

Cost of Living Pressures on Tasmanian Households

Causes and Options for Reform

Report Authors

Richard Eccleston
Brendan Churchill
Helen Smith

February 28th 2014

About the Report

About the Report

This report is the product of discussions between representatives of community and business groups in September 2013 regarding escalating cost of living pressures in Tasmania and their impact on Tasmanian households and businesses.

The final Report has been produced as an independent academic research project which highlights the increasing cost of living pressures being experienced by Tasmanian households and identifies possible reform strategies. It is designed as a conversation starter rather than the last and definite word on cost of living issues.

Reflecting the origins of the project the Salvation Army and The Property Council of Australia have endorsed the Report's broad findings while a wider range of community and business organisations agree with the central elements of the analysis while advocating slightly different reform priorities and solutions. What is clear is that there is broad community consensus that future Tasmanian governments must continue to address cost of living pressures.

Naturally the analysis and detailed recommendations presented in the following pages are the work of the Report's authors and do not necessarily represent the views of the groups associated with the project.

The new empirical analysis presented in the report was conducted with the support of the Property Council of Australia (PCA).

Authors

Professor Richard Eccleston is Director of the Politics and International Relations program at the University of Tasmania. He is a specialist in comparative and international political economy focusing on fiscal policy and tax reform, and has published extensively in these fields in recent years. Richard has just been awarded a prestigious Fulbright Senior Fellowship to spend 3 months in the United States studying the impact of the Financial Crisis on American federalism. Richard is a passionate Tasmanian and a regular commentator on Tasmanian politics and policy.

Brendan Churchill is a quantitative sociologist and associate lecturer in the School of Social Sciences at the University of Tasmania. He is completing a PhD on generational variations in political and social attitudes in contemporary Australia.

Helen Smith has recently graduated with first class honours in international relations from the University of Tasmania. Her thesis examined the international security implications of US energy policy.

Contents

Executive Summary.....	i
Part One	1
1.1. The Australian Cost of Living Debate	1
1.2. A Real Cost of Living Crisis in Australia?.....	3
Part Two.....	5
2.1. Growth in Household Income for Tasmanian households, 2006 to 2012	5
2.2. Tasmanian Household Expenditure on Essentials, 2006 to 2011	6
2.3. Aggregate Cost of Living Pressures on Tasmanian Households, 2006-2012	8
2.4. Aggregate Evidence on Cost of Living Pressures in Tasmania	10
Part Three	11
3.1. Electricity Prices	12
3.2. Water and Sewage Charges	20
3.3. Local Government Rates and User Fees	26
3.4. Transport Costs	29
3.5. Housing and Rents	32
3.6. Food Costs.....	34
3.7. Summary of Sectoral Reform Recommendations.....	35
Part Four	38
4.1. Implementing a More Targeted Concessions Regime	39
4.2. Promoting Efficiency and Limiting Fees Charged by State-Owned and Regulated Corporations	41
4.3. High Income Households are Part of the Solution.....	42
4.4. Better Data on the Nature of Cost of Living Pressures	42
Appendix 1	44
References	48

Executive Summary

The rising impact of cost of living pressures on Tasmanian households over the last five years has attracted a good deal of political debate.

Although cost of living issues have become more prominent in recent years, the looming state election means that it is important to provide an objective analysis of the nature and extent of cost of living pressures in the Tasmanian context. More importantly, this report sketches some broad strategies which we believe the next Tasmanian government must consider if it is to develop an effective, targeted and financially sustainable response to the ongoing cost of living challenge. However, we also acknowledge that the cost of living situation is complex, and reforms designed to reduce cost of living pressures will demand a degree of political risk-taking. In this sense, the report is designed to be a conversation starter rather than the last word – but it is a conversation that the Tasmanian government and community must have.

The Report addresses four key aspects of the Cost of Living challenge:

- 1. It demonstrates the intensifying cost of living pressures confronting Tasmanian households*
- 2. It highlights the acute cost of living pressures facing low-income households*
- 3. It analyses the complexity of both the cost of living problem and of sustainable solutions*
- 4. It identifies short and long term strategies for addressing the cost of living problem*

The analysis presented in the main report builds on existing research by including new data from the national Household Income and Labour Dynamics Australia (HILDA) survey. Whereas existing research largely draws on the ABS Household Expenditure Survey (conducted every six years and last completed in 2009-10), the HILDA survey is conducted annually and captures data on actual household income and expenditure patterns across a sample of Tasmanian households. The relatively small sample size (especially for specific income levels) means there are limits to how we can apply either ABS or HILDA data to state-level analysis. However, when the HILDA survey is combined with ABS data we believe the resulting analysis provides clear insights into the impact of cost of living pressures on Tasmanian households across the income spectrum, and how the challenges facing Tasmanians have intensified over the period between 2006 and 2012.

The Intensifying Cost of Living Pressures Confronting Tasmanian Households

This report supports the widely held view in the community that the cost of living pressures being experienced by many Tasmanian households are real and are intensifying. Indeed, our analysis adds to the evidence that low income Tasmanian households - which we define as being in the bottom 20 percent of the income distribution (with an annual household income of below \$22,000 in 2012) - have insufficient income to purchase the necessities of life. This challenge forces families to ration spending on essentials such as electricity, food, and health services while become increasingly dependent on debt and charity. *This is a cost of living crisis.*

Additionally, while middle income households (comprising households between the 20th and 80th percentile) have enough income to purchase necessities, their discretionary income has largely remained static since 2006 as a result of rising prices and the deteriorating labour market. This trend helps to explain declining retail spending and the pervasive lack of business and consumer confidence which afflicts the Tasmanian community.

This assessment of the cost of living pressures facing Tasmanians should not be interpreted as a partisan critique of past or present Tasmanian governments. Indeed, the 2011 *Cost of Living Strategy* and recent water, sewage and electricity reforms have the potential to provide some cost of living relief. Rather, our message is that all sides of Tasmanian politics and whoever forms government after the 2014 state election need to develop and implement long term strategies which address the structural causes of the on-going cost of living pressures facing the Tasmanian community. As is argued at greater length in the Full Report, this involves promoting the efficiency and cost-effectiveness among utility providers and organisations funded through user fees and charges (including local government), whilst ensuring that regulatory frameworks for determining utility prices give greater priority to consumer interests and their ability to pay. In terms of concessions, we acknowledge that there is limited capacity to increase the quantum of concession payments on a sustainable basis but argue there is a clear scope to develop a more targeted regime that provides more relief to those families in greatest need.

We believe that a long-term structural approach to addressing the cost of living problem is necessary because there is a real risk that the pressures facing Tasmanian households will intensify over the short to medium term. This is particularly troubling because future state governments will have diminishing capacity, as was highlighted in the pre-election budget update, to provide relief through costly and unsustainable subsidies and price freezes - which fail to address the underlying cause of increasing costs in any case. In short, there is a clear need to address the broader structural causes of cost of living pressures rather than treating their symptoms.

1. The Cost of Living 'Crisis' Facing Low-income Households

This report analyses new data generated from the HILDA survey. The results largely affirm existing research, based on ABS data, that highlights the disproportionate impact which rising prices for essential items have on low income households. More detailed analysis of this variability can be found in **Section 2.3** of the Full Report. Our key findings are:

The 'crisis' among low income households

- In 2011, Tasmanian households in the bottom 20 percent of the income distribution may, for the first time since 2006, have spent more than their entire income on essentials. *This implies that Tasmania's poorest households are living on savings, debt or charity, and is consistent with anecdotal evidence of a cost of living crisis.*

The 'squeeze' on the majority of middle income households

- Discretionary income for the 60 percent of Tasmanian households in the middle of the income spectrum did not increase in real terms between 2006 and 2011 and only recovered modestly in 2012.
- While cost of living pressures eased over 2008 and 2009, they have since increased as stimulus-related transfers have been wound back, the labour market has deteriorated, and the cost of essential goods and services has increased.
- *While not a welfare concern, this middle class 'squeeze' does help to explain weak business and consumer confidence and the associated decline of retail sales in Tasmania.*

High income households are doing well

- *High income households in the top 20 percent of the income distribution have experienced a significant increase in discretionary income since 2006.*
- This is because high income households have experienced the strongest income growth of any quintile (7.1 percent p.a.), together with a reduction in housing costs associated with falling interest rates since 2009. Given that this group has the largest average mortgage debt, falling interest rates have more than offset increases in utility prices.

2. The Complexity of the Cost of Living Problem

Whilst emphasising the importance of cost of living pressures on low income Tasmanian families, this report acknowledges that the underlying causes of the problem are complex and cannot be attributed exclusively to regulatory failure within any one industry sector, or the policies of a particular political party, or a single tier of government. Rather, cost of living pressures are attributable to a combination of market dynamics and exogenous cost pressures, the efficiency of public sector and state regulated businesses, and policy shortcomings at both the state and federal levels.

As this is a report primarily aimed at encouraging a mature and pragmatic debate in the lead-up to the 2014 Tasmanian election, our analysis focuses on cost pressures which are responsive to policy reform at the state level. Consequently, this report is particularly concerned with the causes and implications of increased prices across utilities including electricity, water and sewage, and fixed costs including public transport and local government rates.

We believe that clarifying and focusing upon those policy areas in which the Tasmanian government possesses greater capacity to implement reforms will aid in the identification and development of realistic and effective solutions to the problem.

Three key cost of living pressures:

The analysis presented in this report identifies electricity, water and sewage, and other government charges including rates as the most significant sources of cost of living pressures over which the state government possesses a degree of control.

Retail electricity prices

Electricity prices have been a central focus of the cost of living debate in recent years at both the national and state level. Given that retail electricity prices in Tasmania have increased by 66.8 percent since 2008, this is hardly surprising. Increasing electricity prices are not a localised problem, as every jurisdiction in Australia has experienced price increases associated with infrastructure expenditure over recent years.

Water and sewage prices

Tasmanian water and sewage price increases have outstripped inflation or wages growth in recent years. For example, in greater Hobart, average water and sewage prices have increased by 65 percent since 2005. With the passage of the *Water and Sewerage Industry Act 2008*, average price increases have been capped at 5-6 percent p.a. until 2015. However, the consensus is that water and sewage prices may have to increase by 80 and 100 percent over the medium term to fund investment in infrastructure upgrades. This

forecasts suggests that water and sewage costs will continue to contribute to cost living pressures in the future although the current pricing regime is under review.

Such water and sewage price growth impacts acutely on low income Tasmanian households given that a large percentage of water and sewage prices are fixed rather than consumption based.

Rates and fixed charges

This study also finds that Local Government rates and key user charges imposed by various levels of government are rising faster than household income. For example, Local Government rates in Tasmania increased by 7.8 percent p.a. between 2008 and 2012, faster than either state or federal revenue growth. This pattern of governments increasing user fees or taxes on immobile assets is consistent with a global trend observed since the onset of the financial crisis. The strategy may be an effective way of repairing budgets, but it disproportionately impacts low income households and must be examined as part of any holistic cost of living strategy.

Given this trend, the recently announced reviews of both the valuation regimes used to set Local Government rates and of Local Government financial management in Tasmania are welcome. The next Tasmanian government must ensure that rates, user charges and Local Government operating expenses don't increase faster than incomes in the communities which they serve.

3. Strategies for addressing the cost of living problem

The Report concludes by outlining four broad reform strategies which the next Tasmanian government and the broader community should consider to address the long term cost of living pressures confronting Tasmanian households:

1. Promote efficiency and cost effectiveness in state owned, administered or regulated utility businesses and service providers. This strategy should also review pricing regimes to ensure that the interests of consumers and citizens are given priority. The goal is to develop a sustainable regime whereby utility prices and user charges are constrained by consumers' ability to pay.
2. Developing and implementing a more targeted concessions regime.
3. Encouraging high income households to be part of the solution by spending and investing in Tasmania and continuing to support community organisations.
4. Acquiring more comprehensive state-level data in order to identify cost of living pressures, respond accordingly, and accurately evaluate the effectiveness of subsequent policy initiatives.

Part One

An Overview of the Cost of Living Debate

The debate on cost of living pressures gained prominence on the national political agenda in the lead-up to the 2007 federal election, amid increases in the price of essential goods and services. Less appreciated is the counterintuitive fact that these price increases have largely been offset or even outpaced by increases in real income over the same period. However, the analysis of cost of living pressures on Tasmanian households presents a different and more concerning conclusion. Analysis in this report reveals that cost of living pressures for low income Tasmanian households (defined as the bottom 20% of the income distribution) in particular have been increasing, even as they have remained static or decreased for middle and high income households.

