

---

# 2013 WATER PRICE REVIEW

Tariff Issues Paper

---

August 2011

VCOSS Submission



# ABOUT VCOSS

The Victorian Council of Social Service (VCOSS) is the peak body of the social and community sector in Victoria. VCOSS members reflect the diversity of the sector and include large charities, peak organisations, small community services, advocacy groups, and individuals involved in social policy debates. In addition to supporting the sector, VCOSS represents the interests of vulnerable and disadvantaged Victorians in policy debates and advocates for the development of a sustainable, fair and equitable society.

VCOSS respects the land we live in, recognises its Indigenous custodians, and is committed to reconciling all injustices with Indigenous Australians.

VCOSS is committed to social equity and justice, and envisages a society that:

- sees social wellbeing as a national priority;
- ensures everyone has access to a fair share of community resources and services;
- involves all people as equals, without discrimination; and
- values and encourages people's participation in decision-making about their own lives and their community.

**Authorised by:**

Cath Smith, Chief Executive Officer

© Copyright 2011 Victorian Council of Social Service

**Victorian Council of Social Service**

Level 8, 128 Exhibition Street

Melbourne, Victoria, 3000

+61 3 9654 5050

For inquiries:

Dean Lombard

Essential Services Policy Analyst

dean.lombard@vcoss.org.au

Kate Colvin

Policy and Public Affairs Manager

kate.colvin@vcoss.org.au



# INTRODUCTION

The Victorian Council of Social Service (VCOSS) appreciates the opportunity to contribute to the Commission's consideration of water tariffs for the forthcoming water price review. VCOSS's primary purpose in engaging in water policy is to advocate for the interests of disadvantaged and vulnerable households and their right to affordable, reliable access to sufficient water. Safeguarding this right requires more than just appropriate tariffs and prices: a robust customer protection framework is arguably more important, and facilitating efficient usage in vulnerable households of more lasting benefit. Nevertheless, pricing is important, and tariff structures play a significant role in shaping the prices households ultimately face. In this submission we have limited our responses to certain sections only of the issues paper.

## PROPOSED PRICING PRINCIPLES

Overall, VCOSS supports the proposed pricing principles

### **Tariff structure principles**

As discussed below, VCOSS believes that while the capacity of inclining block tariffs (IBTs) to promote water conservation is questionable, carefully designed IBTs can offset the regressive impact of the fixed charge for low-volume users, and create an arbitrary optimal volume–price point upon which concessions and other assistance programs can be overlaid to address affordability problems for typical and special-case customers. At the same time, we are not opposed to flat or other types of tariffs that are compatible with the suite of pricing principles. We agree with the Commission that the critical test for a proposed tariff structure is that it has a clear rationale, its impacts on different types of customer have been analysed, and – where it differs markedly from its predecessor – an appropriate transition strategy is in place.

### **Volumetric charges principle**

As discussed below, VCOSS does not support scarcity pricing and does not believe dynamic price signalling can overcome the inherent demand inelasticity of most customers. Additionally, any significant changes in the ratio between fixed and volumetric charges must be accompanied by transitional assistance for low-income tenants, who will be disproportionately impacted by such changes.

### **Customer focus principles**

VCOSS particularly supports the proposed customer focus principles. Water businesses' tariff structure proposals should consider impacts on different types of customers. Proposals for innovative, alternative tariffs should have some basis in customer consultation. In particular, we consider appropriate customer consultation to be broader than simply engaging with an existing customer consultative committee.

# TARIFF STRUCTURE AND DESIGN ISSUES

## Retail water tariff

Retail water prices need to recover an appropriate share of costs while equitably and affordably delivering water to households and businesses, striking an appropriate balance between economic efficiency and core social objectives such as access (including affordability) and equity (seeking to avoid, for example, overly regressive tariff structures). Water businesses have a critical role in using economies of scale to distribute time- and locationally-variant costs evenly among customer classes.

### *Retail pass-through of variant bulk water and distribution costs*

VCOSS does not support the pass-through of variable bulk water costs at the retail level. We believe that the Living Victoria Ministerial Advisory Council's (and, for that matter, the Productivity Commission's) enthusiasm for customers to demonstrate how much they value water by how much they choose to pay fails to fully consider how most households use water and their ability to respond to price signals. An advantage of centralised, well-connected, state-owned reticulated water authorities is their capacity to carry risk on behalf of households and small businesses and redistribute water resources from where they are to where they are needed. Smoothing time-variant costs into appropriately set constant prices is a core function.

Similarly, we consider that water businesses are well placed to smooth locationally variant costs into postage stamp pricing. VCOSS has long held concerns about locational inequity in residential water pricing and supports any moves toward equivalent pricing within regions if not across the whole state.

