

EPA 05/17552

Mr Stuart Peevor
Manager Pricing and Access
Essential Services Commission of SA
GPO Box 2605
ADELAIDE SA 5000

RE: EPA submission regarding the draft Inquiry report into reform options for SA Water's drinking water and sewerage prices

Dear Mr Peevor

The Environment Protection Authority has reviewed the draft Inquiry report into reform options for SA Water's drinking water and sewerage prices and offers the following comments.

The EPA acknowledges that the review identifies some significant distortions in current drinking water pricing arrangements that warrant further consideration by the South Australian Government regarding potential reforms. These include the following.

- A significant portion of fixed supply charges are being recovered via consumption charges.
- Significant subsidisation of residential customers by non-residential customers.
- The three tier inclining block pricing system for water use under which the lowest price is charged for the minimum amount that is required for essential matters is providing a benefit to both low and high income households, whereas it can be argued that this assistance should only be provided to low income households.

However, the EPA wishes to raise concerns about the issue of incorporating environmental externalities in water pricing and criticism of the conservation case for the inclining block water usage tariffs in the report.

South Australia's water security strategy 'Water for Good' (WfG) states that "water and wastewater prices should reflect the full cost of producing and supplying those products and services (including environmental externalities where feasible and practicable) so that customers are encouraged to use water and wastewater services efficiently". WfG also indicates that whilst externality pricing is difficult to implement, consistent with the National Water Initiative, the State Government will continue to consider options for pricing to incorporate externalities. In this regard the EPA is pleased to note that in its report ESCOSA acknowledges that externalities should be factored into water pricing.

Based on a reading of the report and discussions between yourself and Stefan Gabrynowicz, the EPA recognises that ESCOSA has made some effort to incorporate environmental externalities into its water supply cost estimates. However, in this regard it is suggested that further work needs to be undertaken to derive better estimates of the environmental externalities associated with increased water consumption that would be expected as a result of the proposed reforms to drinking water prices. For example, it is

understood that licence fees for the Adelaide Desalination Plant (ADP) under the *Environment Protection Act 1993* have been incorporated into the cost assessment. However this fee structure only provides a partial indication of the environmental cost of operating the ADP. At full capacity production, the annual licence fee for this plant is about \$70,000. However, this charge primarily relates to the marine discharge aspect of the plant's operations and does not take account of the broader lifecycle impacts of the plant, such as energy usage and associated emissions of greenhouse gases. It is also noted that this charge is heavily based on an EPA cost recovery model and therefore does not necessarily fully value the impacts of discharges from this plant on the marine environment. The extent to which the natural resource management levies that SA Water pays incorporate environmental externalities is also a matter of concern.

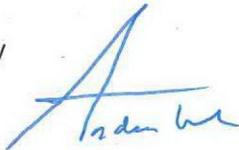
These matters, together with the relatively small estimated benefits of the proposed reforms to drinking water prices of about \$25 million pa highlight the importance of more rigorously quantifying the environmental costs of increased water consumption arising from the proposed reforms. The question needs to be asked "Would there still be a net benefit after allowing for environmental externalities?"

The EPA is also concerned about criticism of the conservation case for inclining block water usage tariffs in the report. It argues that this approach assumes that usage above a certain threshold is wasteful but that it is questionable whether that assumption holds true, as water consumption correlates to a number of explanatory variables, including the number of people in households and geographical location. Whilst there may be some validity in this position, it can also be argued that in many cases higher water consumption is associated with wastefulness such as taking longing showers than necessary, not using water efficient devices and planting water 'hungry' gardens when more drought tolerant native species are readily available. It is also countered that charging higher prices for higher levels of consumption is not just about wastefulness, it is also about charging for the externalities associated with greater consumption. On this basis, the EPA is of the view that price structures for drinking water should retain a component that discourages wastefulness.

Finally, it is also advised that should the recommended review of water planning and management related costs incurred by SA Water proceed, the EPA would appreciate being consulted at an appropriate time to allow for its areas of interest to be addressed.

For further information on this matter, please contact Stefan Gabrynowicz via stefan.gabrynowicz@epa.sa.gov.au or 82041920.

Yours sincerely



Andrew Wood

EXECUTIVE DIRECTOR, OPERATIONS
ENVIRONMENT PROTECTION AUTHORITY

Date:

9/9/14