

Submission to AUSTRALIAN ENERGY MARKET COMMISSION

Re: Review of the effectiveness of competition in the electricity retail market in the ACT.

Submitting Agencies

Care Inc
ACTCOSS
Uniting Care Australia

Care Inc

Care is a community organisation set up to help people on a low to moderate income, living in the ACT, who are experiencing financial difficulties.

Care is an independent organisation with a Board of Management and provides a range of information and financial counselling services and has a Community Development and Education program. The Consumer Law Centre of the ACT and the No Interest Loan Scheme (NILS) are under the auspices of Care.

Care's Community Development and Education Program provides information and education about Care's work and financial counselling topics, including how to deal with debts, budgeting, stress and money, living on a low income and other topics. Care actively seeks to learn from their clients about systemic problems faced by low income and vulnerable clients and consumers.

ACT Council of Social Service

The ACT Council of Social Service Inc (ACTCOSS) is the peak representative body for not-for-profit community organisations, and disadvantaged and low-income citizens of the Australian Capital Territory.

Key social policy areas that ACTCOSS examines include poverty and income disadvantage, housing and homelessness, mental health, disability services, health, employment and economic policy, corrections, gambling, community sector workforce issues, consumer rights and complaints bodies.

The ACT Council of Social Service was formed in 1963. ACTCOSS is a member of the nationwide Council of Social Service network, made up of each of the state Council's and the national body, the Australian Council of Social Service (ACOSS).

Uniting Care Australia

Uniting Care Australia represents over 400 Uniting Care services across Australia, and works closely with people dealing with financial stress in urban, regional, rural and remote communities in programs that deliver emergency relief, financial counselling, aged care, mental health, relationship, youth, family support and homelessness services.

Uniting Care Australia receives funding from the Advocacy Panel to contribute to the development of energy policy across the National Energy Market (NEM).

Submission Overview

The collaborating agencies are concerned about the suggested nexus between effectiveness of competition and removal of price caps.

We regard price caps for the essential services of energy, particularly electricity, as an important element in maintaining consumer protection, particularly for lower income households.

In section 1 we provide an overview of the extent of lower income households in the ACT and some of the cost pressures they confront.

In section 2 we respond to some of the “higher order” discussion in the first draft report.

Section 1 Lower Income Households in the ACT

As part of the analysis of the ACT market for small customers, the first draft report includes the following statement on page 19:

“another attractive characteristic of the ACT market is that the average weekly earnings are relatively high. As at February 2010, average weekly earnings in the ACT was \$1177 per person compared to \$983 in NSW and \$922 in Victoria. A relatively high average income could imply a greater propensity to consume electricity and possibly lower risk associated with bad debt. However these market features are also dependent on the number of low income customers.”

We wish to highlight the extent of low income households in the ACT, and also note that the cost of living is higher in the ACT than in some other Australian jurisdictions.

In the 2010-2011 Budget, the ACT Government announced an increase in the concessions for hardship customers by \$20 per year. In their Budget response, ACTCOSS stated that, while this concession results in a 14% increase since the 2004-05 rate, electricity prices have increased on average by 23%. The concession is a step in the right direction, however, it does not make up for the costs low-income consumers will need to carry.

The Australian Bureau of Statistics reported on the 14th of August 2007 that “Queanbeyan residents paid a median weekly rental of \$185 which was 29% lower than the ACT.” Queanbeyan is geographically adjacent to the ACT, is in New South Wales and so provides a useful reference point of differences between the ACT and the State of NSW.

The ABS report, ACT Stats 2007 (Cat no 1344.55.001) reported “in the 2006 census, ACT residents had the highest median weekly rental payment of all

states and territories. At \$260 per week this was \$70 (37%) above the median weekly rental payment for Australia as a whole.

The ABS Household and Income Distribution Report 2007-8 states that 11.7% of ACT households relied on government pensions and benefits as their primary source of income, and 13.8% of households relied on “other income”, meaning other than wages, salaries, own business or government benefits. It is likely that some of these “other income” households are on fixed incomes living on superannuation or savings income.