Promoting efficient decisions on Integrated Water Cycle Management is, in our view, most equitably achieved by reflecting distribution system costs via locationally variant developer charges. Passing these through to retail tariffs may encourage some owner-occupiers to retrofit accordingly but will disadvantage others, especially tenants.

### *Structure of retail water tariffs*

#### **Inclining block tariffs**

VCOSS agrees with the Commission and others that inclining block tariffs (IBTs) do not reliably encourage water conservation or *in themselves* promote equity. Indeed, VCOSS believes price signals are blunt instruments that have only a minor impact (if any) on water consumption for most domestic consumers.

(Demand elasticity studies indicate that indoor water usage is relatively inelastic (between -0.12 and -0.14) for all income groups and that outdoor water usage, though much more elastic overall, is still fairly inelastic for low income households (-0.19, compared to -0.47 for middle and upper income households).<sup>1</sup> When it is considered that water prices have

---

<sup>1</sup> Water Research Commission (1997) Estimation Of The Residential Price Elasticity Of Demand For Water By Means Of A Contingent Valuation Approach <http://www.fwr.org/wrcsa/790100.htm>

increased markedly in the last decade, it is probable that the concomitant dramatic reduction in household water use has been driven primarily by restrictions, behaviour change campaigns, and the increasing use of water efficient appliances and fixtures.)

However, properly designed, IBTs can largely offset the regressive impact of the fixed charge on low volume consumers. The interaction between tariff blocks and the fixed charge can produce a “sweet spot” – a consumption range where the total unit cost is relatively stable and lower than consumption on either side of the range. Aligning this “sweet spot” with typical moderate consumption for an average household provides a pricing framework upon which additional measures for ensuring affordability for low-income households – including those with atypically high or low consumption – can be more readily deployed. In VCOSS’s opinion, such an approach can still strike a moderate balance between economic efficiency and social equity.

Thus VCOSS supports inclining block tariffs (IBTs) as part of a nuanced tariff structure designed to deliver affordability for average basic essential use with appropriate complementary assistance to large low-income households. Nevertheless, VCOSS is not opposed to flat tariffs, so long as complementary measures to address social equity and affordability are appropriately designed.

### **Balance between volumetric and fixed charges**

VCOSS is conscious of the State Government’s avowed objective to rebalance the relationship between fixed and variable components of residential water tariffs in favour of volumetric charges. While (as discussed above) we believe price signals are relatively blunt instruments that are not significantly effective in promoting water conservation for most residential water customers, lowering fixed charges does limit their regressive impact. Additionally, water bills comprising primarily volumetric charges are more readily reduced by reductions in consumption, thus increasing the cost-effectiveness of investing in water efficiency. Thus, provided households have the capacity to manage their usage and become more water efficient (requiring adequately resourced, targeted assistance for low-income households to improve efficiency: something that is currently lacking) – and pricing structures are designed to work with complementary affordability measures (such as better concessions and additional assistance for large low-income households) – pricing that is predominantly volumetric can be compatible with equity and affordability objectives. However transitional assistance will be necessary for low-income tenants, who will face higher bills but whose rents are unlikely to be reduced when costs shift from landlord to tenant.

### **Innovations in retail tariffs**

As discussed below, while VCOSS has qualms about some possible innovative tariff offerings, we are not opposed in principle to innovation or choice in water tariff offerings. Nevertheless, we believe that water, like energy, is a relatively low-engagement product and most households have little interest in having to choose between numerous product offerings.

Our observation of the evolving energy market suggests that where customer benefit has emerged it has been through price competition rather than tariff innovation – and price competitiveness has really only been possible via ‘soft’ market segmentation whereby some of the relatively small number of households who have actively engaged in the market have found a better offer, while the remainder, on standing offers or basic market contracts, pay more. (We do expect to see a greater diversity of tariff types when smart meters are commonplace and their full functionality activated; it is as yet unknown how this will manifest in the market.) Given the absence of retail competition in the water industry, we expect choice to revolve around increasing or reducing bill certainty, at a premium or discount respectively, as water businesses seek greater revenue certainty. Accordingly, comprehensive information and issues of consent will be critical.

## **Concessions and other policies to protect low-income and vulnerable customers**

Shortcomings in the suite of complementary measures to improve affordability for low-income customers provide challenges in managing the adverse impact of tariffs and prices on vulnerable households. The capped 50% concession, for example, goes some way toward addressing the regressive impact of the fixed charge for small-volume owner-occupiers, while being particularly generous to low-volume tenants and insufficient for some high-volume households (especially owner-occupiers with high fixed charges). The abolition of the *Water Wise* and *Home Wise* programs has left many vulnerable households unable to address (or even identify) unavoidably high consumption caused by inefficient or faulty appliances, pipes, or fixtures. VCOSS hopes that in reimagining tariff structures and innovating approaches to domestic water pricing and billing, water businesses also give some thought to possible new approaches to concessions and assistance programs and open a dialogue with the government and other stakeholders with a view to providing better outcomes for vulnerable and disadvantaged Victorians struggling with water bills.

