



**Submission to the Productivity Commission Draft
Report on Energy Efficiency, April 2005**

**Prepared by the
Consumer Utilities Advocacy Centre Ltd**

The Consumer Utilities Advocacy Centre Ltd (CUAC) welcomes the opportunity to comment on the Productivity Commission's Energy Efficiency Draft Report ('The Report').

CUAC is an independent consumer advocacy organisation, established to ensure the interests of Victorian electricity, gas and water consumers, particularly low-income, disadvantaged and rural consumers, are effectively represented in the policy and regulatory debate.

This submission addresses some of the issues raised in the Report's discussion about energy efficiency in the residential sector (chapter 7), in particular some of the assumptions about barriers and impediments to energy efficiency improvements .

In line with CUAC's mandate, this submission focuses particularly on some of the barriers low-income households face in order to improve the energy efficiency levels of their homes. In our view, the Report's discussion of energy efficiency in the residential sector fails to distinguish between affluent and less affluent households. In order to understand all barriers to the adoption of energy efficiency measures it must be acknowledged that the residential sector is an heterogeneous group and that household finances can be a key impediment to improving energy efficiency.

The Residential Sector

The Report states that only 12 per cent of end user energy consumption can be attributed to the residential sector and that it thus has received a disproportional amount of attention in relation to energy efficiency. There are two comments we would like to make in relation to this view point.

Firstly, that the residential sector's impact on peak demand warrants attention and serious policy consideration. In the current Victorian Electricity Distribution Price Review all the electricity distribution businesses have forecast increase in peak demand growth. The reasons provided by the distributors were increase in penetration of air conditioners, increase in usage per customer and, for certain parts of the network, an increase in customer numbers.¹ Growth in peak demand drives investment in generation and increases greenhouse gas emissions.

¹ Essential Services Commission, March 2005, *Electricity Distribution Price Review 2006-2010*, Position Paper, Melbourne, p 159

Secondly, that basic differences between households and businesses must be acknowledged. To put it simply, a household will usually be steered by other preferences than what is cost effective in the long term and is thus more likely to warrant policy intervention in order to improve the sector's energy efficiency.

Cost of Energy

We strongly disagree with the Commission's assumption that energy is relatively inexpensive to all Australians. The Report refers to figures from the ABS Household Expenditure Survey and states that:

“For households whose gross income was in the bottom 20 per cent of all households in 1998-1999, domestic fuel and power still accounted, on average, for *only* 3.7 per cent of their total expenditure.”²

A recent study using the same ABS data has demonstrated that nearly a quarter of Australian households in the lowest income quintile experience utility stress.³ This shows that the comments about inexpensive energy and the lack of incentives to reduce consumption are not indicative of many Australian households. Furthermore, the Commission is generalising Australian households with the claim that households have “demonstrated that they are capable of quickly changing their energy use when it is cost effective for them to do so, even if it means replacing appliances they have worn out”.⁴ The evidence cited for this being the decline in usage of oil heaters after the oil price shock in 1979.

Although we would conditionally agree with the claim that a price shock can influence behavior, we strongly recommend caution in assuming that prices are the panacea for energy inefficiency. In our view, a substantial number of Australian households would simply have to bear the increased cost and endure further disadvantage from the financial strain. This would certainly not assist these households to make the necessary capital improvements to their homes in order to increase energy efficiency. Furthermore, these increased living costs could conceivably force tenants into cheaper but poorer quality housing.

A study of households disconnected from energy supply due to the inability to pay undertaken by CUAC and the Consumer Law Centre Victoria argues that:

“...while we do not oppose energy and water services being priced on a cost reflective basis to provide an incentive for consumers to reduce wasteful consumption, the unintended consequences of such pricing arrangements for many low-income households must be recognised. If the average household can also afford to undertake private efficiency

² Productivity Commission 2005, *Energy Efficiency*, Draft Report, Melbourne, p 98 (CUAC's italics)

³ Siminski, P in Committee for Melbourne, November 2004 *Utility Debt Spiral Project Report*, Melbourne, p 49. The author notes that the difference higher and lower income households' propensities for utilities stress is perhaps not as large as one would anticipate and that this can be partially explained by the 'age effect' (that older households are unlikely to report utility stress although they typically have lower incomes). Utilities stress refers to households unable to pay utility bills on time due to a shortage of money.

⁴ Productivity Commission 2005, *Energy Efficiency*, Draft Report, Melbourne, p 101

improvements based on energy or water efficiency advice, whilst low-income households cannot, the result might be a ‘double whammy’ for low-income households, which are both disadvantaged by the new pricing arrangements *and* unable to reduce consumption in the same manner as other households. There is also the danger that, as low-income households’ usage levels will diverge from the typical (lower) consumption pattern, the subsequent higher costs for energy or water services faced by low-income households will be justified by the mantra that households should pay accurate and cost reflective prices, ignoring the reasons for these households’ higher usage levels.”⁵

Barriers and Impediments

The Report seeks to explain why householders overlook cost-effective energy efficiency improvements (section 7.2) and outlines the following four reasons: Information asymmetry, that energy efficiency information has a public good characteristic about it, split incentives, and small cost savings.

While we certainly agree that these four reasons act as barriers to householders adopting energy efficiency measures, the need for upfront capital is a major impediment to many.

The greatest financial savings from implementing energy efficiency advice are not achieved through non-cost related behavioural changes alone (such as turning off the power to the television on the switch) but through improving the residence and/or replacing appliances. Both require capital investment.

We therefore recommend that in addition to energy efficiency advice, measures involving financial assistance to low-income households are necessary.