In May 2008 the ACT Chief Minister’s Department released a report titled “Social Impacts of Climate Change in the ACT” which included the following statements”

“low income households: all households in the ANC earning less than \$650 per week, estimated to be around 20,000 households in 2008 or 17% of all households in the ACT” and

“Low middle income households: those households in the agency earning between \$650 and \$999 (per week) either renting or purchasing the home, estimated to be around 7670 households in 2008 in the ACT.”

So, according to these definitions, around 27,670 households in the ACT are the most vulnerable to social impacts (of climate change.)”

We suggest that households that are vulnerable to impacts of climate change are also households vulnerable to impacts of rising energy costs, and so conclude that in 2008, 23% of all ACT households, nearly a quarter, were vulnerable to rising energy costs.

The Canberra Times on Sunday 11th of October 2009 reported the following under the headline “Government steps in as Canberrans face bill stress.”

“The Territory is increasingly shouldering the debt of Canberrans struggling to pay bills, with the amount rising more than twentyfold since the beginning of the decade.”

The Energy and Water Council and, from February, its successor the ACT Civil and Administrative Tribunal paid almost \$340,000 in unpaid bills for Canberrans last financial year.

The amount was up from less than \$16,000 in 2001 and 2002 and more than 45% higher than the previous financial year, according to the Department of Justice and Community Safety’s annual report.

Most of the money was discharged under the debt horizon scheme, through which the Territory effectively matches money paid by individuals. The scheme was introduced in May 2007 to help people struggling to meet spiralling household budgets which made up the bulk of the \$340,000 requested to cover debt. The number of debts discharged jumped 20% on the previous year.

The Commonwealth Grants Commission *Report on GST Revenue Sharing Relativities – 2010 Review* uses the SEIFA Data, breaking state and territory

populations in to 5 categories: least disadvantaged; 2nd least disadvantaged; middle; 2nd most disadvantaged; most disadvantaged.

Population by SEIFA quintile	ACT '000	ACT %
Least Disadvantaged	149.1	43.16
2 nd Least Disadvantaged	108.7	31.46
Middle	55.8	16.14
2 nd Most Disadvantaged	21.1	6.10
Most Disadvantaged	10.8	3.13
Total	345.6	100%

Table 1

This reporting of rapidly rising demand for assistance due to inability to pay essential service bills is also reflected in the experience of financial counsellors who state that electricity bills currently top five issues reported to financial counsellors for people seeking help.

The 10 most frequently recurring issues upon which assistance was sought during the period in descending order is shown in table 2 (and note, more than one presenting issue can be collected per person):

Period: 1 January – 30 June 2010

TOP 10 ISSUES

Housing			
	<i>Public Rent</i>	15%	30%
	<i>Private Rent</i>	2%	
	<i>Mortgage</i>	12%	
Change in Circumstances			29%
	<i>Illness/Injury/Death in Family</i>	7%	
	<i>Unemployment</i>	9%	
	<i>Separation/Divorce</i>	12%	
	<i>Loss of Income/Global Economic Crisis</i>	1%	
Debt Collection			28%
	<i>Responding to debt recovery</i>	15%	
	<i>Seeking hardship relief</i>	10%	
	<i>Repossession</i>	3%	
Consumer Credit: Credit Card			27%
Utilities			23%

	<i>Electricity</i>	13%	
	<i>Gas</i>	6%	
	<i>Rates (General and Water & Sewerage)</i>	4%	
Consumer Credit: Loan Contract			19%
Budgeting/Financial Management			15%
Telecommunications			13%
	<i>Mobile</i>	5%	
	<i>Telephone (landline)</i>	4%	
	<i>Internet/Pay TV</i>	4%	
Bankruptcy			12%
Communication with Creditors			10%

Table 2 Source: Care Inc, Presenting Issues to Financial Counsellors

Care Inc makes the following comments about the 'top 10 recurring issues.'

