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RE: Inquiry into Reform Options for SA Water's Drinking Water and Sewerage prices – Draft Inquiry Report

Dear Commissioners,

Thank you for the opportunity to make a submission to this important inquiry. As the peak body for the community services sector in South Australia, SACOSS has a long–standing interest in the delivery of essential services. Our research shows that the cost of basic necessities like energy and water impacts greatly and disproportionately on vulnerable and disadvantaged people. Our advocacy is informed by our members; organisations and individuals who witness these impacts in our community.

In reference to the Draft Inquiry Report, I note that ESCOSA has confirmed that a significant cross-subsidy exists between households and other water users[1]. In our view Government had a chance to correct this (and release the economic benefits described by ESCOSA) without the regressive impact on households by setting a more realistic value for the Regulatory Asset Base (RAB) via the Treasurer's Pricing Order and realigning tariffs accordingly. SACOSS would welcome further analysis of this by the Commission, beyond the one paragraph reference in the Draft Inquiry Report.

SACOSS is extremely concerned about the limited Terms of Reference for this Inquiry and in particular the lack of direction for the Inquiry to consider the efficiency of SA Water costs or the potential to change SA Water's revenue. We consider that the primary issue for South Australian consumers is the RAB, which is currently excessively high and leading to inefficient costs and excessive revenue with a negative impact on consumers. We strongly believe that water pricing should not be a proxy for taxation by other means.

SACOSS is conscious of the fact that this Inquiry is intended to inform policy as opposed to an intention that all recommendations would be adopted. In our view, water is not a simple economic good for all users and the Inquiry, including its terms of reference, fails to adequately recognise this complexity. From the perspective of household consumers, especially those with the least capacity to pay for energy and water, the Draft Inquiry Report highlights the limited value of restricting the scope only to economics when considering complex public policy issues such as the provision of essential services.

[1] Draft Inquiry Report p9-10 indicates that households only contribute 85% of 'cost reflective' revenue – a shortfall of some $93m

The Draft Inquiry Report discusses three "… *other ways in which the Government can facilitate greater economic efficiency in SA Water's prices while also managing customer bill impacts*"[2]:

- *Ensure subsidies provided by Government to SA Water's customers are well targeted and provide adequate financial assistance to those that require it.*
- *The taxes and transfers system could be reviewed more broadly, to ensure that the Government's budget requirements are recovered in the most efficient manner.*
- *It would also be important to ensure that SA Water's cost base is prudent and efficient. This could be done through the actions of the Commission during price determination processes and the actions of the Government in setting regulatory parameters (such as the value to be ascribed to SA Water's regulatory asset base, through pricing orders under the Water Industry Act).*

SACOSS encourages the Commission to expand on these in the final report. In our view, there is currently insufficient treatment in the Draft Inquiry Report for a critical part of the Inquiry: not what constitutes efficient pricing but how, pragmatically, it can be pursued within a broader public policy context. In particular, we would welcome further consideration of how concessions (as the principal agent of social policy) can be made compatible with the economic reform proposals. We value the Commission's perspectives on how these (often) competing objectives can be progressed in the pursuit of sound public policy and we trust that Government will too.

For information, The Australian Energy Markets Commission (AEMC) is covering very similar ground in its Distribution Network Pricing Arrangements Rule Change[3] and I have asked our utilities adviser Andrew Nance (Principal of St Kitts Associates) for a comparison between the two Inquiries. His summary (attached) underlines this ever-present gap in public policy between energy and water markets and social policy objectives. It is disappointing that this Inquiry has not yet made a more significant contribution to bridging this gap. I encourage you to do so in the Inquiry's concluding stages.

On the issue of water pricing, we are alarmed at the implications of cost reflective pricing for water that would lead to inordinately high supply charges for residential consumers. We believe the Draft Inquiry Report has comprehensively ruled out a move to cost reflective pricing for water and we will continue to urge the Government to retain its opposition to introducing this method of pricing.

