



8 November 2007

By email: [water@esc.vic.gov.au](mailto:water@esc.vic.gov.au)

Essential Services Commission  
Level 2, 35 Spring Street  
MELBOURNE VIC 3000

Dear Commissioners

### **Water Tariff Structures Review – Issues Paper**

We refer to the Essential Services Commission's (the **Commission**) *Water Tariff Structures Review – Issues Paper* (the **Issues Paper**) released on 22 October 2007. Consumer Action Law Centre (**Consumer Action**) welcomes the review and would like to make the following comments.

#### **Timeframe for Review**

Consumer Action is concerned that the time frame allotted for the review will prevent meaningful participation by consumer advocates, including ourselves. The Commission released its issues paper on 22 October 2007, and has allowed 2.5 weeks to provide written comment. We note that a draft report is to be consulted upon, and a final report to be submitted, by 14 December 2007. As a resource-constrained organisation, this amount of time is inadequate. While we will endeavour to contribute, we know our participation will be truncated significantly due to the short time frames proposed. We have written to the Minister for Finance and Water expressing this view.

Changes to the structure of water tariffs in Victoria will have significant impacts on Victorian households. These impacts will be exacerbated by increasing prices due to the augmentation works being proposed by the Victorian Government. Given the significant policy implications of the review, we are concerned that the process will be compromised, resulting in poor policy outcomes for Victorian households. We ask that the Commission make representations to the Minister seeking more time to undertake the Review.

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## Objectives of price setting

Consumer Action (and its predecessors) has long believed that the public interest is served by the maintenance of consumers' access to essential services, including water.<sup>1</sup> That is, consumers should not be disconnected from supply due to an incapacity to meet required financial obligations. Furthermore, the pricing of essential services should be equitable and fair, taking into account the need to maintain the supply for vulnerable consumers as well as the importance of sustainable use of a limited resource.

Considering this, we welcome the Commission revisiting the topic of water tariff structures. Consumer Action believes that the structure of water tariffs is key to ensuring the pricing of water is equitable and fair. Consumer Action recommended the Government and the Commission undertake a comprehensive assessment of tariff structures in its recent report, *Water Reform in Victoria: Independent Pricing Regulation and its Outcomes for Consumers*.

We also welcome the Commission noting that the objectives of price setting are complex, are commonly in conflict and involve trade offs. We agree, and believe that the pricing principles found both in the National Water Initiative (**NWI**) and the Water Industry Regulatory Order (**WIRO**) demonstrate how principles used to set water prices can be in conflict. The principles in these documents consider not only economic objectives such as cost recovery, financial viability and allocative efficiency, but also objectives important to the demand side, including equity, simplicity, transparency and public acceptability. Principle 7 and 9 of the WIRO pricing principles, in particular, ensure equity and simplicity by providing that the interests of consumers, particularly low-income and vulnerable consumers, are considered in price setting, and that prices are set in a way that is readily understood by consumers.

Consumer Action broadly supports the pricing principles identified in the NWI and the WIRO and the implicit acknowledgment that social, environmental and economic objectives all need to be considered in price setting. We do, however, believe that the implementation of these principles has not always resulted in water tariff structures that further the public interest. In particular, we are concerned that the Commission, when setting water prices and approving tariff structures, has pursued economic objectives in preference to other objectives.<sup>2</sup> We have previously recommended that the Victorian Government amend the regulatory framework for the pricing of water to require the Commission to more actively take account of social and environmental factors in making pricing decisions, including those related to tariff structures.

Part of the reason for this is the fact that the pricing principles in the WIRO are very widely drawn, and that they necessarily involve trade-offs, leaving significant discretion to the regulated businesses and the regulator. The Commission itself acknowledges 'that there is a range of feasible tariff structures that pursue community objectives and satisfy economic

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<sup>1</sup> Consumer Law Centre Victoria (CLCV), *Consumer Benchmarks for Energy Water: A Consumer Perspective of Regulation and Service Delivery*, November 1996; CLCV and Consumer Utilities Advocacy Centre, *Access to Energy and Water in Victoria: A Research Report*, November 2004; Consumer Action, *Water Reform in Victoria: Independent Pricing Regulation and its Outcomes for Consumers*, March 2007.

<sup>2</sup> Consumer Action, above n 1.

pricing principles'. The Commission's first price review approved a range of different tariff structures, largely in line with those proposed by water businesses. While we agree that there is 'no single best tariff structure', we do not accept the reasonableness of the Commission imposing wildly varying tariff structures across the Victorian community, the impact of which will affect consumers differently depending upon where they live. We note that both the Premier and the Minister for Water noted their concern with price inequities across Melbourne when they announced the current review.<sup>3</sup> It is our view that the Commission must consider both equity and fairness in assessing water tariff structures.