- Housing issues in the table above have been reported as an aggregate of all issues including public housing, private housing and mortgages. This has consequently placed it as the top issue for which clients seek assistance from the service. The individual figures for each housing type remain similar to those noted in the previous reporting period. Problems in relation to home mortgages has appeared in the top 10 since the July to December 2006 report. Housing affordability will be addressed in the Planning and Policy section of this report
- Budgeting/ financial management is a fairly broad issue and there are many callers who identify budgeting and financial management strategies as one of a number of issues for which they require assistance. It is less common for this to be the only presenting issue. As a result it is usually placed in the top 10 list of issues upon which assistance is sought in any reporting period.
- Debt collection was a new entrant in the top 10 in the previous reporting period with 15% of all contacts requiring assistance with this issue. In this period that figure has risen to 28%. Debt collection activity includes seeking hardship relief and is a further indication that there are many people experiencing financial stress. Financial hardship and recent changes to credit regulation will be discussed in the Planning and Policy section of this report
- **Despite only modest increases in the price of electricity in the past 12months, there has been an increase in the number of clients seeking assistance in relation to utility hardship.**
(Emphasis added to highlight energy aspects of these more general comments)

Further data from Care Inc financial counsellors is included as appendix 1.

Lower income, vulnerable and disadvantaged households already pay a larger proportion of their income relative to higher income households to purchase basic goods and services, including utilities (see table 3 below). They are exposed to and negatively impacted by even slight changes in the costs of goods and services, including utilities. Additionally, they do not have the financial capacity to respond to increases in costs that are inevitable if price regulation is removed in the ACT.

Basic Comparison of Percentage of Income Spent on Utilities

Income Source	Annual Income	Per Fortnight Average Utility Usage Cost	Per Annum Utility Usage Cost	Percentage Income for Utilities (without any concession)	Percentage Income for Utilities (with concession)
Wages	\$75,000	\$80	\$2080	3%	n/a
Age Pension	\$17972	\$80	\$2080	11%	10.50%
Newstart Allowance	\$11,696	\$80	\$2080	18%	16.26%

Table 3

Table 3 clearly shows the highly regressive nature of energy prices and hence the regressive nature of price increases, with households dependent on pensions and benefits as their primary source of income having to forego expenditure on other essential items, eg food and health care, in order to meet energy costs.

Another group of concern to the collaborating agencies are people with mental health problems, who often struggle financially and are vulnerable to predatory marketing, which, for some, is associated with competition in energy markets.

We are concerned that a recommendation to the ACT to remove the price cap offered through a regulated standing contract price, and to focus on customer churn as an indicator of effectively competitive markets, is likely to both increase the level of energy hardship in the ACT, and subject vulnerable and disadvantaged customers to predatory marketing, which is not in their best interests.

We conclude that about a quarter of households in the ACT are currently experiencing difficulty in paying energy bills, due to lower incomes, which belies the observation that ACT households are financially better off than households in other States. While average income in the ACT is high, living costs in the ACT are also high, and higher incomes are not evenly distributed, with a significant number of households being on low or modest income and unable to meet all living costs currently.

Section 2

In considering some of the issues raised in the first draft report, we start from the objective of the National Energy Market which is for the market to operate in the best interests of consumers, in the longer term.