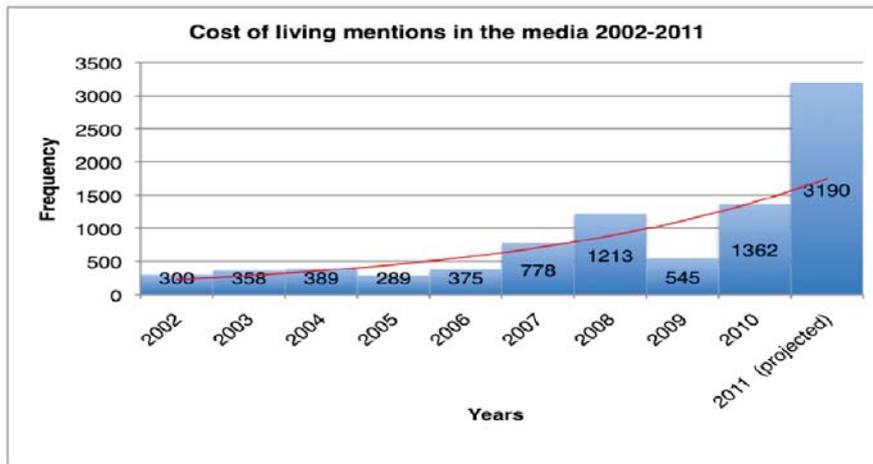
1.1. The Australian Cost of Living Debate

Governments around the world have long been held responsible when rapid increases in the price of goods and services erode citizens' purchasing power and standards of living. This is particularly so when price inflation impacts upon necessities and essential services. In fact, there is clear evidence that rapid increases in the cost of essential goods and services have a particularly significant impact on low income households and the most vulnerable members of our society (Organisation for Economic Cooperation and Development, 2013). In addition to the detrimental impacts of gradual price increases over time, the literature on cost of living pressures highlights the vulnerability of low income households to 'price shocks', or sudden and unanticipated price increases (Department of Premier and Cabinet (DPAC) 2011a, 34).

In the Australian context, debate over cost of living issues was been a recurring feature of the political landscape throughout the twentieth century, and became a central issue during the inflation crisis of the 1970s (Eccleston 2004, 63-68). The issue regained prominence on the Australian political agenda around 2005, when cost pressures began to emerge amid the early stages of the resources boom. This trend is evidenced by the rapid increase in references to the phrase 'cost of living' in the national press beginning in the mid-2000s, represented in Figure 1.1.

Figure 1.1. Mentions of ‘cost of living’ in the national media 2002-2011 (PerCapita 2011, 7).

Figure 1.1: Mentions of the cost of living in the media, 2002-2011



The increased commentary on cost of living pressures coincided with real price increases in a number of essential consumer goods (see Figure 1.2), which served to reinforce existing concerns about housing affordability. The particular cause of the price increases can be attributed to a combination of the Australian drought of the early 2000s and the rapid industrialisation of emerging economies. The former drove up food prices, whilst the latter began pushing commodity and energy prices to record highs (see Figure 1.3). Each of these price increases affected areas of essential expenditure for Australian households. During the same period, changes at the broader macroeconomic level contributed to cost of living stress. Strong economic growth precipitated labour shortages in key sectors of the economy – resulting in more general cost pressures.

Figure 1.2. Price increases for key essentials in Tasmania and Australia, 2006-2011 (DPAC 2011a, 35.)

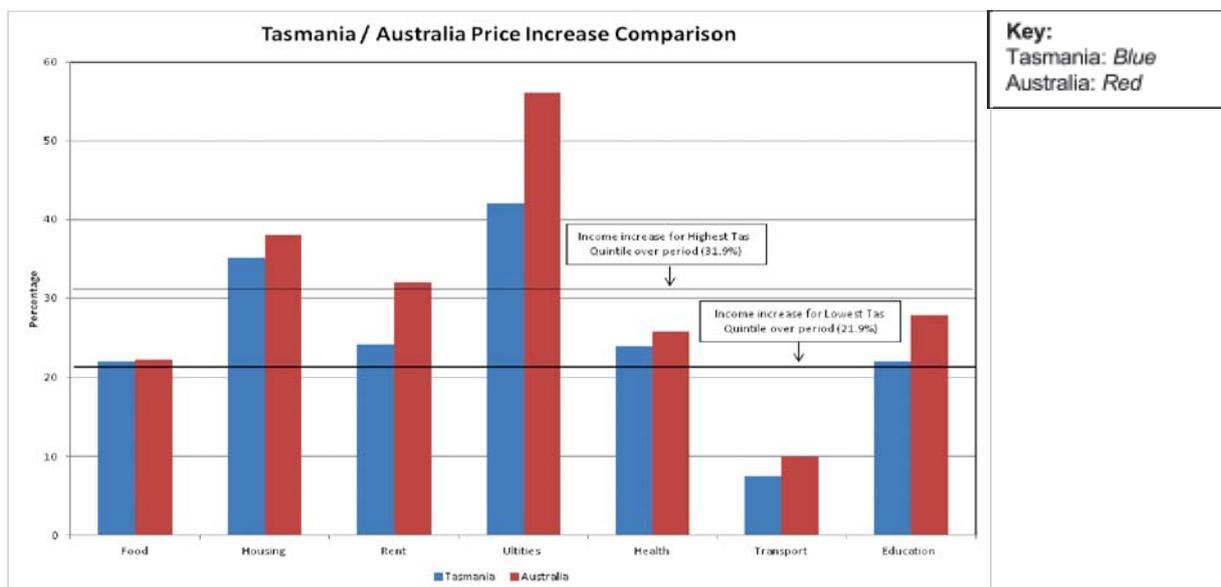
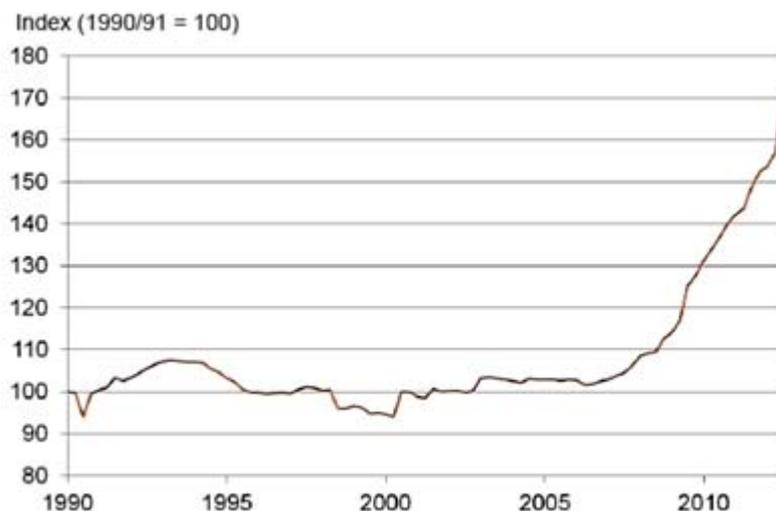


Figure 1.3. Increase in national retail electricity prices, 1990-2012 (Grattan Institute 2012a, 7).



1.2. A Real Cost of Living Crisis in Australia?

Australia's national political debate has inevitably focused on the impact of cost of living pressures on middle class households, and specifically on issues such as whether private health insurance, childcare, and family tax benefits should be means tested. However, as a number of studies have demonstrated, household income for the majority of the Australian population (defined as the top 60 percent of the income distribution) actually *increased* in real terms during the relevant period (2007-2012). Indeed, increases in the cost of utilities such as electricity were more than offset by falling prices for imported consumer goods, mortgages, and fuel. Consumers may have been complaining that their quarterly utility bills were increasing, but the reality was that most households had more disposable income than ever to pay for them.

Indeed, this point was highlighted in a provocative report published in 2011 by the think tank PerCapita. The report argued that the national cost of living debate was being driven by excessive middle class expectations concerning both standards of living and the ability of government to subsidise consumption:

While the costs of some essential items have experienced price rises that exceed the CPIthese must be considered in light of the full economic context. Wage growth, low unemployment and higher household savings levels all indicate a disproportionate level of concern about the rising cost of living. Australian households are, on average, better off now than they ever have been. (PerCapita 2011, 4.)

However, this report seeks to go beyond this critique of the national debate and the associated politics of middle class welfare by examining the changing nature of cost of living pressures in the Tasmanian context. Crucially, the analysis presented in Part Two of this report suggests that the magnitude and scope of cost of living pressures in Tasmania is greater than that experienced in Australia as a whole, owing to our poorer population and the proportionately greater share of income spent on the necessities of life. As discussed in more detail in Part Four, such findings suggest the need to develop policies which can deliver immediate and tangible relief to disadvantaged Tasmanians. To this extent the report argues that more effective and better targeted concessions represent the best approach to addressing this short-term challenge.

However, as our analysis in Part Three makes clear, short term strategies alone will not be sufficient to alleviate Tasmanian cost of living pressures without placing an excessive burden on the state's deteriorating fiscal position. Addressing the long term causes of rising prices is particularly important, given the evidence that cost of living pressures are likely to intensify over the medium term in the absence of further structural reform. For these reasons, it is essential that the next Tasmanian government pursue innovative strategies designed to deliver both short term help and more ambitious policy and regulatory changes which provide significant and lasting relief for vulnerable households.

Adopting a longer term approach to structural reform is especially important given evidence which suggests that cost of living pressures are intensifying, and there is a real risk that they may increase further over the medium term. Factors which may contribute to such an escalation include:

- A depreciation of the Australian dollar will increase the cost of imported goods, food, fuel, and interest rates.
- Lower rates of Commonwealth funding to state and local government will put pressure on both tiers of government to increase fees, ration services, and increase dividends from state-owned business.
- In the electricity sector, Tasmania is at particular risk of what a recent Grattan Institute report (2013a) described as 'an electricity price death spiral' where fixed infrastructure and operational costs are spread over a diminishing customer base, putting upward pressure on unit prices.
- State owned electricity companies are likely to receive lower rates of return on renewable-source electricity exported to the national grid as a result of the abolition of the carbon tax.

Part Two

An Aggregate View of Cost of Living Pressures in Tasmania

In order to accurately assess cost of living pressures being experienced by Tasmanian households it is necessary to analyse variations both in the cost associated with household essentials *and* changes in household income. Whereas many studies focus only on the impact of rising costs, we believe that equal consideration needs to be given to whether households have the income to meet rising expenses. This more holistic approach is particularly important given that average Tasmanian incomes (and income growth) lag behind the national average, meaning that national price increases have a disproportionate impact on Tasmanian households.

In order to assess the combined impact of rising household costs and changing patterns of household income the study uses a combination of data from the Household Income and Labour Dynamics in Australia (HILDA) survey and the Australian Bureau of Statistics. Detailed information on our methodology is included in Appendix A.

2.1. Growth in Household Income for Tasmanian households, 2006 to 2012

As noted above, it is essential to base an assessment of cost of living pressures within the context of the income available to households across the income spectrum. This data is presented in Figure 2.1 and Table 2.2, for the period 2006-2012.

Figure 2.1. Tasmanian household income across all income quintiles, 2006-2012.

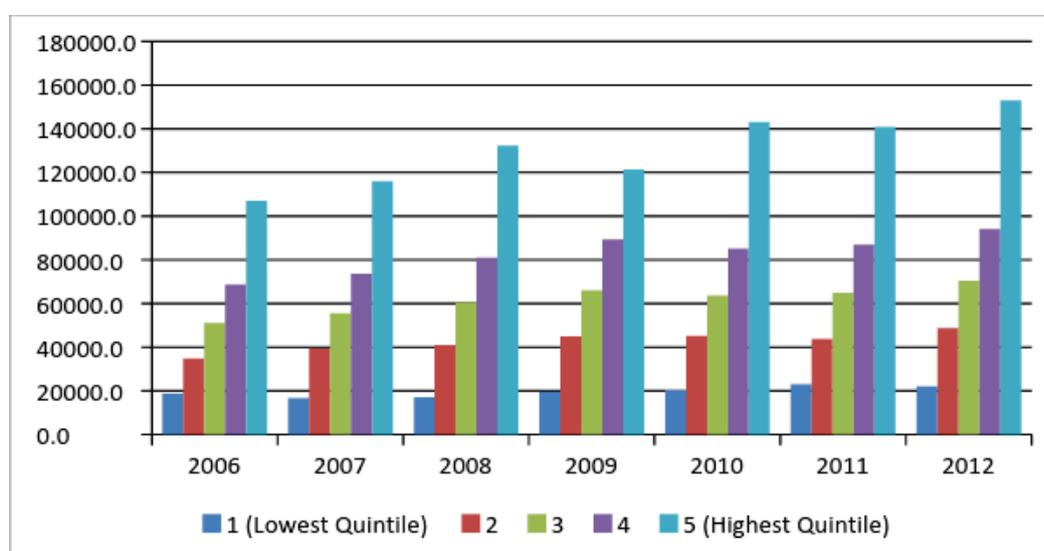


Table 2.2. Tasmanian household income across all income quintiles, 2006-2012.