SACOSS is very concerned about the recommendations of Chapter 6 to bill tenants instead of landlords. As raised in our previous submission, it is the SACOSS view that the shortcomings of the current system are in the inability of tenants to access the same consumer protections as property owners – and that a wholesale change to billing arrangements is not necessary to achieve this. We note that the dominant category of economic benefits is the $47m of "reduced costs of property managers and/or landlords passing on charges to tenants" and that "[t]he Commission expects that these savings would be passed on tenants, over time, through reduced rental charges." SACOSS is not

[2] At s11.6 page 155
[3] AEMC Reference ERC0161 www.aemc.gov.au/Rule-Changes/Distribution-Network-Pricing-Arrangements

convinced that this reduction in rent will actually occur. Further, it is difficult to reconcile the findings and recommendation of Chapter 6 (that tenants be billed directly) with those of Chapter 8 that it is not cost effective for all residential consumers to have their own water meter. We also remind the Commission that, consistent with its approach, tenants only need to be exposed to marginal costs to promote economic efficiency. This is a complex area unique to water policy and we feel that it deserves more extensive treatment from the consumer perspective.

In closing, I would like to draw your attention to the fact that the Consumer Advocacy and Research Fund (CARF) established under the *Water Industry Act 2012* remains unavailable to water consumers over two years since the legislation's proclamation[4]. SACOSS has made this submission from our existing resources and it is therefore less comprehensive than we would have preferred for such an important Inquiry.

We thank you in advance for your consideration of our comments. If you have any questions relating to the above, please contact SACOSS Senior Policy Officer, Jo De Silva on 8305 4211 or via jo@sacoss.org.au.

Yours sincerely,

Ross Womersley
Executive Director

[4] http://legislation.sa.gov.au/LZ/C/A/WATER%20INDUSTRY%20ACT%202012.aspx refer to Part 10 s87 for information on the CARF

SOUTH AUSTRALIAN COUNCIL OF SOCIAL SERVICE

NETWORK PRICING AND PUBLIC POLICY

A background paper to inform policy development by SACOSS

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INTRODUCTION AND SUMMARY

SACOSS is seeking to compare and contrast the draft reports from two utility pricing inquiries affecting households in South Australia.

- ESCOSA's Inquiry into Reform Options for SA Water's Drinking Water and Sewerage Prices – Draft Inquiry Report[1]
- AEMC Network Pricing Rule Change[2]

From the perspective of SACOSS and its constituents, these inquiries relate to the gap in public policy between social policy objectives and the pursuit of economic efficiency through energy and water markets and cost-reflective pricing. This gap is a persistent one and it is disappointing that these inquiries have chosen not make a more significant contribution to its bridging.

Following the arguments presented to their logical conclusions arrives at a view that the permissible scope for concessions is the 'residual costs' (i.e all except the 'marginal cost' price signals). In my view, it would be appropriate for both the AEMC and ESCOSA to be asked to more comprehensively consider the issues of how to implement their proposals alongside a government funded concession regime.

DISCUSSION

The market settings and scope are different in each case but both inquiries are seeking to implement more efficient, cost-reflective pricing for utility networks. Both Draft Reports and the main consultant reports attached to each of them have been reviewed and are summarised below:

- Overall, both reports (with accompanying consultant reports) go to extraordinary lengths (several hundred pages combined) to emphasise the importance of pricing for *efficiency* and that *fairness* must be addressed using alternate methods that do not compromise *efficiency*. However, after hundreds of pages of making this point, there is very little on offer as to how, practically, these *fairness* measures can have a meaningful impact on bills (or, strictly speaking, *Capacity to Pay*) without impacting on the price signals being sent to promote efficiency.

- Both inquiries discuss the concept of economic efficiency and the theoretical basis of marginal cost pricing to considerable length. Both acknowledge that debate exists as to how marginal cost should be measured.

- Both arrive at similar preferences (consistent with economic theory since the second half of the 1800's): ensuring customers are exposed to marginal cost pricing.

[1] www.escosa.sa.gov.au/projects/189/inquiry-into-drinking-water-and-sewerage-retail-services-pricing-reform.aspx
[2] AEMC Reference ERC0161 www.aemc.gov.au/Rule-Changes/Distribution-Network-Pricing-Arrangements

- Both inquiries acknowledge that pricing at marginal cost does not usually recover enough revenue (especially when the network has enough capacity as is the case in both energy and water in South Australia) and so considerable effort is put into the various options available for recovering these residual costs. Constructively, The Brattle Group have provided the AEMC with three principles for the recovery of these costs: *efficiency, fairness* and *gradualism* but, unfortunately, have not considered the role of concessions[3]

- Both inquiries are explicit about their basis in economic efficiency and that the broader context of pricing reform, including impacts on social policy objectives, are matters for the broader role of government.