### **Arguments for water tariff structure reform**

Consumer Action, in its participation in debates around water prices and tariff structures, has noted various arguments in favour of new tariff structures. These arguments fall into three categories that we'd like to discuss:

- the imposition of a 'price signal' to encourage consumers to undertake demand management;
- the desirability of ending cross subsidies between consumers with different levels of use or who create different costs for their providers; and
- improving cost recovery by trying to match the costs of consumption with the bills being sent to consumers.

We would like to provide some comment on each of these arguments.

#### *Reducing demand*

Consumer Action continues to be concerned about the ability and appropriateness of using prices to attend to demand management. While we generally support inclining block tariffs (subject to our comments detailed further below), we are not convinced that they have contributed to consumers reducing their water usage. We believe there is stronger evidence that non-price measures are more effective in delivering reductions in aggregate demand.

In NSW, the Independent Pricing and Regulatory Commission (**IPART**) commissioned a study of international evidence on residential price elasticity which concluded that the factor was around -0.142.<sup>4</sup> This means that a 10% price reduction would cause demand reductions of around 1.4%. Mandatory water restrictions have had far more impact on demand reduction than prices. Over the 12 months to September 2007, water restrictions have resulted in Melbourne's demand for water being reduced by almost 14%.<sup>5</sup> Using the price elasticity findings above, this level of demand reduction might have required a 100% price rise.

We are also supportive of water conservation initiatives, both public education and household audits and retrofits, which have also contributed to demand reduction. Yarra

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<sup>3</sup> Office of the Premier, *Media Release – Reforms of Melbourne's Water Industry*, 14 August 2007.

<sup>4</sup> Independent Pricing and Regulatory Tribunal, *Investigation into Price Structures to Reduce Demand for Water in the Sydney Basin: Final Report*, IPART OP24, Sydney July 2004, p.13.

<sup>5</sup> Minister for Water, *Media release – Stage 3a water restrictions to remain in place*, 28 September 2007.

Valley Water's smart homes program has resulted in ongoing demand reductions of 20% per household.<sup>6</sup> Being targeted at low-income and vulnerable consumers, the smart homes program has had the added benefit of reduced bills for consumers. We recognise that retrofits do come at a cost. Although there is strong evidence that they produce lower consumption, given the cost of delivering the retrofit service, it is not necessarily the case that the overall cost of bills will reduce as a result. Despite this, consumers can take comfort in knowing that the promised result of reduced levels of demand is more likely to be delivered.<sup>7</sup>

### *Cross-subsidies*

Consumer Action is also concerned about arguments to reform tariff structures that aim to reduce cross-subsidies between users. This argument is particularly alive in discussions at the National Water Commission, and proceeds on the basis that full cost pricing should ensure prices reflect different costs in providing water to different areas. As outlined above, we believe that, particularly within an interconnected water system such as Melbourne, consumers should be attended with the same tariff structure no matter where they live. While the cost to provide water to someone in the west of Melbourne, far from the source of supply might be more, we believe that all consumers should receive the same price on the basis of equity.

We are also unconvinced that regional and rural users should be subject to significantly higher water prices compared with urban users, because of the costs of delivery. Regional users already receive higher bills on average and are discriminated against due to the imposition of interest on overdue bills.

### *Cost reflective pricing*

Consumer Action accepts that water businesses need to recover their costs through prices to remain viable. However, we note that an important goal of cost recovery is to ensure adequate funds are raised not only to meet the costs of current consumption but to provide for future demand. By providing signals for new investment, the objective of cost recovery, therefore, may actually frustrate the goal of demand management. We believe that it would be more efficient and effective for new investment decisions to be determined as part of an integrated water services planning function, rather than relying on prices to signal new supply options.

## **Costs and benefits of changing tariff structures**

Consumer Action strongly supports the analysis in the Issues Paper regarding the costs and benefits of changing tariff structures. We agree that there are significant costs in designing and implementing new pricing tariffs. Many of these costs will be borne by consumers as they adjust to the impacts of changes to tariff structures. How such costs are distributed among consumers is an additional important consideration – we would not support the costs

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<sup>6</sup> Yarra Valley Water, *The Droplet*, edition 9, October 2006.

<sup>7</sup> Public Interest Advocacy Centre, *Paying for what?: the impact of utility tariff structures*, Occasional Policy Paper 8, March 2006.

of changes in tariff structures to be borne by a particular class of consumers, for example tenants, without adjustment assistance. We note that the Government is concurrently reviewing the concessions framework applying to water tariffs. We believe that the Commission should closely consider any adjustments to the concessions framework when preparing its advice on water tariffs.