Income	2006	2007	2008	2009	2010	2011	2012	% av. increase
Q1 (Low)	\$18,800	\$16,798	\$17,187	\$19,772	\$20,292	\$23,050	\$22,005	2.8%
Q2	\$34,885	\$39,463	\$40,910	\$44,959	\$45,234	\$43,711	\$48,669	6.5%
Q3	\$51,237	\$55,572	\$60,534	\$66,066	\$63,626	\$64,864	\$70,348	6.2%
Q4	\$68,693	\$73,674	\$80,905	\$89,289	\$85,087	\$86,896	\$94,047	6.1%
Q5 (High)	\$106,965	\$115,973	\$132,260	\$121,294	\$143,137	\$140,950	\$153,067	7.1%

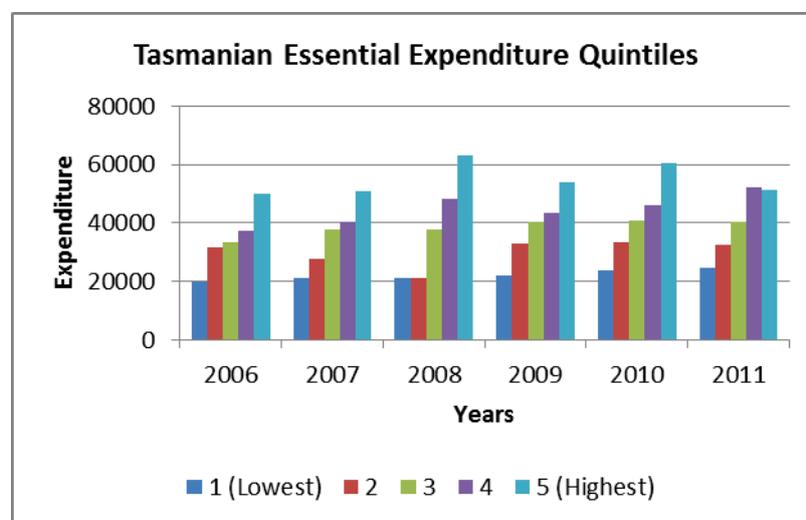
Analysis

Despite some volatility for specific years, clear trends are evident:

- All households enjoyed nominal income growth, although this was strongest for high income households (7.1 percent p.a.).
- The poorest households experienced growth in incomes between 2008 and 2010 of an average of 9 percent. However, given that this trend did not continue, this was most likely due to one-off transfers associated with the Rudd Government's stimulus program, implemented in 2009 and 2010.
- The income of households in the top quintile has been volatile (falling in 2009 and recovering strongly), presumably due to the significance of investment income for wealthy households.

2.2. Tasmanian Household Expenditure on Essentials, 2006 to 2011

The data for Tasmanian household expenditure on essential goods and services across the five income quintiles for the period 2006-11 is presented below in Figure 2.2. and Table 2.3, in terms of absolute expenditure on essentials (expenditure items included in the 'basket' of essential goods and services are listed in Table A.1 in Appendix A). Unfortunately data for 2012 cannot be included because key expenditure items were discontinued from the survey, preventing a direct comparison with previous years.

Figure 2.2. Tasmanian household expenditure on essentials, 2006-2012.**Table 2.3.** Tasmanian household expenditure on essentials, 2006-2012.

Income	2006	2007	2008	2009	2010	2011	%av increase
Q1 (Low)	\$19,886	\$20,933	\$21,003	\$21,851	\$23,915	\$24,606	4.7%
Q2	\$31,553	\$27,906	\$21,103	\$32,815	\$33,280	\$32,344	5.1%
Q3	\$33,293	\$37,669	\$37,754	\$40,578	\$40,826	\$40,402	4.3%
Q4	\$37,170	\$40,478	\$48,176	\$43,591	\$46,163	\$51,986	7.9%
Q5 (High)	\$49,951	\$50,881	\$63,244	\$54,081	\$60,358	\$51,517	6.3%

Analysis

The analysis of expenditure on ‘essentials’ across Tasmanian households is based on the definition of essentials provided in Appendix A.

- Expenditure growth in low income households is consistent with (and limited to) income growth, due to an absence of savings or discretionary expenditure. However, as noted previously, these limitations result in *substitution* – whereby expenditure on food or health is cut to pay for higher, fixed utility prices.
- Expenditure growth on necessities in higher income households is greater and more volatile. This is because high income houses spend more on discretionary food, education, health, and housing (all of which are conceptually difficult to separate

from essential spending), and because such households have more choice regarding spending and saving decisions.

- The significant decline in expenditure for high income households may be explained by the significant decrease in mortgage interest rates (defined as essential expenditure) over the period. This income group typically has the highest level of mortgage debt.
- Volatility is also a product of the limited sampling size. This highlights the need for more comprehensive state-level data, which, as we argue in Part Four, is a vital component of an effective long term cost of living mitigation strategy.

2.3. Aggregate Cost of Living Pressures on Tasmanian Households, 2006-2012

The data shown in Figure 2.3 and Table 2.4 presents the difference between household income and household expenditure on essentials across the five income quintiles.

Figure 2.3. Tasmanian cost of living pressures, 2006-2011 (household income less spending on essentials).

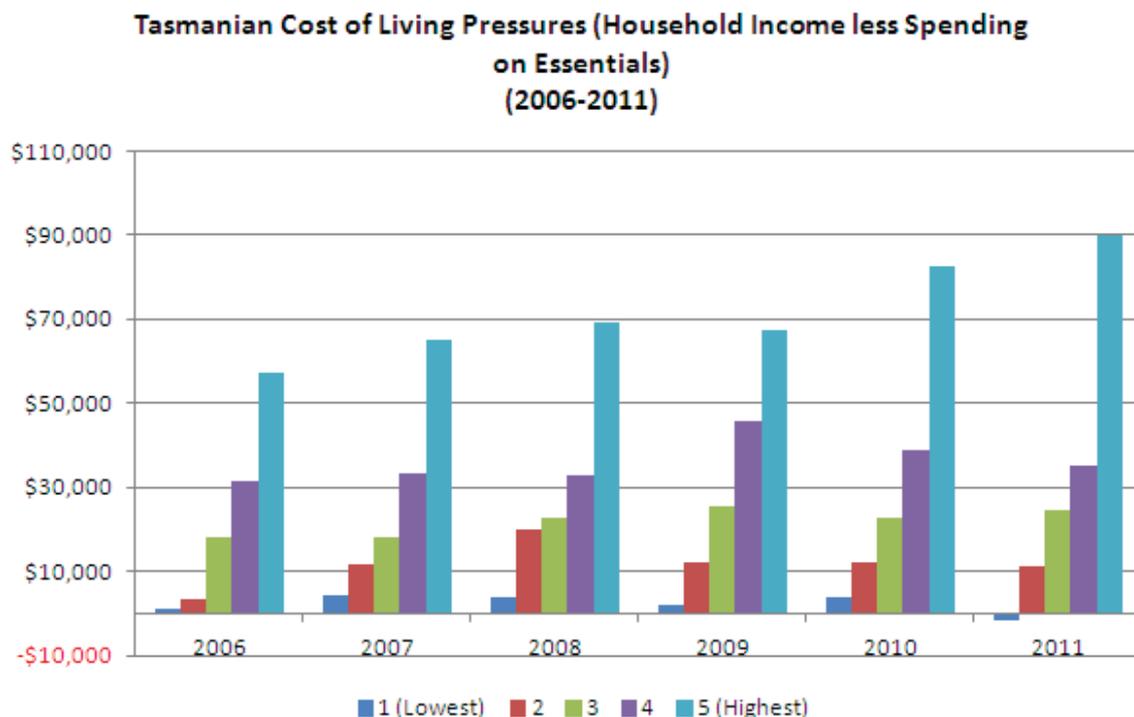


Table 2.4. Cost of living pressures for Tasmanian households, 2006-2011.

Income	2006	2007	2008	2009	2010	2011
Q1 (Low)	\$1,085	\$4,135	\$3,816	\$2,079	\$3,623	\$-1,552
Q2	\$3,331	\$11,556	\$19,906	\$12,143	\$11,953	\$11,336
Q3	\$17,943	\$17,903	\$22,779	\$25,488	\$22,799	\$24,461
Q4	\$31,523	\$33,196	\$32,729	\$45,697	\$38,924	\$34,909
Q5 (High)	\$57,014	\$65,091	\$69,016	\$67,212	\$82,779	\$89,909

Analysis

The data presented above provides an overview of discretionary income for Tasmanian households across the income spectrum, providing insights into the incidence of cost of living pressures.

Despite some volatility between specific years, some trends are evident:

- Low income (Q1) households spend the vast majority of their income on essential expenditure. The HILDA survey indicates that, in 2011, the sample of low income households spent \$1,552 more than they received in income – suggesting that they were reliant upon savings, debt or charity. This situation is unsustainable and must be monitored closely.
- Middle class households (Q2, Q3, and Q4) have experienced a decline in surplus income available for discretionary spending since 2008-2009. While not comparable to the acute need of Q1 households, this trend is consistent with a relative increase in cost of living pressures experienced across the developed world since the onset of the financial crisis.
- In contrast, high income households have experienced strong growth in discretionary income since 2009. This is attributable to falling mortgage interest rates, the recovery in investment income, and a solid professional labour market.¹

¹ This data is consistent with what leading British political economy scholar Colin Crouch describes as ‘privatised Keynesianism’. Crouch argues that – in contrast to using fiscal policy to stimulate demand – expansionary monetary policy (low interest rates) disproportionately benefits the wealthy (who invest more in interest rate sensitive assets). Perhaps contrary to policy intentions, expansionary policy has a weak impact on domestic demand because high income households have a lower marginal propensity to spend (Crouch 2009).

2.4. Aggregate Evidence on Cost of Living Pressures in Tasmania

The aggregate analysis presented above confirms that low income households experience the most acute cost of living pressures, and that these pressures appear to be increasing. This suggests the need for policy action to alleviate the short and long term risks for the poorest Tasmanians. However, before this can be done, a more detailed understanding of the underlying contributors to cost of living pressures is necessary. For this reason, the more specific sectoral analysis presented in Part Three focuses on the impact of discrete cost pressures on low (Q1) and low-middle (Q2) Tasmanian households.

Part Three

The Tasmanian Cost of Living Problem: Evidence and Policy Implications

The aggregate assessment presented in Part Two highlights the general cost of living pressures on Tasmanian households across income levels. This section builds upon these findings by exploring the specific causes of increased cost pressures in Tasmania in recent years across the various expenditure categories identified as essential?.

This report has the broad aim of promoting an informed policy debate concerning the causes of Tasmania's ongoing cost of living pressures in the lead-up to the 2014 state election. In accordance with this goal, our focus is on:

- issues which have been subject to political debate in Tasmania over the course of the 2010-2014 parliament; and
- prices over which the Tasmanian government has some control.²

The analysis which follows therefore includes expenditure categories which meet these two criteria. Here, we examine Tasmanian cost of living pressures arising from the following sectors and expenditure categories:

- Electricity prices
- Water and sewage charges
- Local government rates
- Transport costs
- Housing and rents
- Food costs

The purpose of this section is to highlight the complex causes of Tasmania's cost of living problem, and to present possible sector-specific solutions for further debate. This sectoral analysis informs four general policy recommendations presented in Part Four.

Our analysis of the specific causes of key cost of living pressures in Tasmania is designed to provoke a debate over how best to address the underlying structural and regulatory causes of increasing prices. We acknowledge that governments face political

² It is important to note that these two categories are not identical, given that the state government is not directly able to control all issues which may have gained political traction. This is because a wide range of factors influence the price of goods and services consumed by Tasmanian households. These include market forces, and policies and regulations at the federal, state, and local levels. It is important to highlight that the state government has more influence over regulated utility markets integral to cost of living pressures (albeit less so than in the past, given the rise in national regulation) than it exerts on other markets relevant to the cost of living debate – such as housing .

incentives to focus on short term policies addressing the symptoms of cost of living pressures, such as price freezes, concessions and other compensation payments. However, the state government's capacity to fund such initiatives is increasingly limited – the pre-election budget update predicted cumulative state deficits of \$879 million over the forward estimates to 2016-17. This report therefore advocates a two track strategy for future Tasmanian governments. The evidence presented in this section of the report suggests that the complexity of the problem is such that future governments must implement short term relief for households facing acute cost of living pressures, whilst also pursuing broader long term regulatory and governance reforms designed to promote efficiency and accountability across the public sector and state owned or regulated utilities.

3.1. Electricity Prices

Alongside housing, electricity prices have been the main focus of the cost of living debate over the past five years – at both the Tasmanian and national levels. This is not surprising, given that retail electricity prices have increased by 66.8 percent in Tasmania from 2008 to 2013, far outstripping average income growth over the same period (see Table 3.1). These increases have placed unprecedented pressure on the state government to review the regulation and governance of the electricity sector, and to provide assistance to households struggling under the financial burden of rapidly increasing power bills.