This last point is consistent with longstanding policy positions of governments in both cases. For energy, the Second Reading Speech of the *National Electricity Bill 2007* by then South Australian Energy Minister the Hon PF Conlon (27th September 2007) clarified the intent:

> *"… It is important to note that the National Electricity Objective does not extend to broader social and environmental objectives …. Environmental and social objectives are better dealt with in other legislative instruments and policies which sit outside the National Electricity Law."*

Further, the Australian Energy Market Agreement states[4]:

> *"14.14 The Parties agree that social welfare and equity objectives will be met through clearly specified and transparently funded State or Territory community service obligations that do not materially impede competition."* [emphasis added]

For water, the South Australian Government's 2010 *Water for Good* plan[5] provides the current policy basis for the *Water Industry Act 2012*. The document made it clear that the intention was to move towards economically efficient, cost reflective water pricing and equity considerations were to be addressed through "*targeted income support (concessions) measures*". This is also consistent with the National Water Initiative Pricing Principles[6] and the Productivity Commission's Inquiries into Urban Water (2011) and Electricity Network Regulatory Frameworks (2013)[7].

So, in both cases, the unambiguous policy context is for equity objectives to be met through the continuation of publicly funded concessions but for these to be delivered in a way that does not impact on competition. Both inquiries provide examples of how pricing to aid *fairness* often distorts the pursuit of *efficiency* as if to over-emphasise an established point but then balk at providing concrete

[3] Brown T & Faruqui A "*Structure of Electricity Distribution Network Tariffs: Recovery of Residual Costs*" August 2014. Available from the AEMC project page.
[4] Australian Energy Market Agreement (AEMA) as amended – December 2013 available from www.scer.gov.au. The text was at 14.11 (b) in the Oct 2011 version
[5] Part 6 of *Water for Good* at www.environment.sa.gov.au/about-us/our-plans
[6] The National Water Initiative (NWI), agreed in 2004 by the Council of Australian Governments, is the national blueprint for water reform www.environment.gov.au/resource/national-water-initiative-pricing-principles
[7] www.pc.gov.au/projects/inquiry/electricity/report and www.pc.gov.au/projects/inquiry/urban-water/report

recommendations. Unfortunately, neither provides much analysis on how a concession regime can be integrated with their preferred pricing structure (in order to pursue *fairness* without compromising the pursuit of *efficiency*). Both inquiries just recommend a review of concessions.

To be fair, the ESCOSA inquiry report offers to assist the Government with such a review [p156] and even makes a brief but clear preference for the attributes of concessions [p10 and p157]:

> [p10] *"While the design of any subsidy or concession scheme is a matter for government, it is recommended that payments be made as a fixed amount, rather than incorporated into water usage charges, to avoid distorting the price signal benefits of cost-reflective usage pricing."*

> [p157] *"If water pricing is to remain as a tool for delivering social equity objectives, to ensure that usage charges remain cost-reflective, any exemptions and concessions should not be dependent on the amount of water consumed (i.e. they should apply to the fixed charge only). It is important that usage charges be set at cost-reflective levels to promote economic efficiency. Applying subsidies to usage charges would distort consumption decisions and reduce economic efficiency…"*

This gap in public policy between social policy objectives and the pursuit of economic efficiency through energy and water markets is a persistent one. It is disappointing that these inquiries do not make a more significant contribution to bridging this gap. In my view, it would be appropriate for both the AEMC and ESCOSA to be asked to more comprehensively consider the issues of how to implement their proposals alongside a government funded concession regime. The late Professor of Political Science and Public Policy at University of California Berkeley, Aaron Wildavsky wrote (over 25 years ago in 1987)[8]:

> *"I would like to return to a (by now) ancient verity of policy analysis: economic analysis by itself is insufficient; compleat analysts place their studies and their search for organizational support within a broader political and organizational context."*

In order to follow the arguments from these reports to their logical conclusions for concessions I have attempted to distill the arguments down into a simple sequence of logical steps as follows:

1. Energy and Water prices should be of a level and structure that incentivises economic efficiency

2. Public policy objectives related to *fairness* or the *environment* should be pursued only in ways that do not compromise efficiency. The contemporary policy mechanism for this is via concessions (rebates directly to consumers) and community service obligations (CSO's; rebates directly to suppliers)

3. Economic efficiency is most likely when the marginal cost of consumption (i.e. the price of the next unit of energy or water) reflects the marginal cost of production.

