on a 'flat rate' charging system for sewerage services because such an approach is highly regressive. As such fixed sewerage charges significantly disadvantage lower and modest income households which are quite contrary to acting in the best interest of consumers, our principle 3.

With any change in pricing system there is going to be some winners and losers, however property value remains a good proxy for capacity to pay for an essential services like sewerage charges and property based pricing for sewerage provides a much more equitable approach than any of the other approaches suggested in the issues paper.

The current property value based arrangements for sewerage pricing are also efficient because property valuations are undertaken on a regular basis and therefore can be readily applied to sewerage charging, with minimal marginal cost for sewerage service consumers.

Given our ongoing support and strong presentation to ESCOSA about the merits of maintaining property value based arrangements for sewerage service charging, we recognise that there is still some need for improvements to improve the fairness of the current system. In particular the major criticism, particularly on equity grounds, for property based charging is for households that have high property values, but low income; typically pensioners living in the family home are examples of this sort of situation. We believe it would be appropriate to have an adjustment provided to households in this situation based on application to the concessions unit of Department of Social Inclusion, whereby people with high property values, but low income would receive a reduction in their sewerage charges based on their reduced capacity to pay. This adjustment uses existing processes and so does not add significant costs to the current system, but adjusts for inequities.

We are keen to be part of further debate about this vexed issue, but at this point we are strongly of the mind that sewerage charges should continue to be levied on the basis of property value for both equity as well as efficiency reasons.

A critical issue for sewerage charging is that consumers are charged no more, in aggregate, than the actual cost of providing sewerage services. This includes renters who cannot experience actual rental increases from any process that leads to sewerage charges becoming exogenous rather than endogenous to rent.

Structure of Drinking Water Tariffs in SA

Uniting Communities supports the principles of cost reflective pricing with the rider that there is careful consideration of likely impacts on different classes of consumers before any significant changes are introduced. In particular, we are still aware of the sudden increase in electricity prices when full contestability was introduced and retail prices for consumers leapt by 25% to 30%. This had a massive impact on our clients and other low income and disadvantaged households. A repeat of this experience would be a disaster!

It is fair and reasonable however that the actual price of delivering water services is charged in as cost effective manner as possible and in particular it is crucial that where consumers use less water, for example through conservation measures and other approaches, then water prices need to come down. Our experience with electricity prices is that consumers get very angry when they use less electricity, and yet their bills keep going up.

Postage Stamp Pricing

We understand the range of issues associated with state wide pricing, or 'postage stamp pricing', but believe that the essential nature of water means that affordable water supply needs to continue to be available for everybody and that postage stamp pricing should remain for residential drinking water and sewerage services, where these exist. We are however open to further consideration of this question through forums. The availability of, perhaps, additional data about costs and benefits and for whom, of postage stamp pricing would also help make more informed choices.

Price Variability over Time

We are not attracted to the idea of water prices changing over time; with weather, seasonal variability or whatever other factors change. This is particularly the case given that we regard the supply of adequate levels of water to households to be a core responsibility of government (our principle 3) and this is a core responsibility irrespective of the weather or the season. Similarly, consumers have been paying for water management and infrastructure for a long time, so that the vagaries of weather and rainfall are managed, in the interests of all consumers.

Pricing Water Planning and Management Costs

We believe that reasonable planning costs are part of the operating costs of providing water and sewerage services; however we are wary of utilising water and sewerage prices to implement broader policies whether called for by communities, or decreed by governments. Where environmental policy, for example, impacts on water issues, the costs of this sort of planning and management needs to be borne by other parts of State Treasury and not be added into residential water and sewerage charges.

This is another issue that we would be keen to be part of further discussion regarding particularly with additional information and data being available.

Changes to Metering

We accept the principle that every water consumer should have access to metering which enables an accurate reading of their use. We recognise that this is not easy in some multi tenant dwellings.

However, we oppose individual metering in more institutional care setting, for example high care nursing home beds, hostel care, mental health boarding houses and supported residential facilities where each individual has only a bedroom of their own and all other facilities are shared. In this instance, water charging should be levied to the property owner, or property manager who would then determine the appropriate ways of covering costs for water and sewerage. Where a service provides more autonomy to a resident, and there is capacity for the resident to adjust their water use, for example in 'transition to independent living' then individual metering is probably appropriate.

