

**National Competition Council
The 2004 Policy Assessment
for Water Reform**

Submission by

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This submission has been made in response to the invitation contained in "The 2004 National Competition Policy Assessment Framework for Water Reform" (NCC December 2003).

This submission relates to the review relating to water reform obligations to be assessed in 2004 and to the review of water legislation in Tasmania with particular reference to pricing of urban water and wastewater.

It is argued once again that a significant gap remains before Tasmania can be said to have met its Council of Australian Governments (COAG) obligations with respect to Full Cost Recovery and Rate of Return Reporting and the adoption of Two Part Tariffs.

It appears that it has been accepted that the pricing regimes adopted by local government authorities in Tasmania have provided sufficient evidence to GPOC that full cost recovery is being achieved, though there remains some concern about the manner in which it is being achieved and the transparency of the water pricing process at the retail level.

It is, however, of particular concern that there is considerable reluctance to introduce 2-part pricing amongst some of the larger southern Councils and a stubborn adherence to using AAV as the basis for urban water and waste water pricing.

The argument against volumetric pricing for water and waste water consumption has been based on a claim that the fixed costs of supplying water first as bulk water to the Councils and then the on selling to businesses and households are very high. That is that the variable costs associated with volumetric consumption are very small. Consequently, if a 2-part tariff is to be introduced then variation in consumption will have very little effect on the final price.

The use of property values and AAV to determine the charges for urban water and waste water has been long defended by local councils that apparently see no need to relate the price they pay for bulk water to the bulk water authority (Hobart Water) and the consumption of water within their council area.

The last audit into compliance with NCC principles and Tasmanian Government Guidelines by GPOC concluded that the practice of basing urban water and wastewater charges on AAV could be defended on "efficiency grounds". The test that was applied by GPOC, and apparently accepted by the Tasmanian Government in correspondence to the Property Council of Australia was that the charging system was efficient because no user of urban water or wastewater had elected to be disconnected from the reticulation system.

In subsequent correspondence The Property Council of Australia (Tasmania) has argued that this test is flawed in a situation where a natural monopoly exists since the purchasers have no alternative but to pay the charges. In the absence of a 2-part system the whole of the charge is a fixed cost with no scope for reducing the charge by reducing consumption. And even where a 2-part system exists and the fixed cost is arbitrarily set to reflect the greater part of the cost of supplying water, then volumetric charges will play little part in determining or discouraging consumption.

Taken to its logical conclusion this efficiency test can hardly be presented as an acceptable basis for public policy making in utility pricing where no practical competitive alternative exists and the test is accepted by the regulator.

It is strongly recommended that the NCC ask the Tasmanian Government and GPOC whether it is prepared to defend the use of AAV for water pricing and to base the defence of its use on an efficiency principle that rests on the “unwilling to disconnect” criterion.

The second area of concern is the setting of bulk water prices where GPOC has the responsibility of approving the proposed charges that the bulk water authority sells water to the local government councils. An inquiry into bulk water prices is about to commence and it is recommended that the NCC pay particular attention to the process and the way in which bulk water prices are arrived at.

The argument of using AAV to determine the wholesale price of water might be expected to prevail also. Logically, the bulk water authority (with the approval of GPOC) should be able to use the efficiency test to charge any price that not only reflects the fixed cost of supplying water to Southern municipalities but also justifies such a charge on the grounds that no Southern Council has elected to disconnect from the bulk water supply. Hence the system must be efficient.

The Water Reform Assessment Framework 2004 suggests that the NCC is well satisfied with the progress that Tasmania has made towards water reform in the areas of urban water and waste water despite the fact that 2 part pricing has not been introduced in southern councils and that even where it does exist cross subsidies exist between classes of users.

It is appreciated that NCC may be more focussed on ensuring that the Tasmanian public are not subsidising the water business to local organisations and that by so doing they are allowing Tasmanian industry to gain a subsidised and hence competitive advantage compared with operators in other Australian States. The available evidence on water charges in metropolitan areas indicates that this is far from the case and that Tasmanian business and many householders pay more for water than their mainland counterparts.

It is argued here that the NCC should also be concerned with the establishment of a level playing field in which Tasmanian businesses and property owners are not disadvantaged in a competitive environment by a flawed pricing system.

Finally, whilst the NCC may be primarily concerned with interstate competitiveness and competitiveness between authorities within a State and either the abolition of cross subsidies between classes of consumers or the transparency of such arrangements, it can be argued that the existence of cross subsidies between consumers within a particular class is also a matter for concern and should be addressed by the NCC during the current assessment.

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