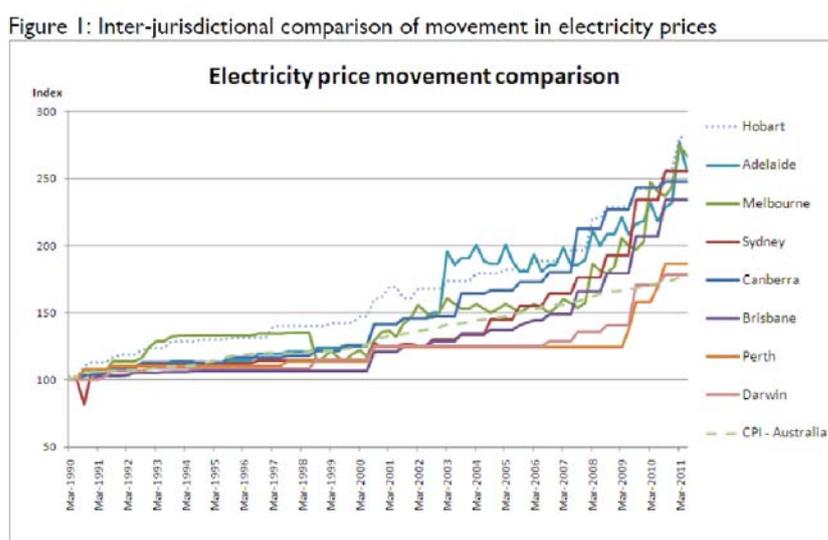
Our analysis of the impact of Tasmanian electricity prices on the cost of living utilises HILDA data of actual spending on electricity by a sample of households across the income spectrum. We then build upon these findings in Part 3.1.2, which locates the analysis within the context of other relevant research on the impact of electricity price increases on cost of living pressures in Tasmania. Following this, a brief discussion of the current Tasmanian policy debate and options for reform is presented in Part 3.1.3.

Table 3.1. Annual increases in Tasmanian retail electricity prices, 2008-2013 (Aurora Energy 2011, 24; Aurora Energy 2013, 44).

Date	Increase
July 2008	16.0%
July 2009	3.9%
July 2010	7.2%
July 2011	14.8%
July 2012	10.5%
July 2013	1.8%
Cumulative increase	66.8%

It must be noted that despite the increased pressure on the state government to reduce prices, electricity price increases are not a localised problem. Prices have risen across Australia, particularly in the jurisdictions participating in the National Energy Market (NEM) (see Figure 3.1).³ The fact that all Australian jurisdictions have experienced significant electricity price increases over the relevant period – irrespective of the generation source, such as hydro or coal – suggests that price pressures are being driven in part by national factors, albeit with significant state-level variation.

Figure 3.1. Price movements in average electricity prices for Australian capital cities, 1990-2011 (DPAC 2011b, 8).

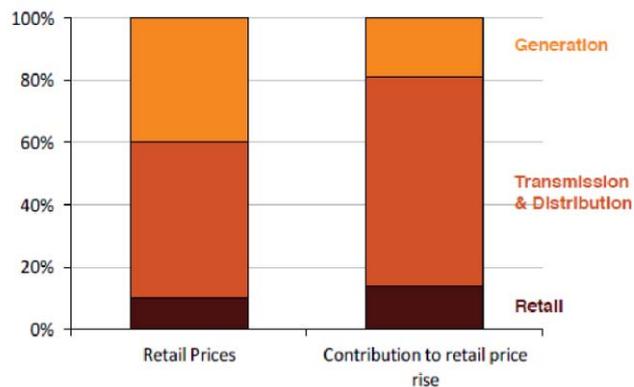


The price impact of NEM mandated distribution charges

The broad increase in Australian retail electricity prices since 2007 can largely be attributed to the mandated increase in distribution charges. This was implemented in order to fund the renewal of transmission infrastructure in the national electricity grid. As indicated in Figure 3.2, increased transmission and distribution costs represented almost 80 percent of the cost increase in retail electricity charges in 2010. These findings have precipitated an important national debate as to whether this constitutes an over-investment in transmission infrastructure (so-called ‘gold plating’). The impact of these regulatory failures on the electricity charges paid by Tasmanian households is provided below, while a brief discussion on reform options and possible state-based strategies designed to address electricity price inflation is provided at the end of this section.

³ The NEM includes all Australian states and territories with the exception of Western Australia and the Northern Territory.

Figure 3.2. Proportion of retail electricity price increases attributable to transmission charges in 2010 (Grattan Institute 2012, 8).



3.1.1. HILDA analysis: Aggregate and proportional Tasmanian electricity expenditure

The data presented below reveals the *total* annual household spending on electricity across the four income quartiles from 2006-2012 (see Table 3.2 and Figure 3.3).

Aggregate Tasmanian electricity expenditure

Figure 3.3. Total annual Tasmanian household electricity expenditure across income quartiles, 2006-2012.

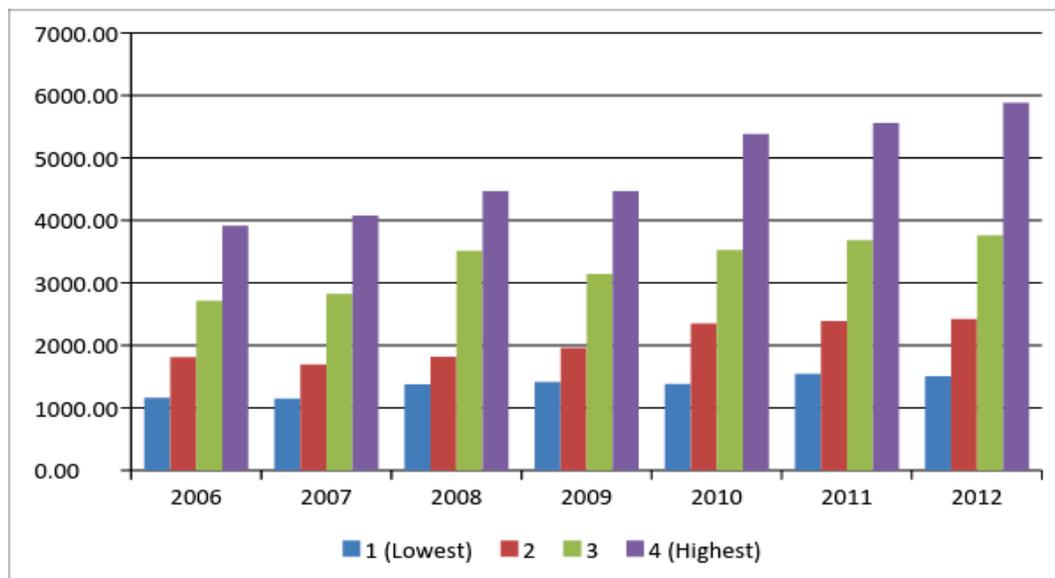


Table 3.2. Total annual Tasmanian household electricity expenditure across income quartiles, 2006-2012.

Income	2006	2007	2008	2009	2010	2011	2012
Q1 (Low)	\$1162	\$1152	\$1375	\$1415	\$1383	\$1543	\$1504
Q2	\$1811	\$1696	\$1817	\$1960	\$2353	\$2392	\$2422
Q3	\$2712	\$2824	\$3510	\$3143	\$3525	\$3684	\$3760
Q4 (High)	\$3913	\$4075	\$4466	\$4468	\$5382	\$5561	\$5883

Analysis

Table 3.2 and Figure 3.3 summarise total expenditure on electricity across the household income spectrum in Tasmania. The data for actual household expenditure is clearly related to the increase in retail prices presented in Part 3.1. However, the details of this relationship require further elaboration:

- According to the HILDA survey, actual expenditure on electricity in low income households (Q1) has increased by 29.4% over the relevant period –less than expenditure growth for Q2, Q3 and Q4. While further research is needed, this suggests that the lowest income households have been forced to ration power as its unit price increases. This is especially likely for the 33,000 Tasmanian households which use Pay As You Go (PAYG) metering. This conclusion is consistent with both the case study research discussed in Section 3.1.2 and the significant increase in demand for emergency assistance to pay electricity bills that has been reported in recent years.

3.1.2. Electricity prices and evidence of ‘cost stress’ in Tasmania

The HILDA data presented above is consistent with and adds to existing research on the ‘cost stress’ resulting from recent electricity price rises. Indeed, the evidence suggests that the incidence of cost stress caused by energy prices in Tasmania has increased significantly in recent years relative to the rest of Australia. This is attributable to both low income levels and higher rates of energy usage necessitated by climactic factors. These findings are further supported by research published by the Australian Energy Regulator (AER) in November 2013, which finds that low income Tasmanian households consume over 30 percent more energy than other states owing to factors such as a cooler climate, inefficient heating, and poor home insulation (AER 2013, 14).

As noted above, the HILDA data presented above reports that low income households' total spending on electricity over the six years to 2012 has been lower than middle income households. However, this finding is consistent with the 'rationing' behaviour highlighted in other studies, whereby low income households without other financial resources are forced to consume less power as prices increase. Indeed, this behaviour is well documented in the Tasmanian context. Case study research conducted by Anglicare (2011) highlights electricity rationing behaviour in low income households. Such rationing is particularly likely for low income consumers using PAYG metering given the need to have ready cash to purchase electricity during periods of high demand. Moreover, a good deal of research suggests that low income earners using a regular regime will cut expenditure on other essentials such as food and health services in order to avoid disconnection (Lynne and Morris, 2011). These trends demonstrate that electricity induced cost stresses have a particularly significant social impact in Tasmania, warranting both short term relief and long term structural adjustments.

As further evidence of this need, the social and financial impact of recent increases in electricity prices on the poorest Tasmanians has been highlighted by other recent data and reports. Examples include:

- The 2608 payments made through Aurora Energy's new Hardship Fund, established in July 2012 (Aurora Energy 2013, 45).
- That in financial year 2012-13, 35 percent of Aurora's customers on a hardship program had debt levels of \$2500 or more (AER 2013, 29).
- The 353 self-disconnections in the June quarter of financial year 2012-13, representing a significant increase from previous quarters, which 'may provide an indication of financial hardship' (AER 2013, 35).

In this context, future decreases in retail electricity prices anticipated to result from both the recent price determinations (5.23 percent decrease expected from 1 January 2014) and the longer term flow on from new retail competition and the merging of retail and wholesale distribution business is clearly welcome. However, the reality for most low income Tasmanian households is that electricity bills will continue to consume a large proportion of household income – especially during the winter months. Moreover, as the Grattan Institute has argued recently (2013a), there is a real risk that electricity prices will continue to increase faster than household income because network costs have to be funded by a declining customer base. Of particular import for the next government is Tasmania's highly acute vulnerability to what the Grattan Institute terms the electricity price 'death spiral', given the risk of the local market's vulnerability to losing large industrial customers. With these considerations in mind, it is vital that the next government goes beyond politically palatable short term relief and includes long term risk abatement in its electricity sector policy.

3.1.3. Policy analysis: options for electricity market reform

The Australian electricity market and the governance regime which supports it are extremely complex and have been subject to a number of state-level reviews and reforms. It is beyond the scope of this report to provide a detailed assessment of the National Energy Market (NEM) and how future policy changes (such as the abolition of the carbon tax), market developments (such as the closure of major industrial customers), and state and national electricity reforms will impact on Tasmanian electricity prices. However, it is important to make the following observations:

- Although most of the factors influencing Tasmanian electricity prices are structural, regulatory reform designed to promote competition and efficiency in the sector can exert downward pressure on prices.
- Grattan Institute analysis published in December 2013 predicts such reforms could cut annual residential electricity bills by \$100 (2013a, 22).
- These observations suggest that, in addition to short term concessions, future state governments must explore long term structural policies if they are to deliver meaningful and sustainable cost of living relief to struggling Tasmanians.
- We do not advance a view on whether Tasmanian electricity assets should be privatised. However, it is likely that privatisation of some electricity assets will occur over the next decade, given the current political and economic environment. If divestment does take place, we believe that a portion of the proceeds should be preserved in a trust fund to provide a sustainable increase in electricity concessions available to low income households.