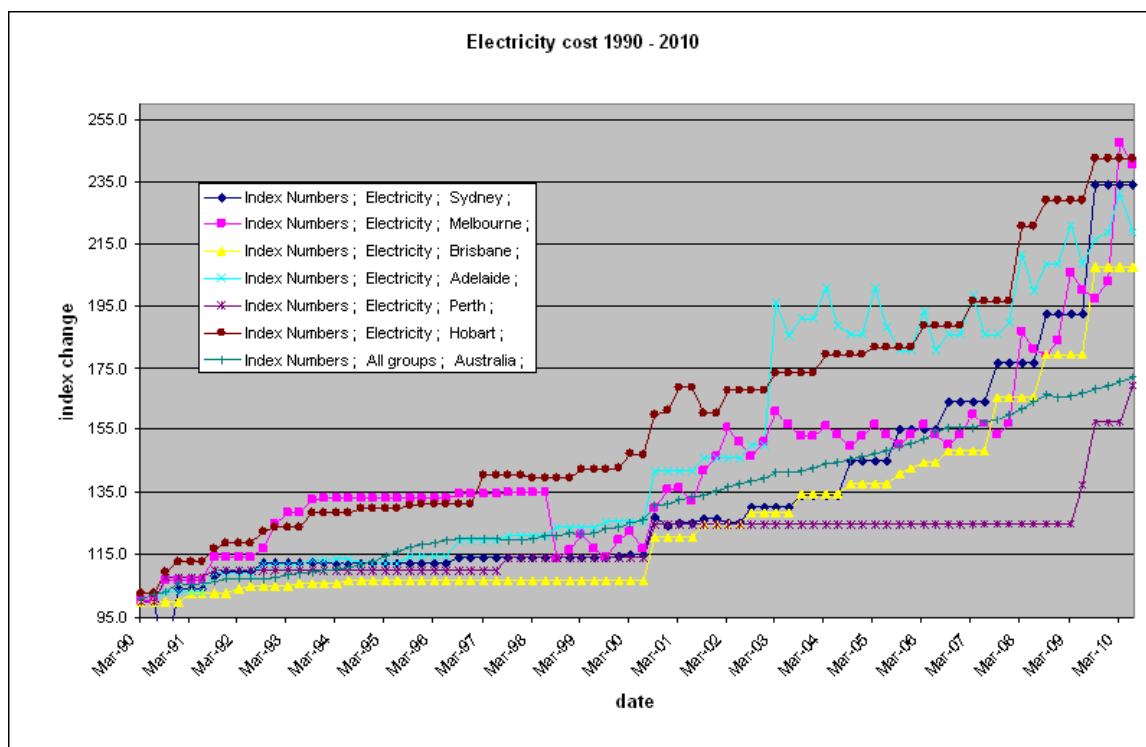
The first draft report correctly makes the finding that energy markets in the ACT are not competitive, at least in the manner normally understood for competitive markets, namely a number of suppliers, competing on price, to achieve an optimal equilibrium in the market between demand and supply.

We cannot question the finding that the ACT energy market is not competitive, in the traditional sense, but we do question whether forcing the market to appear to behave like a competitive market is really in the long-term interests of consumers.

We observe an apparent “competition paradox” where the objective of competitive energy markets is to drive down the price paid by consumers (as markets become more efficient and pass efficiencies onto consumers), however the main proposal to make the market more competitive is to increase the price paid by consumers!

We observe that in Australian energy markets, the promise of lower costs to customers by privatising energy markets is illusory. Graph 1 below shows index change in electricity prices for the capital cities of all Australian States since 1990.

The introduction of full retail contestability from early in the 21st century shows both an increase in costs paid by consumers and greater volatility in all cities, except Perth, which is in the only state not part of the NEM. Over recent years, in particular, the cost of electricity has risen at a rate greater than the ‘all groups CPI’ for Australia, despite energy markets becoming more competitive. The Melbourne market is often cited as the most competitive electricity market in the world, yet on the data presented in graph 1 shows that Melbourne electricity costs have risen at least as fast as anywhere in Australia in the two decades from March 1990. It is certainly contentious to conclude that the most competitive electricity market in the world has delivered benefits to residential consumers.



Graph 1, Source ABS CPI data

The following responds to aspects of the first draft report, on a chapter by chapter basis, mainly responding to conclusions at the end of each chapter.

Chapter 4 Market Definition

The collaborating agencies support the conclusion defining the market for the ACTU Retail Review as the ACT geographic area; for both short and long-term considerations.

Chapter 5 Market Structure

The collaborating agencies support the conclusion that the ACT “appears to be an attractive market even though there are a relatively small number of customers.” Of particular relevance is the small geographic area covered by the market, and distribution costs should be significantly more alive than for jurisdictions with much larger geographic areas.

The conclusion that the transitional franchise tariff is the most significant barrier to entry to the market for new retailers, “specifically the exclusion of customer acquisition costs from cost index”, is not accepted. There is no consumer benefit in increasing the cost paid for electricity, by residential consumers, so they can be ‘marketed at’. We do not regard this to be in either the short or long term interest of consumers.

Economic theory that is predicated on the basis that inefficient companies will find efficient ways of providing their goods or service is what drives benefits to consumers. Artificially increasing the cost paid by consumers is promoting inefficient markets to the consumer’s detriment.