[8] Wildavzky, A "*Speaking Truth to Power / The Art and Craft of Policy Analysis*", 2nd Ed 1987, Boston

4. This provides for efficient decision making but does not provide enough revenue to cover the costs of existing assets and services.

5. These *residual costs* can be recovered in a number of ways but the aim is to have minimal impact on consumption decisions (i.e. maximise economic efficiency through marginal cost pricing alone).

6. For concessions to similarly have minimal impact on the marginal cost price signals, it follows that they must be structured similarly to how tariffs recover residual costs (and therefore can only impact on *fairness*, not *efficiency*)

The conclusion therefore seems to be that the "*residual*" is the scope (or boundary) for concessions and that they should only be applied as a fixed amount.

IMPLICATIONS FOR ENERGY AND WATER CONCESSIONS IN SOUTH AUSTRALIA

The broad implications for electricity and water in South Australia are:

- The Energy Concession (applied to Electricity bills) is a fixed amount of $215 pa (paid quarterly). This would be considered efficient.

- Water concession is applied as 30% of the bill subject to a minimum and maximum amount. This would be considered inefficient.

- Sewerage concession is a fixed amount of $110 pa. This would be considered efficient.

For interest, I have prepared a short worked example based on a residential demand tariff. recently introduced by South Australian Power Networks (SAPN)[9]. The tariff can be considered broadly consistent with the Draft Rule and indicative of the future direction of residential tariffs and is presented in Figure 1 below. In summary:

- No fixed charge (compared to 42.92 c per day = $156 pa on the existing residential tariff)

- $18/kW per month in summer (NOV-MAR) (min 1.5 kW = $27 x 5 = $135 pa)

- $9/kW per month in winter (APR-OCT) (min 1.5 kW = $13.50 x 7 = $94.50 pa)

- TOTAL: $229.50 pa min fixed charge (plus retail fixed costs of around $100-$130 pa = $330-$360)

[9] Available from July 1st, 2014. Refer to www.sapowernetworks.com.au/centric/industry/our_network/network_tariffs.jsp

- Usage rate is 10c/kWh compared to (compared to 16c for 4000kWh pa and 22c for more than that)

In this case, the monthly demand charges represent the 'marginal cost' price signal and therefore the part that the AEMC would consider off limits when considering concessions - above the minimum charge for 1.5 kW of capacity at least. In theory then (and depending on what retail tariff accompanies this network tariff) concessions could remain as a fixed amount but be increased to well over $300 pa without a risk of compromising efficiency.

SA Power Networks NETWORK TARIFFS

APPLIES TO USAGE FROM 1 JULY 2014

Customer Category	Units	Min Qty.	DUOS excl GST	Veg Mgmt excl GST	METER excl GST	Total SA-PN excl GST	TUOS excl GST	PV JSO excl GST	Total excl GST	Total incl GST
NEW TARIFFS										
Low Voltage Residential - Monthly Demand										
Supply Rate	$/day		0.000000			0.000000			0.000000	0.000000
Summer Monthly Demand Rate	$/kW/mth	min 1.5 KW	11.140000	0.480000		11.620000	2.670000	2.070000	16.360000	17.996000
Winter Monthly Demand Rate	$/kW/mth	min 1.5 KW	5.570000	0.240000		5.810000	1.335000	1.035000	8.180000	8.998000
Additional Monthly Demand Rate	$/kW/mth		0.000000	0.000000		0.000000	0.000000	0.000000	0.000000	0.000000
Usage Rate	$/kWh		0.061900	0.002700		0.064600	0.014600	0.011500	0.090700	0.099770

(o) A Low Voltage Residential monthly demand customer is a Distribution Network User that is a residential customer taking supply at less than 1 kV. Consumption is charged at a flat rate. A charge also applies for the maximum demand each month with different prices applying in the summer months (November to March) and the winter months (April to October), as detailed in the Tariff Schedule. The time period when the monthly peak demand is measured is between 1600 and 2100 local SA time. The User utilises a type 1-5 NEM compliant meter read monthly An excluded service charge applies where SA Power Networks is required to read the type 1-4 meter (eg for tier one customers and for tier two customers < 160MWh pa). An excluded charge also applies for the monthly reading of Type 5 meters. This tariff is invoiced monthly. Note that this is an optional tariff. A customer may elect to switch to another tariff after 12 months on this tariff.

Figure 1: SA Power Networks Residential Demand Tariff – an optional tariff available from July 2014