Specific recommendations for the Tasmanian energy sector

a) Greater oversight of capital and operating expenditure in the energy sector and the analysis of these costs on regulated prices

We have already noted that the main driver of increased retail power prices has been an overinvestment in electricity transmission and distribution infrastructure, combined with the application of above market rates of return in pricing models. While the governance of the NEM is largely the responsibility of the Australian Energy Regulator (AER), it is important that the Tasmanian government actively promotes a regime which addresses overinvestment and ensures that operating and capital expenditure growth within the regulated elements of the Tasmanian energy sector do not increase in real terms. This is especially important given the likelihood that Tasmania will experience significant decline in electricity demand as a consequence of medium term deindustrialisation. In short, we advocate a regulatory framework and pricing model that reflects consumer interests and their ability to pay

To this end, the next Tasmanian government must carefully consider the key recommendations of the Grattan Institute's December 2013 report *Shock to the System: Dealing with Falling Electricity Demand* (2013a, 22). We endorse the following recommendations:

- Empower the AER to set the rates of return earned by network business at a lower level, to better reflect the low levels of risk faced by these businesses.
- Transfer responsibility for setting reliability standards from state governments to the AER, and make improvements to network reliability subject to a cost benefit test.
- Reduce the risk of overinvestment in network assets by implementing annual reviews of distribution businesses' capital expenditure forecasts.
- Improve the corporate governance of government-owned network businesses, or privatise these businesses, to ensure they operate as efficiently as those that are privately owned.

b) Enhanced competition and privatisation

- We concur with the 2012 Tasmanian Electricity Review Expert Panel's assessment that retail competition in the Tasmanian electricity market should be pursued, and that Aurora retail should be privatised as part of this process.
- We share the Expert Panel's assessment that there would be limited interest in new retailers entering the Tasmanian market in the absence of competition in the wholesale market, due to Hydro Tasmania's market power.
- The Expert Panel's above assessment has been vindicated by the Tasmanian government's failure to sell Aurora retail.
- We support the government's decision to merge wholesale and retail electricity distribution businesses. The next Tasmanian government must ensure that the cost savings from this rationalisation are passed on to consumers.

In light of these pressures and recommendations, the Tasmanian energy sector is at a critical juncture. A broad framework for deregulation and varying degrees of privatisation has been developed, but the Tasmanian government's attempts at incremental reform have attracted little interest from private investors. Given this situation, the next Tasmanian parliament will have to debate the merits of a more aggressive deregulation and privatisation strategy.

c) Using the proceeds of privatisation to increase electricity concessions for needy households

Irrespective of whether further privatisation is pursued, we believe that the most effective strategy to relieve electricity price pressure on low income households is to build on recent work by establishing better targeted and therefore more substantial concessions for the neediest consumers. Unless state-owned electricity businesses are privatised (see below) the aim should be to increase concessions to the neediest households, without necessarily increasing the total quantum of concession support. It must be noted that there are a number of existing concessions, including:

- An annual concession of \$458.84 per year for Pensioner and Health Care Concession Card holders.
- New Community Service Obligations (CSOs), including concessions for asylum seekers and other high needs groups.
- Concessions for customers dependent on electronic medical devices.
- A new flexible hardship payment regime (commended by the AER).
- A hardship payments regime, which made 2608 payments (at an average of \$134) in 2012/13.

However, more needs to be done. Given the evidence of electricity induced cost stress presented in this report and elsewhere, there is a clear case for better targeted and more significant concessions. These may involve:

d) More effective targeting of electricity concessions

As is explained in more detail in Part Four, the means test on Pension Concession Cards is too generous. Retired couples with income in the top half of the income distribution can receive the same concession as households in the bottom quintile.

Aurora has approximately 33,000 customers on Pay As You Go (PAYG) metering. Many of these are concession holders who have been forced into this regime as a result of failing to pay regular bills. However, the most recent Price Comparison Report published by the Economic Regulator (2013) found that PAYG customers pay a similar tariff to retail customers. Furthermore, new data from the St Vincent de Paul Society shows that non-concession card holders on the PAYG scheme pay \$180 more p.a. on fixed costs than customers on a standard tariff, offsetting the potential benefits of reducing consumption (St Vincent de Paul Society 2013, 15). These findings suggest the need for more substantial concessions.

e) Increasing the quantum of concessions using the proceeds of privatisation

Increasing the quantum of concession payments involves difficult political trade-offs, and increasing the overall public investment in concessions (especially in the absence of better targeting) may not be financially sustainable in the longer run. However, we believe that any future proposal concerning the privatisation of Tasmanian electricity assets should include a commitment to devote a significant portion of the proceeds to the creation of an independently managed trust fund, with the real income from this venture devoted to bolstering concession payments to needy Tasmanians. Such a framework would ensure that low income earners receive a sustainable long-term dividend from the sale of a state owned asset. There are many precedents for such a proposal, including the creation of the Tasmanian Community Fund from the proceeds of the sale of the Trust Bank.

3.2. Water and Sewage Charges

Tasmanian water and sewage prices have increased by over 65 percent since 2005. This has occurred amid a period of significant and far reaching reform, beginning with the passage of the *Water and Sewerage Industry Act 2008*. This legislation created three new local government owned water corporations (which were subsequently merged to form TasWater in 2013), and marked the introduction of a new, two-part pricing regime. The reforms have increased water and sewage costs, partly because prior to 2009 most Tasmanian councils were not charging a full cost recovery rate for water and sewage services, which resulted in aging infrastructure and falling reliability standards (Tasmanian Economic Regulator, 2012). The resultant capital investment program aims to bring Tasmanian water and sewage infrastructure in line with national standards and community expectations.

As noted, however, the reforms have generally resulted in price increases for residential and commercial customers alike. Average price increases are capped in the range of 5-6 percent p.a. over the transitional pricing period until 2015 (see below). However, analysis published by the Tasmanian Economic Regulator indicated that revenue would have to increase by between 80 and 100 percent on 2010 levels over the medium term in order to achieve full cost recovery (Tasmanian Economic Regulator 2011). Given this requirement, there is a clear risk that water and sewage prices for both residential and (to a lesser extent) commercial customers will increase significantly after the current transitional price determination period ends in 2015.

Despite the concerns about rising water and sewage costs, it is difficult to provide a general assessment of water and sewage prices. This is because of the complexity of the pricing regime during the transition to two-part pricing. There are significant variations within the pricing regime both across regions and between customers, determined by the relationship between their historical tariff and the new target tariff determined by the economic regulator.

Nevertheless, two broad indicators of water and sewage price increases can be provided. The first is based on the price determinations published by the Economic Regulator for the period 2013-15. The scheduled increases for fixed residential water and sewage costs and the target tariff rate are provided below. As noted above, the actual rate increase for a given household will depend on whether their historical tariff was above or below the target. However, the situation is further complicated by the fact that most commercial customers are at or near their target tariff, but most residential customers are not. Consequently, residential customers will have to shoulder more of the cost burden during the transition to full cost recovery. This burden will have a particularly detrimental impact on low income households.

Table 3.4. Projected increases in residential water and sewage charges for southern Tasmania (Tasmanian Economic Regulator 2012, A-63).

	2012-13	2013-14	2014-15	Annual increase
Fixed water charge	\$272.32	\$288.65	\$305.97	6.17%
Fixed fire service charge	\$68.08	\$72.16	\$76.49	6.17%
Fixed sewage charge	\$488.71	\$518.03	\$549.11	6.17%
Potable water rate (\$/KL)	.90	.923	.947	2.61%
Average household usage cost	\$197.10	\$202.13	\$207.39	2.61%
Total Cost	1026.21	1080.97	1138.96	5.5%

Unfortunately for our analysis, there is an absence of specific HILDA data on the relative impact of increasing water and sewage charges on low income households. As outlined above, water and sewage cost pressures are largely prospective and would not be captured in the survey data. However, historical data on water and sewage costs in greater Hobart is available from the ABS household expenditure survey, presented below (see Figure 3.5). The data reveals a 7.3 percent annual price increase between 2005 and 2013, indicating

that water and sewage costs were increasing at twice the rate of inflation prior to the implementation of water and sewage reforms.

Figure 3.5. Cumulative increase in water and sewage prices in Hobart, 2005-2012 (ABS 2013a).

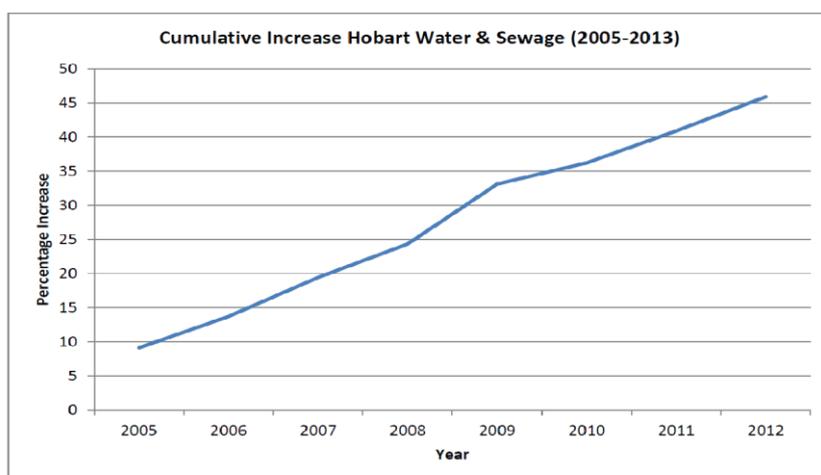


Table 3.5. Cumulative increase in water and sewage prices in Hobart, 2005-2013 (ABS 2013a).

	2005	2006	2007	2008	2009	2010	2011	2012	2013
Annual %	9.1	4.6	5.7	4.9	8.8	3.1	4.7	6.3	5.0
Cumulative %	9.1	14.1	20.6	26.6	37.6	41.9	48.6	58.0	65.8

3.2.1. The impact of water and sewage costs on low income households

Two general observations can be made regarding the impact of water and sewage costs on low income households:

- The Tasmanian regime's high reliance on fixed charges (over 80 percent for a typical Hobart residence) makes it difficult for low income households to save money through water conservation.
- On the positive side, the water regime includes a concession of \$169 per year for home owners who hold pension or health care cards (TasWater, 2013). However, as in most mainland jurisdictions, low income private tenants are ineligible for such concessions. This is because, unlike with electricity supply contracts, it is landlords rather than tenants who purchase water and sewage services from TasWater, even in cases where tenants pay water charges (TasCoss, 2011).

The dynamic and complex nature of water and sewage pricing means that it is difficult to establish whether associated cost pressures disproportionately impact low income households, despite case studies and media reports which indicate that this is the case (Anglicare 2011). In light of this deficiency, there is a clear need to collect and publish data on the specific impact of water and sewage costs on low income Tasmanian households generally, and on low income earners in private rental accommodation in particular.

3.2.2. Strategies for limiting further water and sewage price increases

The process for setting water and sewage prices is extremely complex, and has been subject to various consultations and reviews in recent years. It is important to note that state and local governments have the capacity to influence many of the factors which determine the regulated price of water and sewage services. It must also be noted that we support the broad objective that the new water and sewage pricing regime should generate sufficient revenue to ensure the long-run sustainability of the water and sewage network.

Notwithstanding these constraints, there is a real risk that over the medium term, water and sewage price rises will continue to exceed income growth. This means that the Tasmanian government must address the following policy issues, both within the existing framework for reviewing price determinations and more generally if required:

a) Are we over-investing in water and sewage infrastructure?

As noted above, we support the aim of ensuring that the provision of water and sewage services is financially sustainable. However, it can credibly be argued that many of the criticisms which apply to the setting of regulated electricity prices also apply to the water and sewage sector. First, there is a clear need to give a higher priority to consumer interests and customer's ability to pay in price determinations. There should be a public debate about the trade-offs between the need for increased capital expenditure vs. their impact on water prices. Such a debate should be conducted at a state level to avoid the underinvestment which occurred when water and sewage infrastructure was managed by local government.

Second, as in the electricity sector, the model for calculating the cost of replacing infrastructure puts significant pressure on current prices. In particular, it can be argued that the Weighted Average Cost of Capital (WACC) used in price determinations is relatively high for infrastructure projects in the current low interest rate environment, especially given the modest financial risks associated with operating a regulated monopoly infrastructure company.

Given these considerations, the Tasmanian government should benchmark the WACC relative to that used in other jurisdictions via the Economic Regulator, and model the price implications of different capital cost assumptions on final prices. It is important that Tasmania avoids creating a regime which encourages overinvestment funded by increased

user charges, as occurred in the national electricity transmission network (Grattan 2013a). We understand that both of these issues are being considered by the Economic Regulator in the lead-up to the next price determination.

b) Are TasWater dividend payments to local government too high?

Evidence suggests that most of the cost pressures in the water and sewage sector are the product of TasWater's capital investment program, as it seeks to upgrade inadequate infrastructure. Although this investment is necessary, there needs to be a debate as to whether local government should be receiving dividends during the capital reinvestment phase, given their role as shareholders and the indirect cost pressure the upgrades are placing on pricing. Indeed, forecasts published in the annual reports of the regulated water and sewage entities indicate that total dividends returned to the local government owners of the water and sewage corporations is expected to increase from \$22.66 million in 2011-12 to \$29.37 million in 2014-15 (see Table 3.6). The business community, the welfare sector and the Tasmanian government (most recently) have argued that a portion of these profits could be allocated to defraying the costs associated with reducing developer charges (see below), or providing additional concessions for low income households.