The Commission indirectly acknowledges this barrier in its discussion about whether subsidies can be an effective policy tool. In our view however, the Commission has presented a very limited outline of the capital cost barrier and the range of policy responses that should address the problem.

Financial Incentives

As demonstrated in the Report a large proportion of energy consumption in the residential sector can be attributed to space and water heating.⁶ It is therefore appropriate that energy efficiency measures prioritise improvements in these two areas.

The Commission suggests that the impact of subsidies can be low as many recipients would have undertaken the improvements independently of government rebates.⁷ We believe that uptake and impact could be increased if rebate schemes focused on improving low quality

⁵ Consumer Law Centre Victoria/Consumer Utilities Advocacy Centre, November 2004, *Access to Energy and Water in Victoria – A research report*, p 105

⁶ Productivity Commission 2005, *Energy Efficiency*, Draft Report, Melbourne, p 99

⁷ As above p 108

housing through insulation and the installation of high rating gas hot water tanks. These schemes may appear somewhat mediocre or mainstream but the reality for many households are that these are unaffordable improvements that could reduce non-discretionary energy consumption substantially. These rebates should be substantial enough to attract applicants (however eligibility could be restricted).

The Warm Front program in the UK offers grants for insulation of homes (for both home owners and private tenants) to people on income support. Government subsidies for increased energy efficiency must be seen in relation to government expenditure in assisting households with energy bills. In 2002-2003 the Victorian Government spent over 800 times more on utilities concessions and relief grants than they did on Capital Grants.⁸ In the UK the Warm Front program assisted over 300 000 households with an average grant of £445 (in 2002). The improvements undertaken to the grant recipients' homes had the potential to reduce the fuel bill by £150 per annum (on average).⁹ The initial grant cost of insulation and heating is thus recouped in just three years by fuel savings. We strongly recommend the Commission review some overseas initiatives, including Warm Front.

Split incentive

The Commission rightfully acknowledges the effect the split incentive phenomenon has on the adoption of energy efficiency improvements. CUAC is particularly concerned about tenants in private rental properties as they have little opportunity to improve the energy efficiency of their home. At the same time, we know that a very high proportion of people having difficulties in paying their energy bills live in rental accommodation.¹⁰ As argued above, we do not agree with the notion that energy costs are too low for consumers to care about. Furthermore, we disagree with the Commission's questioning of the energy-performance rating scheme for existing dwellings on the grounds that energy is such a small part of a household's expenditure that "the decision to rent or purchase a dwelling is likely to be driven more by other considerations, such as the general amenity of the property and its proximity to schools, shops and workplaces".¹¹ Again the Commission fails to acknowledge that the group they are referring to is extremely heterogeneous and that for a low-income consumer paying \$200 in weekly rent the difference between \$10 and \$20 in energy related costs per week is enormous. For someone purchasing a home for half a million, on the other hand, energy-performance might be given less consideration (or improvements could be budgeted for).

CUAC believes that for tenants in the private rental market the split incentive is the single largest barrier to householders improving energy efficiency. Information such as performance-ratings is a step in the right direction but for many tenants (especially in the

⁸ Department of Human Services (DHS), Concessions Unit, Annual Report 2002-2003, Melbourne. The Capital Grants scheme delivers once-off assistance with the repair or replacement of an essential household appliance that is causing high utility costs.

⁹ National Audit Office June 2003, *Warm Front: Helping to Combat Fuel Poverty*, London. See discussion in Consumer Law Centre Victoria/Consumer Utilities Advocacy Centre, November 2004, *Access to Energy and Water in Victoria – A research report*, p 104-108

¹⁰ Siminski, P in Committee for Melbourne, November 2004 *Utility Debt Spiral Project Report*, Melbourne, p 53.

¹¹ Productivity Commission 2005, *Energy Efficiency*, Draft Report, Melbourne p 136

lower half of the private rental market) information alone will not improve housing stock. If a household cannot afford or is denied access to better quality housing, that individual or family will be forced to live in inefficient homes. In our view landlords should be required to provide a minimum standard of acceptable quality housing. We believe the government has a role in setting standards as well as developing and/or providing financial incentives (positive or negative) to landlords if deemed necessary.

The role of government

The Commission's draft finding 5.2 states that:

Other barriers and impediments that are not market failures (for example, high transaction costs, risk and uncertainty in implementation) may provide rational reasons for the nonadoption of energy efficiency improvements that appear (to an outsider) to be privately cost effective. The role of government in addressing these issues may be quite small.

One of the key points the Commission makes in its discussion of the residential sector is that it is difficult to justify government subsidies for actions that are already cost effective to the recipient. To justify such subsidies the real policy goal would have to be something other than energy efficiency per se, such as reducing pollution or other negative externalities.

CUAC recommends the Commission take the following impacts of energy inefficiency into account when discussing the appropriateness of government intervention for the residential sector:

- 1) A number of state governments already assist households to improve the affordability of energy. Energy efficiency improvements could reduce these outlays.
- 2) Welfare organisations across the country provide households with emergency relief assistance to enable them to pay their energy bills. Improved energy efficiency and lower bills could reduce these outlays for welfare organisations and the money could be directed towards other areas of need.
- 3) Households in financial hardship often under-consume energy to lower their costs. This impacts upon living standards and can have health implications. Energy efficiency improvements could improve the living standards for many Australians as well as having a beneficial impact on public health.
- 4) Households in financial hardship divert expenditure from other areas to afford energy, including through foregoing food and medical expenses. Energy efficiency improvements could result in households having more money to spend on other essential goods and services such as food, education and healthcare.