The conclusion that ‘the market structure of the ACT electricity retail market is not consistent with what would be expected in a market in which there is effective competition’, is generally supported.

Comment

Uniting Care notes the use of the market concentration indices, section 5.3.3 on page 25 of the first draft report and welcomes the reporting of three-firm and four-firm concentration ratios along with the Herfindahl Hirschman Index. As UnitingCare Wesley Adelaide noted in its submissions regarding the South Australian Review of Effectiveness of Retail Competition, concentration indices provide very important clues as to the true nature of a market. They opined that concentration indices for most Australian jurisdictions are more in line with oligopoly markets than with effectively competitive markets. Uniting Care Australia maintains the view that oligopoly market structures are under-considered in the context of Australian energy markets, yet require different regulatory responses than competitive or near (effectively) competitive markets.

Chapter 6 Market Conduct

The use of ‘switching’ data as a primary indicator for effectiveness of competition is not supported by the collaborating agencies. We believe that the arguments against switching as a prime indicator were well-made in the Victorian Review of

Effectiveness of Competition by community agencies and so direct the AEMC's attention to the arguments presented in that review. We see little value in reproducing the arguments here.

We observe that some customers in the ACT choose to switch provider, an indication that there is the capacity for consumers to switch, while the markets can be described as 'slow', various capacity for new retailers to move into the market and some customers are prepared to switch, suggesting 'effective competition', spurred by the potential for new market entrants, rather than 'Paretian ¹optimal' competition.

Chapter 7 Market Performance

This chapter focuses on prices and profit margins for retailers in the ACT, and considers market performance more broadly.

We note from the data given in table 7.1 that unit price per megawatt hour as determined by the ICRC, has risen by 14% in three years, a greater increase than CPI, indicating that consumers are paying more for electricity and suggesting that the increases allow plenty of scope for efficient retailers to operate.

An aspect of market performance that we wish to highlight is the importance of the ICRC Act requiring decisions to address the protection of consumers, including consideration of the social impacts of any decision. This perspective must be retained for the essential service of electricity.

We also note in table 7.4 that retail margins in the ACT, from 2008-09 through to 2010-11, comparable with other Australian jurisdictions are higher than the average margins across the NEM. This supports our view that retail margins in the ACT are adequate.

On page 60, an inactive retailer interview is reproduced where the inactive retailer is quoted as saying "whereas if it (retail margin) was to increase by 20% or 30%, I might say, "I think they are serious about this (increasing competition)". They are suggesting that this is the sort of headroom required to catalyse competitive behaviour amongst a range of retailers. The great concern we have with this approach is that it is a massive impost on consumers, a growing number of whom are already feeling the pinch of rising electricity costs.

A significant aspect of this chapter is reporting on customer satisfaction. The draft report states that "most survey participants in the ACT, 93% of residential consumers and 92% small-business customers, had never encountered any of these (seven identified) problems."

The graph in figure 7.2 clearly shows that complaint levels in the ACTU are significantly lower than for Victorian and South Australian jurisdictions, and the number of complaints in the ACT was static from 2005-06. The important question for this review is how to interpret this data.

¹ Paretian Optimality refers to the principle developed by 'classical economist' Vilfredo Pareto that a move (policy action) is an improvement if it leaves at least someone better off, without leaving anyone worse off. Paretian optimality is achieved when nothing can be done without someone being worse off, ie a market optimum (equilibrium) has been reached; the theoretical 'bliss point' delivered by a competitive market.

We suggest that this data indicates that ACT consumers are satisfied with the service they are receiving, and while some have concerns about rising prices, there is a prevailing view that, to quote the old adage, “if it ain’t broke, don’t fix it.”

In terms of economic theory, we suggest that the ACT energy retail market is an excellent example of where the “theory of second-best” is appropriately applied. We think the ACT market is too small to provide the scale for a range of retailers to be effectively competing in a cost-effective manner that is in the long-term best interests of consumers.