However, we also recognise that reducing dividend payments to local government involves trade-offs which may have other cost of living consequences. Specifically, any decrease in dividend income received by local government may result in decreased service provision or increased general rates (which are already increasing in real terms in Tasmania – see Part 3.3 of this report). These changes are likely to disproportionately impact low income earners. Given such trade-offs, it is important to consider the funding and efficiency of local government as part of a holistic cost living strategy (see Part 3.3 of this report for further detail).

Table 3.6. Increase in local government dividend returns from water and sewage investment (in millions of dollars).

	2011-12	2012-13	2013-14	2014-15
Total Distributions \$ million	\$22.66	\$24.40	\$26.60	\$29.40
% increase		7.6%	9.0%	10.5%

c) Benchmarking operating costs and quantifying the efficiency dividend from water and sewage reforms

In the long term, the centralised management of water and sewage assets should result in more efficient and higher quality service provision. In order to achieve this objective, and given its position as a publically owned monopoly, TasWater should be

subjected to regular public benchmarking to ensure that its operating costs are equal to or lower than similarly sized and structured water and sewage businesses in comparable jurisdictions. Similarly, having completed the industry restructure, there should be an audit of staff and total wage costs across both TasWater and local government to ensure that efficiency gains have been achieved. Such an oversight framework would enhance both the accountability and political legitimacy of water and sewage reforms.

3.2.3. Headworks and private developer charges

In addition to the changes described above, the new water and sewage pricing regime also requires TasWater to charge private investors and developers for the costs associated with increasing the capacity of water and sewage infrastructure for new developments (headworks charges) on a full cost recovery basis.⁴

This new regime for calculating headworks charges under the 2012 price determination has been the focus of much political debate, amid claims of significant increases in developer charges (Property Council of Tasmania, 2013). These concerns have even been echoed by the Local Government Association of Tasmania (LGAT), the peak association representing the councils who own TasWater. Even while supporting the principle of developer pays, the LGAT agrees that there is a clear case to review the headworks charges policy (LGAT 2013).

In light of these concerns, and given similar debates in other Australian jurisdictions, a review of the current methodology for calculating infrastructure charges is being conducted. This review will be incorporated into the next pricing determination, due to be released in August 2014. The current review of the water and sewage infrastructure regime has been welcomed by most stakeholders. Amid a construction downturn and in the context of the looming State election, both major parties have announced policies designed to provide relief from headworks charges until the next price determination comes into effect in December 2015. While these policies may stimulate construction in the short term, the fact that they shift costs onto either local (if funded through lower dividends) or state (if funded from consolidated revenue) governments means that such policies are unlikely to be sustainable in the longer term and may have unintended cost of living impacts.

Given this risk, we believe the current review of headworks charges should instead focus on developing a policy which is both sustainable and consistent with broad public policy objectives. We believe that developers should make a reasonable contribution to the cost of providing new water and sewage infrastructure, but should not be responsible for contributing to retrospective or 'sunk' costs attributed the depreciation of existing infrastructure. A public subsidy may be warranted where an area is mandated for

⁴ It must be noted that headworks charges and developer fees are not new in Tasmania, and local governments imposed various charges prior to the current water and sewage reforms.

development (perhaps including affordable housing or other community infrastructure) under the state planning scheme. Under these circumstances the subsidy may be used to encourage private investment which is consistent with state planning objectives. Having established state-wide planning, water and sewage regimes, there should be scope for greater policy coordination whereby water and sewage subsidies are used to achieve broader development and planning goals.

Recommendations for the Tasmanian water and sewage sector

Given that the challenges described above are an evolving policy issue in a complex regulatory environment, we propose the following actions for the next government:

- A public debate concerning the current price determination model, including options for balancing consumer needs with the capital requirements of the sector.
- A review of options for ensuring needy tenants can access concessions for water and sewage expenses.
- A review of the capital assumptions informing price determinations, including the appropriateness of WACC benchmarks used relative to other jurisdictions, and a commitment to making the modelling of the impact of different capital assumptions on final prices available.
- A review of the TasWater dividend policy, noting the scale of the current infrastructure investment program. Such a review must include local government and consider the implications of dividend policy on local government finances.
- Ensure that the current review of developer infrastructure charges tempers the aim of achieving full cost recovery, with the broader objective of ensuring price consistency, certainty and coordination with other government policy objectives.

3.3. Local Government Rates and User Fees

Tasmania's 29 local governments collectively raised \$317 million in rates and related charges in the 2011-12 financial year. This represents an average cost of over \$1000 p.a. on most households, depending on the assessed annual value (AAV) of their property. While low income private tenants do not have a direct local government rates liability, the rates will be reflected in the rent which they pay under normal market conditions. Therefore, rates have an indirect impact on housing affordability and cost of living pressures. Furthermore, rates and user charges on essential services and products are what public finance experts call an *inelastic tax base* because taxpayers can't easily move house or stop consuming an essential service to avoid rate and user charge increases. Given the fixed nature of such charges, it is essential that they are subjected to independent scrutiny. This is especially important in an environment in which all tiers of Australian government are under significant budgetary pressure and will be tempted to increase rates and user charges.

We have included a brief analysis of the cost of living impacts of local government rates in this report for the following reasons:

- Local government rates have increased faster than either State or Commonwealth taxes over the past decade (see Table 3.6). Indeed, in the Tasmanian context, local government rates have increased by 7.8 percent p.a. between 2008 and 2012 (see Table 3.7).
- This directly contributes to cost of living pressures, particularly for low income households.
- Cost pressures on local government also create indirect cost of living pressures, by influencing water and sewage pricing (as noted above).
- Local government funding is relevant to the broader debate over local government sustainability and reform.
- The land valuation formula for determining local government rates is currently under review and new procedures for promoting the financial accountability are being evaluated.

Table 3.6. Taxation revenue growth for state, Commonwealth, and local governments 2000-2011 (DPAC 2012; with data obtained from ABS 2013b).

	Growth per annum	Growth above CPI	Growth above CCI	Growth per population	Growth per population above AWE
State	5.92%	2.1%		1.25%	-0.13%
Commonwealth	6.32%	2.32%		0.56%	-1.23%
Local	8.41%	3.99%	2.48%	3%	1.41%

Table 3.7. Annual increases in local government rates, 2008-2012 (ABS 2013b).

	2008	2009	2010	2011	2012	Average Increase
New South Wales	5.7%	3.3%	4.7%	4.2%	4.3%	4.4%
Victoria	9.0%	7.5%	7.6%	8.5%	7.0%	7.9%
Queensland	9.4%	10.2%	6.5%	8.6%	5.4%	8.0%
South Australia	6.0%	8.1%	6.3%	7.1%	6.9%	6.9%
Western Australia	8.7%	12.1%	8.9%	9.4%	8.7%	9.6%
Tasmania	9.6%	10.0%	4.9%	8.0%	6.4%	7.8%
Northern Territory	7.9%	10.3%	10.7%	2.4%	7.1%	7.7%
National Average	7.8%	7.5%	6.5%	7.3%	6.1%	7.0%

There are growing concerns about the financial sustainability of local government in Australia across all jurisdictions, including large metropolitan councils and small rural municipalities. These concerns have been manifested through demands from local government for constitutional recognition and guaranteed federal funding, and through more general proposals for improving local government efficiency through amalgamation or by implementing alternative models of resource sharing. Table 3.7 indicates that these broader trends are also evident in Tasmania. Indeed, local government rates in Tasmania have been increasing more rapidly than either taxation rates or average wages.

We believe that it will be difficult for local government to sustain the growth in rates revenue experienced over the last decade. In combination with the likelihood of declining Commonwealth funding, this means that the local government sector will face significant financial challenges.

Therefore, it is necessary for the Tasmanian government to work with local government to create a sustainable financial model for the sector. This includes developing proposals to ensure an equitable and sustainable funding regime. The new regime should be

less reliant on flat user charges for essential services on the revenue side, and consider all cost saving options on the expenditure side which may improve local government productivity – including resource sharing and, in some cases, amalgamation. In this context we welcome the current review of the land valuation regime used to determine local government rates in Tasmania and the proposals to subject local government to financial oversight. A state-wide framework to limit rate increases, drawing on models used in other jurisdictions, should also be considered.

Recommendations for the Tasmanian local government sector

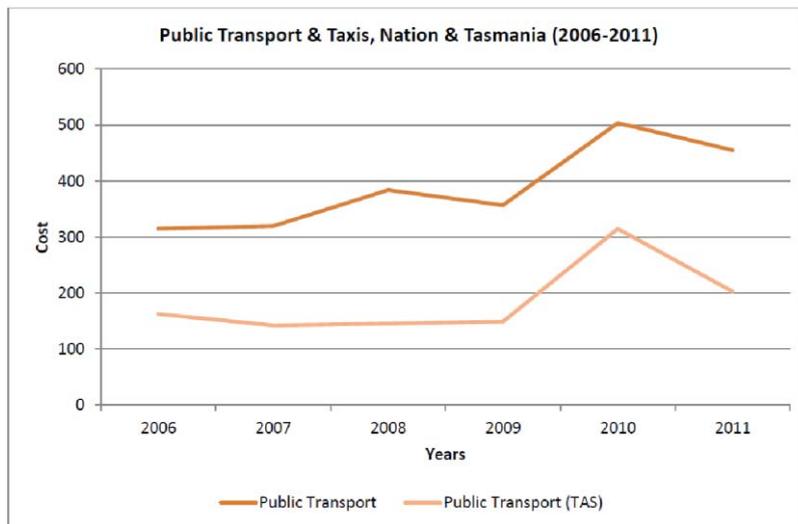
- Broaden the existing rate base through a more targeted concessions policy, given that a 30 percent rebate is available to all Pension Concession Card holders.
- Use independently established capital land valuations as the basis for determining rates, as opposed to the volatile annual assessed valuation.
- Subject all local governments to independent performance audits and benchmark levels of service provision and efficacy.
- Impose a state-wide cap on annual rate increases, which can be imposed by local government.

We believe that local government has an important role to play in providing community representation and services. However, we do believe that local government does need to be subjected to greater financial scrutiny and must take further steps to improve the efficiency and effectiveness of service delivery. Simply continuing to increase rates and other charges faster than levels of income growth in the communities that councils serve is unsustainable and will exacerbate cost of living pressures.

3.4. Transport Costs

Transport costs represent a major expense for most households, both in terms of public transport fares and the expense associated with operating a private vehicle. This is especially true in Tasmania, where the relatively dispersed population and limited public transport infrastructure means that many low income Tasmanians have to use private transport to access employment and essential services. The corollary of this high dependence on private vehicles is that average household spending on public transport and taxis (across all income groups) is less than half the national average (see Figure 3.6).

Figure 3.6. Annual expenditure on public transport: Tasmania versus the national average, 2006-2011 (ABS 2013a).



In order to determine low income households' average total transport expenditure, Figure 3.7 combines expenditure on public transport with the cost of owning and maintaining a private vehicle (registration, insurance, maintenance and fuel), because public transport costs represent approximately 20 percent of total expenditure in this category. The cost of purchasing a vehicle has been excluded on the basis that the quantum spent on purchasing a vehicle is highly variable. As is explained below, the main factor which accounts for variation in transportation costs is the price of fuel, which is determined by international market prices and federal taxes and excises, rather than the state government. The average retail price of unleaded petrol in Hobart over recent years is provided in Figure 3.7.

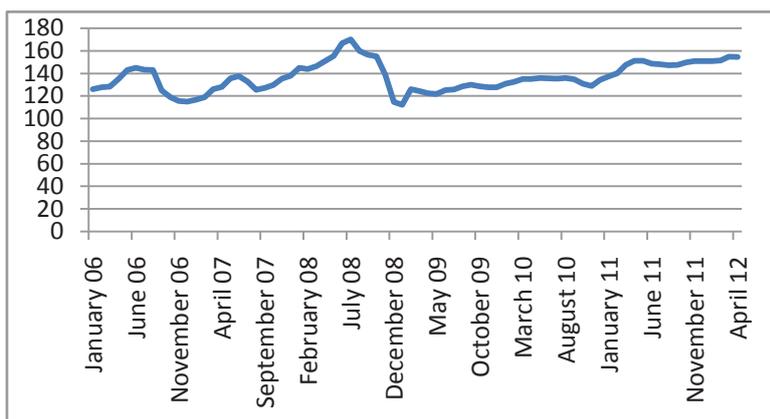


Figure 3.7. Average Hobart price for unleaded petrol, 2006-13 (Australian Automobile Association, 2013).

The data presented below demonstrates that transport is a necessity of life, to the extent that low income Tasmanian households (Q1 and Q2) spend a much greater proportion of income on transport relative to high income earners (see Figure 3.8 and Table

3.9). The second conclusion which can be drawn from the analysis is that petrol prices, which, as noted, are not determined by state policy, are the main determinant of household transport prices. The spike in transport costs in 2007-08 coincided with the period in which average Tasmanian unleaded petrol prices exceeded \$1.60 per litre.