We are aware of some talk about the merits or otherwise of "smart metering". We recognise that there are some benefits for consumers under some smart metering arrangements but invariably the benefits are more likely to accrue more to the water industry providers than end consumers. The particular test that needs to be applied to smart meter considerations is whether the introduction of smart meters will unequivocally save customers money in the medium term? We would suggest a payback period of no more than 5 years. Of critical importance too is the cost that would be borne by consumers directly or indirectly for new metering arrangements. Any change in metering can only occur, in our opinion, where there is an unequivocal case that consumers will be better off and within a reasonable timeframe.

The crucial point is that renters cannot be confronted with increases in rents due to endogenous water and sewerage charges being made exogenous and added to prevailing rental costs.

Who Should Pay Water and Sewerage Charges?

The principle here should be that users pay efficient water and sewerage charges and that water charges are based on use for use beyond a reasonable 'essential allocation'. Water and sewerage costs must be reasonable and affordable for all households. Should there be a change from current arrangements for rental properties in particular, where landlords currently pay water and sewerage charges and these are incorporate into the rental payment made by tenants, then it is essential that any transition from the current arrangements to a new system only occur in a manner that is cost neutral to tenants.

This would mean that a transition path would be required for shifting charging from landlord to tenant and we would strongly suggest that side constraints would be needed to set bounds that would limit the range in which any price increases could occur. Again this is an issue that would be a useful topic of a forum of interested parties.

How can the Impacts of Price Reform be Best Managed?

We believe that there is strong argument for establishing affordability benchmarks for essential services, including water. A water affordability benchmark set as water, and sewerage (costs) as a percentage of household income would be a useful guide. We do not have the data to make an informed estimate as to what an appropriate benchmark would be, but strongly suggest that establishing an affordability benchmark before making significant changes to pricing arrangements for residential consumers for drinking water and sewerage services would provide a sound basis for any change.

Our experience of the dramatic increase in electricity prices during the 2003/04 period highlights to us the importance of any transition being carefully managed with a price path set for individual consumers. Any change arrangements that are occurring must include 'side constraints' to limit adverse impacts on consumers. Also, any change in pricing arrangements should only be undertaken with very clear modelling about likely winners and losers under any proposed new arrangements.

Careful consideration, including active consumer engagement, needs to occur, particularly with consumers likely to be adversely effected. This would likely occur in a manner that would help to determine what the best transition arrangements are and to help consumers identify where their longer term best interests were being served.

Further Information or questions

Please direct any questions or comments regarding this submission to;

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Appendix 1

The Economic Characteristics of Essential Services (eg Water)

Defining an Essential Service

Water and Sewerage pricing should be based on an understanding of what it is that makes a service an essential service, which then leads to the question as to whether an essential service should be managed / considered / operated in different way to a standard economic good or service. In short: "is water different from a can of coke or a hair cut?" Does market theory need to be modified when managing the provision of an essential service?

Core elements of an economic good or service

From economic theory there are standard characteristics of any economic good or service:

- Generates utility/benefit for the consumer
- Has price
- Has value
- Demand increases as price decreases

Other characteristics of an economic good or service

Economic theory also suggests that an economic good or service is also likely to have the following characteristics:

- Homogeneity (the good or service has consistent characteristics that can be described, but there may be some variability eg an apple is a good but there are subtle variations between good, a granny smith and royal gala are different, but both are universally recognised as apples)
- Safe (within socially determined or regulated limits)
- There is accurate and accessible information about the good or service
- Scarcity (there are tangible limits to the amount that can be produced / consumed)
- Substitutes exist

Economic theory has also recognised that not all goods and services have the same characteristics, nor are they equally desirable

Characteristics of a "Merit Good"

The concept of a merit good was introduced into economic thought by Richard Musgrave (1957, 1959). A merit good is a commodity that an individual or society should have on the basis of some judgement about need, rather than ability and willingness to pay. Two core characteristics of merit goods were identified as being:

1. When consumed, a merit good creates positive externalities (an externality being a third party/spill-over effect which arises from the consumption or production of the good/service). This means that there is a divergence between private benefit and public benefit when a merit good is consumed (i.e. the public benefit is greater than the private benefit). However, as

consumers only take into account private benefits when consuming merit goods, it means that they are under-consumed (and so under-produced).
2. Individuals are myopic, they are short-term utility maximisers and so do not take into account the long term benefits of consuming a merit good and so they are under-consumed.

