

Reform Options for SA Water's Drinking Water and Sewerage Prices Draft Inquiry Report, 2014

Submission

by John Standingford

Interest

My interest is as a consumer, for whom water and sewerage charges now exceed other utilities', and as a practising economist with a liking for fairness and transparency in public policy.

Overall Comment

The Draft Report is well written and the findings are well explained and presented. My only complaint is that all the values and assumptions underlying the calculation of long-run marginal costs are not available for scrutiny. It was explained at the public consultation on 15 August that commercial confidentiality precluded full disclosure.

History

I have lived in Adelaide for 35 years and remember when water was a small item in the household budget – provided that one did not consume much more than an allowance that depended on the fixed charge calculated as a percentage of the capital value of one's home.

I remember when the policy changed and we had to pay for every kilolitre that we consumed. Public resentment was assuaged by assurances that the fixed component of the tariff would be reduced over time as the variable component increased, thereby discouraging unnecessary consumption. It made sense at a time of water scarcity and fears for the future health of the River Murray.

Unfortunately I have not kept my old household bills, but I am pretty sure that both fixed and variable components of the tariff have gone up and up – until the very recent slight reduction in the variable component.

This calls to mind the state governments' failure to honour their commitment to phase out stamp duty and other economically harmful state taxes in return for receiving their shares of GST revenue from the Commonwealth. (I am talking about all the state governments, not just the South Australian Government.)

The consequent public distrust of state governments (our own included) will be an obstacle to gaining acceptance of another change in tariff policy, especially one which would produce many more losers than winners.

Long-Run Marginal Cost of Potable Water

Many people are surprised that the estimated long-run marginal cost of potable water is so much lower than the existing usage charge. I suspect that a key assumption is the extent to which future demand have to be met from the desalination plant.

The Draft Report looks at the possibility of a higher ‘scarcity price’ to recover higher costs when water is scarce. There may be complications and therefore costs associated with implementing a scarcity price, but it would be perceived by the public as fair and sensible and should be given serious consideration.

Principles

I support the principle that customers should pay the true long-run marginal cost of the goods and services they consume. This is fair and it sends price signals that encourage rational behaviour.

If there is little difference in cost between providing and maintaining a connection to a small consumer and to a large consumer, the tariff should reflect this. If there is a big difference between supplying water to an urban consumer and to a rural consumer, the tariff should reflect this too.

However, I suspect that it will be politically impossible to make the radical changes to tariffs that a strict application of that principle would require. Consumers have become accustomed to large-scale hidden cross-subsidies. Some residential consumers may genuinely find it difficult to pay the fixed charges that would represent their fair share of SA Water’s total costs.

Subsidies

I am not ideologically opposed to all forms of subsidy, but I do believe that they should be explicit. I also believe that meddling with charges for goods and services (including essential services) is neither an efficient nor a fair way to implement redistributive social policy. I suggest the following two alternatives:

1. Compensation

Phase in the full application of fair pricing based on long-run marginal costs, with a counter-vailing adjustment to welfare benefits to the most vulnerable consumers. This would entail some unintended gains and losses among individuals but there would be rational price signals.

2. Transparency

Retain an element of cross-subsidy but a) reduce it over time and b) show on everyone’s bill the fair price and the actual price that they are asked to pay, so those who bear the subsidies and those who receive them know what they are.