Figure 3.8. Tasmanian transport and fuel costs as a percentage of expenditure for Tasmanian income quartiles, 2006-2012.

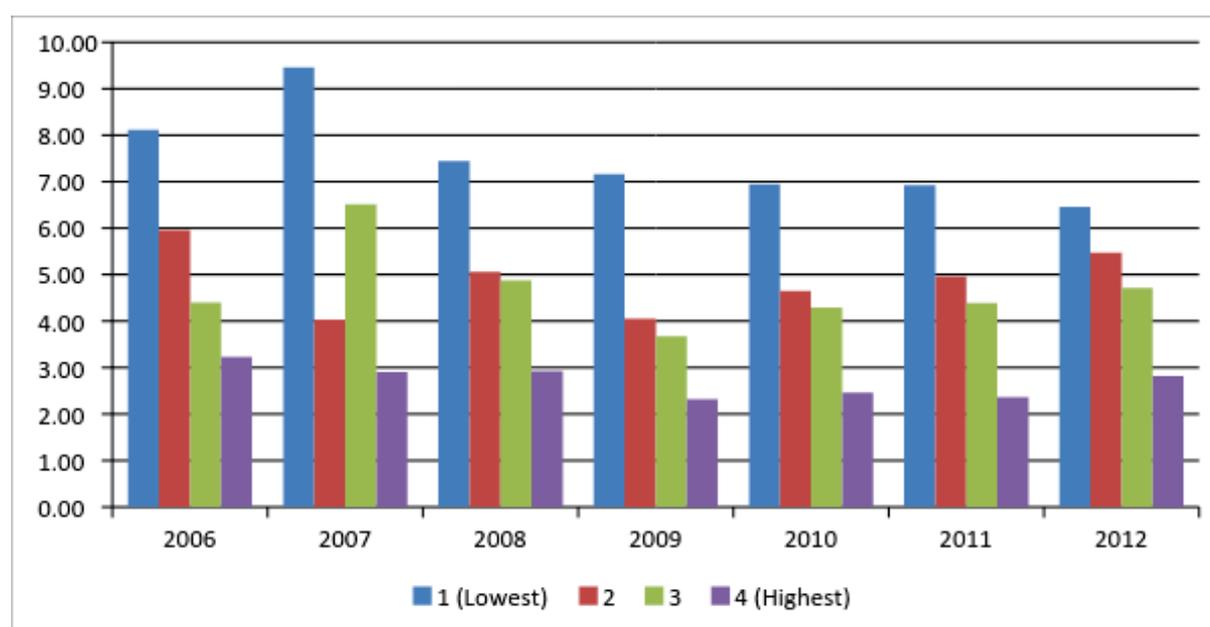


Table 3.9. Transport and fuel costs as a percentage of expenditure for Tasmanian income quartiles, 2006-2012.

Income	2006	2007	2008	2009	2010	2011	2012
Q1 (Low)	8.12	9.46	7.44	7.16	6.95	6.93	6.45
Q2	5.96	4.03	5.06	4.06	4.64	4.97	5.48
Q3	4.40	6.51	4.87	3.67	4.29	4.39	4.71
Q4 (High)	3.23	2.91	2.93	2.32	2.46	2.37	2.82

Recommendations for transport policy

As noted, the main determinant of transport costs is petrol prices. Though the state government's capacity to influence petrol prices is extremely limited, this does not mean that state policy cannot improve or exacerbate non-petrol related transport cost pressures. Indeed, given the centrality of petrol prices to cost of living, it may be argued that the state government has a responsibility to actively mitigate other transport costs – particularly

given that Tasmania's small population and highly dispersed communities means that private transport is likely to remain disproportionately high relative to public transport.

With these factors in mind, several conclusions can be drawn. Crucially, any increase in transport related user charges is highly regressive and may exacerbate social disadvantage and exclusion. For example, the Tasmanian government's 2012-13 Budget included the decision to increase motor tax and compulsory MAIB premiums charges, resulting in a \$41 average increase in registration fees – which is likely to have a disproportionate impact on low income households (RACT 2013, 3). The next Tasmanian government must avoid imposing further registration increases, and must ensure that the recent decline in MAIB claims is returned to motorists in the form of lower fees. Providing such relief from transport related costs is particularly important given the likelihood that petrol prices will rise to historic highs as the Australian dollar depreciates.

3.5. Housing and Rents

Housing affordability has become the most prominent issue in the national cost of living debate. This is justifiable, given that housing costs represent the single largest source of household expenditure, and that, as with most types of essential expenditure, poorer households spend a greater proportion of income on housing relative to wealthy households (see Figure 3.9 and Table 3.10). This trend has become even more pronounced since 2009 as wealthy households have benefited from historically low mortgage interest rates. Low income households, including public housing tenants and those in the private rental market, have not experienced such relief.

As previously noted, the majority of influences on housing prices are beyond the direct control of the Tasmanian government. A complex array of factors influence the housing market, including broad market dynamics, monetary policy, and tax policy. Moreover, the residential housing market is highly segmented and specific policies are required to address price pressures and supply shortages in public housing, the private rental market, and the first home buyers' market.

Figure 3.9. Tasmanian mortgage and rent costs as a percentage of income quartiles, 2006-2012.

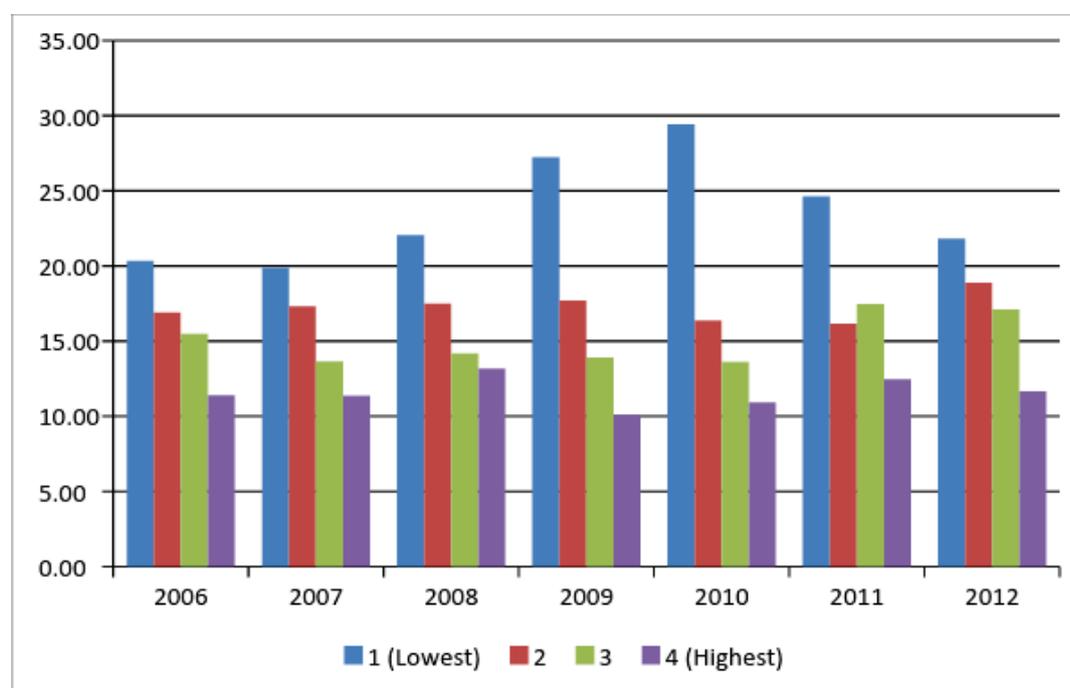


Table 3.10. Tasmanian mortgage and rent costs as a percentage of income quartiles, 2006-2012.

Income	2006	2007	2008	2009	2010	2011	2012
Q1 (Low)	20.3%	19.8%	22.0%	27.2%	29.4%	24.6%	21.8%
Q2	16.9%	17.3%	17.5%	17.7%	16.3%	16.1%	18.8%
Q3	15.4%	13.6%	14.1%	13.9%	13.6%	17.4%	17.1%
Q4 (High)	11.4%	11.3%	13.1%	10.1%	10.9%	12.4%	11.6%

Recommendations for housing policy

Despite being a minor player in the housing market, the Tasmanian government should continue its efforts to increase the supply of affordable public and private housing, in addition to the provision of emergency housing options.

Additionally, while first home buyers' grants are politically popular, the evidence suggests that they do little more than artificially increase demand and may ultimately serve to exacerbate housing cost pressures. Grants which specifically target first home builders may be more effective, if they stimulate construction and improve housing supply.

Furthermore, initiatives designed to improve energy efficiency in public housing and low cost private rental housing should be encouraged on both cost of living and environmental grounds.

3.6. Food Costs

Like housing, food is clearly a necessity of life, and low income households spend a far greater proportion of income on this expenditure category than high income households (especially once restaurant meals are excluded) (see Figure 3.10 and Table 3.11). The HILDA analysis reveals that expenditure on food as a portion of income peaked in 2009 and has abated slightly in recent years. This is most likely because food prices are influenced by market dynamics (such as drought and the exchange rate) rather than by state government regulation.

Yet despite the fact that food prices peaked in 2008, most welfare agencies in Tasmania have reported a significant increase in demand for emergency food relief over the past two years. This is most likely a consequence of the substitution effect, whereby households forego food in order to pay rent and utility bills.

Figure 3.10. Food expenditure as a percentage of total household expenditure across income quartiles, 2006-2012.

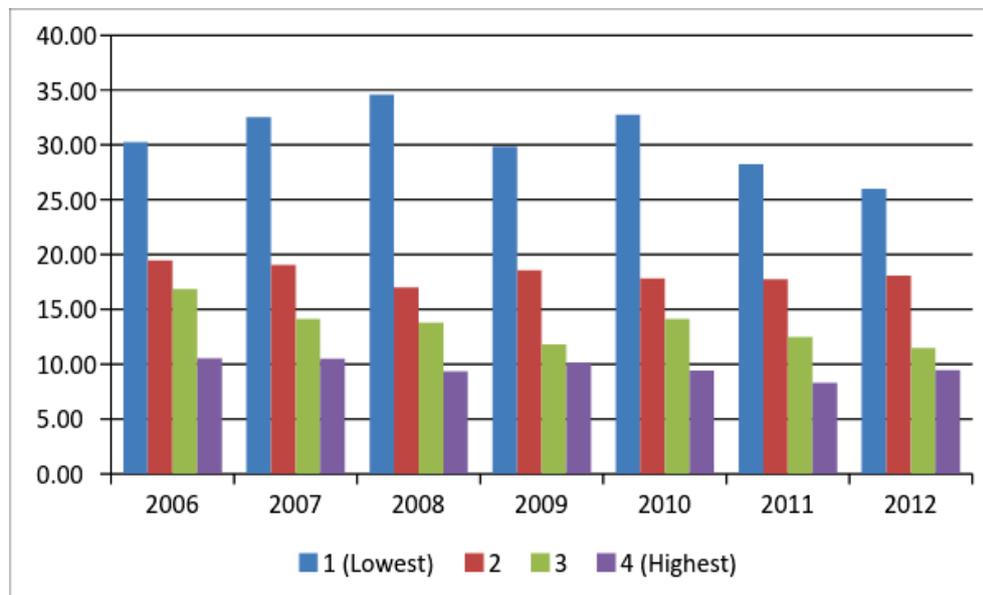


Table 3.11. Food expenditure as a percentage of total household expenditure across income quartiles, 2006-2012.

Income	2006	2007	2008	2009	2010	2011	2012
Q1 (Low)	30.2%	32.5%	34.5%	29.8%	32.7%	28.2%	26.0%
Q2	19.4%	19.0%	17.0%	18.5%	17.8%	17.7%	18.1%
Q3	16.8%	14.1%	13.7%	11.8%	14.1%	12.4%	11.4%
Q4 (High)	10.5%	10.5%	9.3%	10.1%	9.4%	8.2%	9.4%

Recommendations for food policy

As with housing policy, the Tasmanian government has little direct impact on market food prices. However, in light of the growing cost of living crisis and the marked increase in demand for emergency food assistance reported by welfare agencies, the state government must do more to help community organisations provide emergency food relief. The Tasmanian government should continue to support the successful community garden projects which have been established in recent years. Not only are community gardens a source of healthy low cost food, evidence suggests that participation in such programs has longer term health and social benefits.

3.7. Summary of Sectoral Reform Recommendations

Part Three of this report has sought to identify and analyse underlying contributors to Tasmania's cost of living problems within the sectors over which the Tasmanian government exerts some control. Our analysis indicates that many of the factors which increase cost of living pressures are the result of unsustainable or avoidable structural problems. Given Tasmania's precarious fiscal position, it is not viable for the Tasmanian government to rely on concessions and subsidisation to mitigate cost of living pressures. Though these strategies may be politically popular and effective in the short term, they do not constitute a real solution. This suggests that any meaningful attempt to address the issue must include long term reforms that will, over time, reduce both cost of living pressures and the fiscal strain placed on the state budget – in addition to providing immediate short term relief to households with the most urgent need.

