



Department of Water
Government of Western Australia

Economic Regulation Authority inquiry into tariffs of the Water Corporation, Aqwest and Busselton Water

Submission on Issues Paper

September 2008

About the Department of Water

The Department of Water is the lead agency in the Government of Western Australia for the management of the state's water resources and lead adviser to the Minister for Water Resources on water policy and governance. These responsibilities include:

- water resource management and planning
- water source protection
- water governance
- water services policy
- water reform, including the National Water Initiative, *State water strategy* and *State water plan*
- Indigenous water services.

The department operates throughout Western Australia with offices in eight regional areas.

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Disclaimer

The views expressed in this submission are those of the Department of Water and should not be taken to reflect the views of the Minister for Water Resources or the Government of Western Australia.

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1 Introduction

In Australia, water has historically been treated as a resource so abundant that everyone can have as much as they want, priced only to recover the direct cost of capturing and providing it to customers. In recent years, the scarcity of water has become more apparent and the indirect costs of water and wastewater services have increasingly been recognised. Competition and water industry reforms have also linked regulated monopoly prices to service standards based on customer demands.

In this environment, thorough investigation and refinement of prices through the entire water cycle is an essential part of delivering reliable and high standard water, wastewater and drainage services. It is also important for the management of water resources and their dependent ecosystems.

The Department of Water is the government department that supports the Minister for Water Resources in the roles of setting prices for water and wastewater utilities and of making policy for the licensing of services for water, wastewater and drainage. It is also the department responsible for the management of Western Australia's water resources through the entire water cycle. The *Inquiry into the tariffs of the Water Corporation, Aqwest and Busselton Water* is of particular interest to the Department of Water.

The Department of Water offers the following comments in response to the issues paper.

2 Current service levels

The most recent comprehensive review of service standards was undertaken by the former Office of Water Regulation in 2003. Since this time significant changes have occurred in water industry standards.

The Department of Water acknowledges the need to review the adequacy of current service standards.

3 Pricing principles

Under the current water pricing system, water prices are exactly the same in drier years as in normal years. Conceptually, a system where prices reflected the availability of water could encourage more efficient water use. Unlike water restrictions, it could also encourage reduced and more efficient indoor use.

Urban water supply is viewed by many people as a social obligation of government. A proposal that may intentionally increase water bills with the aim of reducing consumption can be expected to be controversial, irrespective of its net benefits. Some people would view it as unfair.

Public acceptance may be more likely after a degree of public debate informed by tangible indications of the likely benefits and impacts of the proposal.

The issues paper also canvasses a faster transition to long run marginal cost pricing. The Department of Water asks that in examining this issue, the ERA discuss the potential benefits for customers that could result from proposed changes.

4 Country water charges

The cost of supplying water in country towns is often higher than Perth, and commercial customers and high-volume residential customers in these towns pay higher charges.

Where country towns have lower supply costs than Perth, it is important that this be reflected in charges as far as practicable. If country prices only reflect costs when these are higher than Perth, this could create a perception of unfairness against country areas.

5 Wastewater charges

The Department of Water would support examination of the feasibility and potential for efficiency offered by wastewater charges based on estimated volumes, including for residential customers. However, it acknowledges that several matters that could affect this proposal.

- If the long run and short run marginal cost of augmenting wastewater service capacity is low, there may be minimal efficiency in a volumetric charge.
- An estimated volumetric charge could overcharge some customers, for example those with a large proportion of external water use. However even if conservative assumptions were made about the proportion of water discharged to sewer or about the proportion of wastewater revenue that could be collected through volumetric charges, estimated volumetric charges may still be more efficient than a pure fixed charge.
- Depending on the extent to which water and wastewater are complementary goods, volumetric wastewater prices could also affect efficient water consumption.

6 Drainage

The Department of Water is investigating the feasibility of modifying existing drainage funding arrangements. However no specific proposal for reform has been agreed, and the Water Corporation's existing responsibilities for drainage could be expected continue for at least some time.

The Department of Water expects that the inquiry would still need to recommend on the Water Corporation's regulatory revenue requirements for its existing drainage responsibilities, pending any reform of funding arrangements.