## **Sewerage tariff**

VCOSS believes that the fixed and (where applicable) volumetric retail sewerage charges should be incorporated into the fixed and volumetric water supply charge. We question its value as a price signal: households seeking to reduce their water bills primarily change their consumption, not disposal; and their incidental water disposal savings (say, by collecting waste water and using it for another purpose) are not reflected in their volumetric sewerage charge anyway (except by the rather indirect route of reduced hypothecated disposal due to the reduction in consumption). On the other hand, VCOSS is aware of considerable consumer misunderstanding about the purpose, nature and calculation of the volumetric sewage disposal charge. An integrated water usage charge, along with an integrated fixed charge, that covers water delivery and disposal as well as the associated infrastructure, best serves the interests of efficiency, simplicity, equity, and customer responsiveness.

# TARIFFS AND CUSTOMER CHOICE

VCOSS is not convinced that Victorian households want choice in their water supply arrangements. As a basic essential service, most households simply expect access to water on demand, and are (more or less) happy to pay a reasonable price for the privilege. The evolution of the competitive energy market over the last decade suggests that while direct competition can bring (relatively) lower prices for some, increased choice often leads to customer confusion; and tariff structure diversity makes it difficult for many households to figure out the relative merits of competing offers for their particular circumstances.

On the other hand VCOSS recognises that, in the absence of direct competition and the battle for market share, there is less incentive for the kind of misleading and unconscionable market conduct that has been a feature of the energy marketplace. Accordingly, VCOSS cautiously supports moves toward some customer choice so long as the best interests of customers remain in focus.

## *Default tariffs*

VCOSS supports the Commission's preference to require a default tariff made available to all customers in a class. Forcing a choice on customers would likely lead to poor outcomes

for some customers who do not have the capacity or inclination to choose the most appropriate tariff for their circumstances.

### *Alternative tariffs*

Alternative tariffs should be subject to approval by the Commission with regard to the pricing principles, balanced with other considerations as outlined in section 6.4 of the issues paper. That said, we have qualms about some possible tariff offerings:

- Security of supply based tariffs risk creating a tiered market where the quality and sufficiency of a household's water supply is determined by their income or wealth. Wealthy households can already augment their reticulated water supply by installing rainwater tanks and grey water systems, purchasing additional water, or drilling a bore. Such inequity should not be institutionalised within the water system. Additionally, it is our understanding that the success of water restrictions in the past has largely been due to the evolution of new social norms around water conservation and public disapproval of profligate water use. A system whereby some people can use as much as they like while others are subject to restrictions will undermine this.
- Variable tariffs (such as scarcity pricing) are unsuitable for many households whose ability to respond significantly to price changes is limited by the inelasticity of their demand. Timely communication of price changes is also necessary for this kind of tariff; this is compromised by low-income households' limited access to electronic communications technology<sup>2</sup>. As an optional tariff, we understand that no household will be forced onto it. However we are wary of the possibility of vulnerable households signing up to such a tariff because they believe it will be cheaper. Such tariffs need to be communicated very clearly and households considering them should be assisted to model their existing consumption patterns over the likely pricing scenario.
- Fixed quantity type tariffs (with excess usage charges) also present a risk of cost blow-out if inappropriately entered into. However we consider that it's much simpler to model the cost impact of such a tariff given sufficient historical usage data. Thus we cautiously support such tariffs providing they are clearly communicated and modelled.
- Additional service tariffs such as the environment and community tariffs given as examples in the issues paper present few risks to vulnerable households. So long as the higher prices are clear and the premium is indeed redirected to its avowed purpose, these types of tariffs are a positive contribution to the market.

### *Consumer protection*

Any move toward tariff choice would do well to implement learnings from the privatised energy market. The issues paper identifies the key areas that need to be addressed:

- Information provision – including clear information on how the tariffs work as well as terms and conditions.
- Facilitating decision-making – including an appropriate method for customers to assess the cost impact of alternative tariffs against each other and against their existing tariff, using their real consumption data.

---

<sup>2</sup> ABS (2009) 8146.0 – Household Use of Information Technology, Australia, 2008-09; Australian Bureau of Statistics



- Switching – including the process by which switching occurs (ensuring explicit informed consent is obtained and minimising the potential for billing errors), mandating an appropriate cooling off period, and limiting entry and exit costs.

## CONTACT DETAILS

For further information regarding the VCOSS submission to *2013 Water Price Review Tariff Issues Paper*, contact:

Dean Lombard  
Essential Services Policy Analyst  
03 9654 5050  
[dean.lombard@vcoss.org.au](mailto:dean.lombard@vcoss.org.au)