## **Proposed tariff structures**

### *Increasing volumetric component*

We welcome the Commission's discussion of increasing the volumetric component of water tariffs. We support fixed charges being reallocated to the water consumption charge wherever possible. We note that the Commission references our work for the proposition that increasing the volumetric component of water tariff structures will be ineffective in changing customer demand.<sup>8</sup> While we agree that consumers' ability to respond to price signals is limited, and that many consumers have cut back water usage due to water restrictions further limiting the potential for demand reductions, we believe that large fixed charges frustrate any possibility of consumers engaging in water conservation receiving lower bills. For this reason, we support minimising the fixed charge in water bills.

### *Inclining block tariffs (IBTs)*

Consumer Action and its predecessors lent support to the introduction of IBTs on the basis that the first, low price block of consumption was to be set at a level which would include all non-discretionary usage. Such a tariff recognises that water for essential purposes is a human right, and that consumers should have affordable essential water use. We have noted, however, that there has been no concrete evidence to conclude that IBTs have resulted in lesser overall demand.

We do continue to be concerned that IBTs penalise larger households even where their consumption is necessary for basic living standards. In our recent report, we called on the effectiveness of the IBT to be independently assessed, and that any assessment should focus on:

- whether the first block is set at a level that ensures an essential water supply is affordable; and
- whether measures to address affordability problems experienced by large families or other vulnerable groups are effective.

Should IBTs proposed by water businesses ensure an affordable essential water supply, perhaps through the overlay of a 'social tariff' (see below), we would continue to support such tariff structures.

### *Connection based charges*

We continue to have mixed views about connection based charges which would impose fixed charges on the basis of household rather than title, such that block of flats on a single

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<sup>8</sup> ESC, Issues Paper, p 37.

title will attract a separate fixed charge for each separate occupancy. We do agree that charging all households the same fixed charges would be equitable. We also note that adjustment assistance may need to be provided for low-income consumers living in apartments, as they will not have been subject to such charges before.

Our main concern with such charges, however, is the perverse impact they may have on sustainable life choices. Consumers who choose to live in apartments will generally have lesser water consumption due to the fact that they will have limited outdoor usage. Additional charges on sustainable household choices may act as a disincentive to such choices being made. With projected population growth being perhaps the most significant driver of future water demand, we believe that there should be incentives for consumers to make sustainable lifestyle choices, including through apartment or medium-density household living.

If fixed charges are largely to recover infrastructure costs, an alternative to this would be to levy fixed charges based on rates values of properties, as recommended by the Society of St Vincent de Paul. While this option requires further consideration, it may contribute to equitable outcomes by ensuring those with greater wealth (defined by home ownership) pay proportionally the cost of infrastructure. We would welcome further analysis of a rates based approach to fixed charges.

#### *Combining water and wastewater charges*

We support water businesses' proposals to combine water and wastewater charges on bills, primarily in achievement of the goal of simplicity. Most consumers do not understand how wastewater charges are calculated, and they cause confusion and complaints, adding to costs for businesses.

#### *Price paths*

We strongly support the need for any price rises to water to be smooth year-on-year increases to avoid 'price shock' and financial difficulties from large one-off price rises. Many consumers who experience price shock will just result in increased costs for businesses – including costs of dealing with complaints and additional credit recovery costs.

#### *Scarcity pricing*

We are not convinced about the value of scarcity pricing, given our comments about consumers' ability to respond to price signals outlined above. If scarcity pricing were to be introduced, additional charges should only be placed on households with higher levels of demand, rather than those consuming for essential use.

#### *Social tariff*

Consumer Action encourages the Commission to give further consideration to a 'social tariff', which would perhaps operate as part of an IBT structure or along the lines of John Quiggan's proposal for free water allowances.

The primary objective of such a social tariff would be to provide a minimum allowance of water to ensure households have an adequate standard of living. A social tariff should operate so as to mitigate the impact of general tariff structure on households who are pushed into larger consumption brackets through no fault of their own. For example, it could apply where large families whose usage brings them into a higher or more expensive block tariff be shielded from the additional charges. It could also operate along the lines of the UK's vulnerable group tariff.<sup>9</sup> Whichever method, we believe that a social tariff should apply for households:

- with a large number of members;
- with particular health needs which involve high water use;
- who are tenants; and
- that have limited financial means.

I would welcome discussing this submission further with the Commission. Should you wish to discuss, please contact me on 03 9670 5088.

Yours sincerely

**CONSUMER ACTION LAW CENTRE**

A handwritten signature in black ink that reads "Gerard Brody". The signature is written in a cursive, flowing style.

Gerard Brody  
Director – Policy & Campaigns

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<sup>9</sup> See Consumer Action, above n 1, 22-3.