Irrespective of future drainage funding arrangements, it will still be necessary to establish a sound charging basis. The Department of Water would be interested in receiving the Economic Regulation Authority's perspective on the advantages of alternative charging methods.

For example, charges based on property size may correlate well with an 'impactor pays' approach of assigning costs, especially for commercial properties that can vary substantially in size. However it may also add administrative complexity.

7 Community service obligation payments

It is important to transparently demonstrate appropriateness, effectiveness and efficiency for large funding programs such as the government's program of community service obligation (CSO) payments related to water services.

The CSO payments for country services and revenue concessions aim to ensure that essential water needs are affordable to all households.

Additionally, CSO payments for country services potentially contribute towards the government's regional development objectives as articulated in *Better Planning, Better Futures*.

The Department of Water notes that CSO payments also fund the infill sewerage program. This program aims to eliminate the risks to the environment, groundwater and public health that can be caused by septic tanks in developed areas.

The Department of Water supports contestability of CSOs and associated payments. Contestability may offer a means ensuring cost-effectiveness of CSO expenditure, or of increasing confidence in the efficiency of current arrangements. Two measures that may improve contestability of CSOs include:

- increased transparency of cost information, for example, reporting of CSOs at the scheme level and/or business segment reporting
- allowing contestability on an outcomes-basis as far as is practicable. This may encourage innovative approaches to meeting the environmental, health, affordability or customer service outcomes desired by government.

8 Uniform tariff threshold

In examining any reforms to the uniform tariff thresholds, Department of Water believes that it is important to highlight any benefits for typical customers, in terms of both bills and water security, as well as any related environmental impacts of change.

If changes to the thresholds could impact upon the government's desired regional development or social equity outcomes, the Economic Regulation

Authority's views about alternative measures for achieving these outcomes would be welcomed by the Department of Water.

9 Discounts for low water usage

A reduction in the discounts for low water usage could improve efficiency, particularly if it sent improved price signals to small households with minimal potential for outdoor water use. However, it has the potential to penalise tenants who would not receive any corresponding reduction in fixed charges. The Department of Water would be interested in the Economic Regulation Authority's views on potential means of addressing this disparity.

10 Higher usage charges for very high volume users

In addition to the issues raised by the Economic Regulation Authority, the National Water Commission paper *Approaches to urban water pricing* argues that such charges may be inequitable because they can disadvantage large, low income households.

11 Demand management

In addition to the matters raised by the issues paper, the Department of Water would ask that the Economic Regulation Authority have regard to two other possible sources of market failure in considering the effectiveness and efficiency of demand management measures and in recommending any alternative options.

- Landlords do not pay any part of water use charges so they do not receive any direct financial benefit for the installation of water saving measures.
- Currently, cost-reflective volumetric pricing has an extended phase in period. The absence of complete price signals, may suppress demand for water saving technologies and increase demand for water during this period.

12 Externalities

Recovery of water resource management and planning costs

Many water resource management and planning activities undertaken by the state government directly benefit water users by ensuring water quality and security. Some activities also reduce or mitigate the environmental impacts of water use. If water were not taken from the environment, these activities would not be necessary and are thus directly related to water use.

Where the costs of managing water resources efficiently and sustainably are passed on to water users, this may help to improve the efficiency of price signals for water use.

In *Western Australia's Implementation Plan for the National Water Initiative*, the government stated that recovery of water resource management and planning costs (apart from licence administration and metering) would be implemented only after extensive consultation, the completion of statutory management plans and the establishment of long-term secure water access entitlements.

Externality charges

Cost recovery is different from the concept of an externality charge. An externality charge would be intended primarily to convey an efficient price signal to users to help achieve a level of consumption that better reflects the optimal net benefit to society. Externality charges achieve their effect by using the charge to influence behaviour – they do not need to be spent on any particular purpose.

The Department of Water agrees that there would be significant challenges with the design of an efficient externality charge.

Charges to address environmental externalities could require ecosystem valuation or other non-market valuation of environmental services and impacts. Such techniques can be expensive to undertake and can be controversial. Calculation of externality charges would also require reasonably robust quantitative relationships between customer actions and environmental impact.

13 Technical issues and issues specific to each utility

The Department of Water supports the scope of the technical issues and the issues specific to each utility that the Inquiry proposes to examine.