We reproduce below an extract from the Journal of Economic Studies regarding the general theory of second best ²

A general theorem of the theory of second-best

“It is well known that the attainment of a Paretian optimum requires the simultaneous fulfilment of all the optimum conditions. The general theorem for the second best optimum states that if there is introduced into a general equilibrium system a constraint which prevents the attainment of one of the Paretian conditions, the other Paretian conditions, although still attainable in general are no longer desirable. In other words, given that one of the narration optimum conditions cannot be fulfilled, then an optimum situation can be achieved only by departing from all the other Paretian conditions. The optimum situation finally attained may be termed a second-best optimum because it’s achieved subject to constraint which, by definition, prevents the attainment of Paretian optimum.

From this theorem follows the important negative corollary that there is ‘a priori’ a way to judge as between various situations in which some of the Paretian optimum conditions are fulfilled while others are not. Specifically it is not true that a situation in which more, but not all, of the optimum conditions are fulfilled is necessarily, or is even likely to be, superior to a situation in which fewer are fulfilled. It follows, therefore, that in a situation in which there exist many constraints which prevented the fulfilment of Paretian optimum conditions, the removal of one constraint may affect welfare or efficiency by raising it or by lowering it or by leaving it unchanged.

The general theorem of the second best states that if one of the Paretian optimum conditions cannot be fulfilled, a second best optimum situation is achieved only by departing from all other optimum conditions.”

In applying the general theorem of the second-best to the ACT electricity market, we suggest that lack of market size constitutes a suboptimum condition. This is because scale economies in production mean that only a small number of firms can profitably enter the market, so that effective competition is forestalled.

² R. G. Lipsey and Kelvin Lancaster, Journal of economic studies 24, 1956, 11-32

Therefore, an optimum, albeit a second-best optimum, is achieved by departing from attempts to create Paretian optimum type conditions.

We suggest that the second-best, and therefore optimum outcome given the market circumstances, is for continuation of current arrangements which seek customers and maintain adequate regulation to keep in check the dominant retailer.

We support the conclusions for this chapter which state that the ACTU electricity retail market is not consistent with what would be expected to exist in a competitive market. We agree that customers are generally satisfied with the retail services provided to them. We would add the opinion that this is consistent with application of the theory of second-best which, in this instance, means that the optimum outcome for consumers is the maintenance of existing arrangements, including regulation specified in the ICRC Act.

Chapter 8 Compliance with social welfare and equity objectives.

We support the finding that “the social welfare objectives set out by the ACT government are clearly designed to achieve certain desirable outcomes. In addition, development programs that implement these policies have been clearly specified and transparently funded as required.

We offer a note of caution at this point about the ‘bundling’ arrangements, whereby various essential service and related utility providers, some with shared parentage, are bundled together as a range of services at a discounted rate. We are concerned about the potential for cross subsidisation and the high potential for lack of transparency with this practice. We are also concerned about the actual incidence of costs and benefits and whether low income households have equitable access to any benefits of bundling, or whether they are effectively cross subsidising higher income consumers. We are unable to answer these questions and are aware of concerns about bundling from some ACT consumers.

Summary

The collaborating agencies wish to highlight that, despite relatively high aggregate income levels in the ACT, there are significant numbers of low and modest income households who have to cope with higher costs of living than in other parts of Australia.

About 23% of ACT households are vulnerable to rising energy costs, and people with mental illness or in receipt of pensions and benefits as their primary source of income are particularly vulnerable.

While the ACT energy market is not “effectively competitive”, as identified in the first draft report, we submit that the best response to this situation is to apply the theory of second best. This suggests to us that rather than trying to force a competitive market type structure onto the ACT market, the optimal outcome is the ‘second best’ outcome, which we contend is maintenance of the current regulatory environment with a dominant retailer. The current arrangements are supported by ACT households which have a very low rate of complaint.

Any suggestion of removing price regulation is rejected both because it is counter-initiative to competitive market models whereby competition delivers benefits to consumers through lower prices, not higher price ceilings, and because impacts of price rises on low and modest income households will mean too many people going without other basics, including food and health care, as they seek to pay for energy increases.

Please direct any questions about this submission to:

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Appendix 1

CLIENT PROFILE DATA FOR PERIOD 1 JULY – 31 DECEMBER 2009 (Supplied by Care Inc)