Merit goods include education, parks and health prevention goods.

There is also another class of goods that have been identified: public goods.

Characteristics of a public good
A public good or positive externality will have these characteristics:

- Non rivalrous (does not exhibit scarcity, at least not to the same extent as an economic good exhibits scarcity)
- Non excludable (once it exists, no one can be excluded)
- Plus core characteristics above, generates utility, has value, has price, but not necessarily determined by a market.

Yet another category of goods are natural monopolies

Characteristics of a natural monopoly
A natural monopoly exists where the marginal costs of production of a good or service diminish as quantity produced increases (economies of scale). There is an understanding from economists that the efficient supply of a natural monopoly is best provided by a monopoly that is (at least) the subject of strong government regulation and monitoring. These standard economic definitions lead back to the question of whether an essential service has some characteristics that are different from a standard economic good or service.

We believe that none of these categories of a 'good; satisfy the specific characteristics of an essential service, in this case, water. We think that economics (and regulators) needs to recognise the specific characteristics of an essential service, we suggest the following.

Suggested characteristics of an 'essential service'
We suggest that an essential service has the following characteristics:

- Universality, all citizens need access to the good or service, at least to a pre-determined (regulated) level.
- Access to the service is generally regarded as a 'human right'
- There is public benefit as well as private utility derived from provision / consumption of the service.
- No clear substitute good or service exists
- Levels of demand, and capacity to purchase, vary greatly between consumers
- There are elements (at least) of natural monopoly associated with provision of the service
- There are health / safety / well-being consequences of non-supply for individuals.

Implications of water being an essential service

In developing water and sewerage pricing policy, specifically for supply to residential consumers and small business, differences between an 'essential service' and a standard economic good need to be understood and taken into account in developing policy. In order to consider this question the following are presented as factors that differentiate an essential service from a standard economic good / service:

- Supply guarantee: There needs to be a guarantee of a minimum level of supply to ensure that all customers have access to the essential service to at least meet their most basic needs.
- Regulation and Monitoring: Government regulation and monitoring is essential, including setting some price limits and safety guarantees
- Primacy of regulation: Where regulatory outcomes are in conflict with 'effectively competitive market' models, then it is the regulated outcomes that must endure.
- Risk not socialised: Governments / regulators must have regard for market outcomes for supplier entities, but have no responsibility to guarantee profits, or to set a predetermined profit margin.
- CSO's: Communities through governments can require suppliers to meet certain Community Service Obligation (CSO) goals, recognising the capacity of businesses to utilise market mechanisms to meets CSO goals or targets.
- Regulators should require information to be provided from the market, and be readily available to the public to ensure transparency to enable informed consumer decisions
- Default choice. While competitive markets are assumed to operate optimally where consumers have choice and reflect preferences though price, many consumers have limited capacity to make informed choices in complex market with considerably less than perfect information being available to consumers. For these consumers a 'default choice' needs to be available that provides a fair service at a modest (and reasonable) cost. This default choice needs to be determined by an independent regulator and readily available to consumers.

While discussion about the supply of water generally recognises it as an essential service, there is little shared understanding about what it means for electricity to be understood as an essential service. The discussion above attempts to provide further clarity about the essential nature of water, in the context of economic regulation. We also recognise that not all domestic consumption of water is 'essential'. For example domestic swimming pools and spa baths are, in our opinion, luxury uses of water.

We recognise that the one undifferentiated service having essential, discretionary and luxury applications adds complexity to policy considerations, particularly pricing. In this submission, Uniting Communities has focussed on the supply of water that is an essential service. Sewerage services we regard more simply as a 'public good'