With this in mind, our sectoral recommendations include combinations of both short term concession based strategies and long term structural reform. We urge the next Tasmanian government to include both in its cost of living strategy.

Electricity Prices

- We propose the following **long term** structural changes: further reform of the model used to establish electricity prices to give greater weight to consumer interests and their ability to pay; an urgent review of the model for determining the cost of capital invested in electricity infrastructure to ensure fair and sustainable electricity prices; enhanced competition and privatisation in the Tasmanian electricity sector to reduce market prices; and, if privatisation does occur, an increase in electricity concessions to the neediest households using the proceeds of privatisation, managed through an investment fund.
- We propose the following **short term** strategy: more effective targeting of electricity concessions, so that these are limited to the neediest of customers and PAYG customers are no longer paying disproportionately high fixed costs.

Water and Sewage Charges

- Proposed **long term** structural reforms include: reviewing the current price determination model to balance consumer needs with the capital requirement of the sector; reviewing the capital assumptions informing price determinations; and reviewing the TasWater dividend policy, noting the scale of the current infrastructure investment program and ensuring developer infrastructure charges balance the aim of achieving full cost recovery with the broader objective of ensuring price consistency, certainty and coordination with other government policy objectives.
- In the **short term**, we suggest: reviewing options for ensuring needy tenants can access concessions for water and sewage expenses.

Local Government Rates and User Fees

- In order to mitigate the need to further increase rates and, consequently, cost of living pressures on Tasmanian households, we propose that local governments work with the state government to develop a more sustainable funding model for the **long term**. The new model should be less reliant upon flat charges and increases in rates, and a balance should be struck between stable revenue raising and expenditure reductions. The latter would preferably occur through amalgamation and resource sharing rather than reduced services provision (given that reducing services has more adverse impacts on low income households).
- In the **short term** we propose the implementation of a state wide cap on annual rate increases, and the introduction of independently established capital land valuations to replace the more volatile annual assessed valuations which currently determine rates.

Transport Costs

- We encourage future Tasmanian governments to avoid imposing further registration fee increases on motorists over the **long term**, because these charges are highly regressive and only exacerbate transport cost pressures resulting from fluctuating petrol prices (which the state government cannot minimise). In the **short term**, we propose returning the recent decline in MAIB claims to motorists through lower fees.

Housing and Rents

- We propose that the Tasmanian government moves to increase housing supply over the **long term** by shifting grants and subsidies to stimulate increased construction rather than increased demand, so that prices are not artificially inflated to the current extent.
- We recommend that energy efficiency in public housing and low cost private rentals is improved over the **short and long term**, so that low income Tasmanian households are more easily able to reduce the proportion of their income devoted to the fixed cost of housing.

Food Costs

- The Tasmanian government should maintain its support for emergency food relief and community gardens in the **short term** and, if possible, increase this support over the **long term**.

Part Four

Strategies for Addressing the Cost of Living Problem

This report has sought to establish the precise nature of the cost of living challenges confronting low income Tasmanian households, and how these have changed over time. The report analysed the variability and complexity of the cost of living problem and its underlying causes, with the aim of encouraging a mature and non-partisan debate about the nature and extent of the problem. We conclude this report by identifying the central themes which can be drawn from the analysis and by presenting four broad strategies for addressing cost of living pressures on low income Tasmanians. To reiterate, these are complex problems. Consequently, this final section of the report is designed to provoke debate and contribute to establishing a longer term strategic agenda for addressing the structural causes of cost of living pressures in Tasmania.

These strategies include:

1. Implementing a more targeted concessions regime.
2. Promoting efficiency in state owned and regulated corporations and service providers, in order to minimise user charge increases.
3. Encouraging high income households to be part of the solution by spending and investing in Tasmania and continuing to support community organisations.
4. Acquiring more comprehensive state-level data in order to identify cost of living pressures, respond accordingly, and accurately evaluate the success of subsequent policy initiatives.

4.1. Implementing a More Targeted Concessions Regime

The most effective **short term** strategy for mitigating cost of living pressures on low income households is the implementation of a more targeted concessions system.

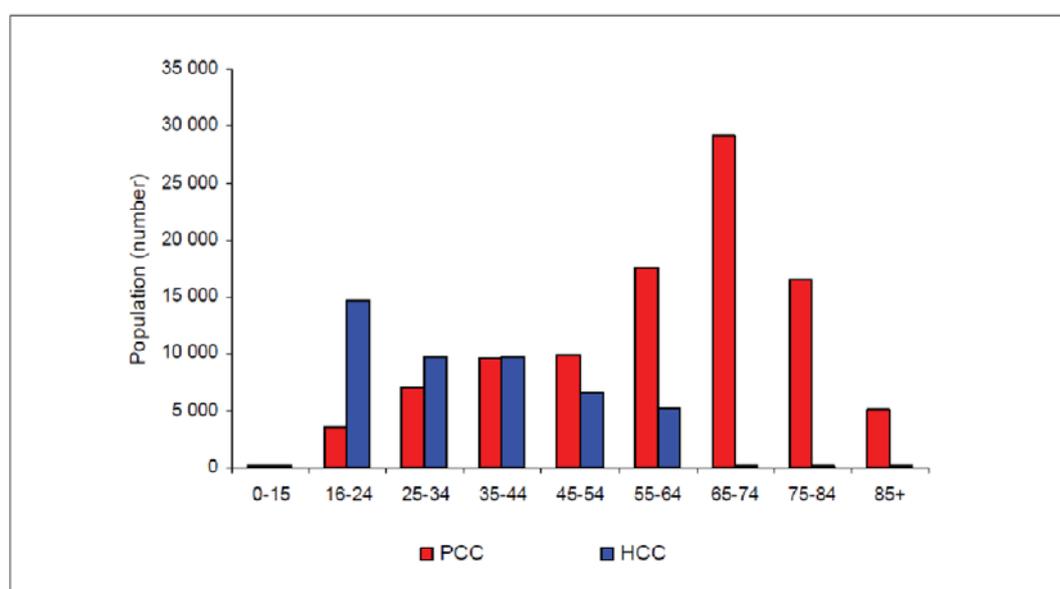
The Tasmanian Treasury conducted a comprehensive *Review of State Concessions* in 2008. This Review noted that in 2007-08 the Tasmanian government provided concessions worth over \$295 million. This figure would have increased significantly since then, because of the combined impact of the Financial Crisis and Tasmania's ageing population.

Eligibility for specific Tasmanian government concessions is determined by a range of criteria. However, eligibility for the majority of concessions is linked to the provision of one of two Commonwealth concession cards:

- Pensioner Concession Card (PCC); or
- Health Care Card (HCC).

As of 2007, an estimated 144,000 Tasmanians (29 percent of the population) were PCC or HCC card holders, and qualified for a concession in the order of approximately \$800 per year each. The distribution of concession card holders by age is provided below. Furthermore, the Tasmanian Government's 2011 *Cost of Living Strategy* found that 66,000 (33 percent) of Tasmanian households rely on government benefits for the majority of their income (DPAC 2011a, 3).

Figure 4.1. Distribution of Tasmanian Concession Card holders by age (Department of Treasury and Finance 2008, 8).



Tasmania's current concession regime is relatively transparent and efficient to administer. However, based on the analysis presented in this report, it can be argued that the existing concession regime has been ineffective in alleviating cost of living pressures on Tasmania's neediest households.

In light of this, and given the prohibitive costs associated with increasing the quantum of funding available to low income Tasmanian households, we believe there is a case for developing more targeted eligibility criteria for concessions.

Policy Recommendations

a) Concession reviews

The reform priority must be reviewing the income limit for a couple to be eligible for a part aged pension (and hence a PCC), which is currently \$72,000 p.a. (\$47,060 for a single pensioner). This threshold only excludes the top 40 percent of Tasmanian household incomes. When combined with the fact that many PCC card holders in the middle of the income distribution own their home outright and have control of their investment income, there is a growing risk that many middle class retirees will have access to state government concessions. With an aging population, it is inevitable that a growing number of retirees will be eligible for the PCC in the absence of better targeting (notwithstanding the increase in the pension age to 67).

Given ongoing budgetary pressures, **we recommend that the next Tasmanian government analyse the incidence of concessions (who benefits), and explore options to ensure they are limited to households in the lowest 40 percent of the income distribution.** Given that both PCCs and HCCs are administered nationally, Tasmania should lead a national debate on concession reform.

b) Concessions and the divestment of public assets

Additionally, the next Tasmanian government must take into consideration the growing national debate concerning the privatisation of government owned assets and business enterprises (as alluded to in Part Three of this report). Given the complexity of these issues, it is beyond the scope of this report to assess the merits or otherwise of privatisation. However, should a future Tasmanian Government privatise electricity assets, we believe that **a significant portion of the equity realised from asset sales should be invested in an independently managed trust fund – with real investment returns being used to assist low income households through either concessions or emergency assistance funds.** Such a scheme would be equitable, sustainable and, above all, would ensure that needy Tasmanians receive a long term dividend from the sale of public assets.

It must be noted that such an idea is not without precedent. Indeed, previous Tasmanian experiences with 'trust funds' provide evidence of the practical benefits of such a scheme. For example, as a condition of privatising the Trust Bank in the late 1990s, the

Tasmanian government committed to making a statutory allocation to the Tasmanian Community Fund (currently over \$5 million per annum, which is subsequently distributed via community grants (Tasmanian Community Fund, 2013).

4.2. Promoting Efficiency and Limiting Fees Charged by State-Owned and Regulated Corporations

Potentially, the most significant **long term** strategy for mitigating cost of living pressures on low income households lies in addressing the underlying structural contributors to high prices for essential services including utilities. A key finding emerging from this report is that rising utility prices and user fees are the most significant contributor (over which the state government has significant control) to cost of living pressures facing Tasmanian households. Furthermore, the rising costs of essential utilities have highly regressive effects with significant social welfare implications because low income earners have comparatively little discretion over their consumption choices in these areas.

Given the growing budgetary pressures facing all levels of Australian government, we believe that it is necessary to address the structural causes of rising utility prices. This is because increasing concessions and other measures designed to lessen the impact of utility price increases on low income households are unlikely to be sustainable in the long term, because they do not address the root causes of cost of living pressures.

The factors that contribute to increasing utility prices in specific markets and jurisdictions are complex, but the following general conclusions can be drawn:

- National and state-level regimes used to set prices in key utility markets have failed. They have provided incentives to over-invest in infrastructure and have not subjected state owned or regulated utilities to sufficient financial scrutiny.
- High levels of operating and capital expenditure growth in state owned or regulated utilities have directly contributed to significant increases in utility prices, which have been highly regressive in their impact.

Policy Recommendations

- **There must be a debate about moving to a consumer-orientated utility pricing model.** In contrast to the current regime, whereby retail prices are determined by utility company's costs, state-owned or regulated companies must be subjected to the discipline of operating a budget determined by consumers' capacity to pay. Such a regime would force utility companies to ensure that operational expenses were in line with income growth in the communities they serve.
- Where there is a clear case for increased investment in infrastructure, **the Tasmanian government should explore new and innovative models for**

infrastructure funding and take part in the national debate about promoting investment and productivity.

- Just as increasing utility prices is highly regressive, so too are user charges – especially when the charges relate to essential services. The next Tasmanian government must resist the temptation to increase user charges faster than income growth. Instead, **future Tasmanian governments must explore revenue options which are more efficient (in terms of their economic impact) and equitable.**

4.3. High Income Households are Part of the Solution

Current discourse concerning Tasmania's economy and society is overwhelmingly negative. It's undeniable that overall economic conditions in the state have deteriorated over the past three years and – as this report has demonstrated – many low income households are facing a cost of living crisis. However, there are many good news stories in the midst of this pervasive negativity and it is important that these successes are celebrated and capitalised on.

The unambiguously positive news in this report is that 30,000 to 40,000 high income Tasmanian families in the top 20 percent of the income distribution have seen their discretionary income increase by approximately 30 percent since 2006 (see Table 2.4). This has occurred as a result of strong wage growth, a recovery in asset prices since 2009, and significant decline in housing costs as a result of historically low mortgage interest rates. This is consistent with the global trend of high income individuals constituting the main beneficiaries of crisis-induced macroeconomic policy.

We do not advocate overtly redistributive policies at a state level. However, we do believe that the Tasmanian government and the Tasmanian community should acknowledge that a significant minority of households are prospering, and should therefore be encouraged to spend and invest in Tasmania and continue supporting those in need in the Tasmanian community.

The need for this is particularly acute given the deep seated structural forces which are exacerbating inequality at both the state and national levels. Given this context, we believe that political, business, and community leaders must continue to promote community engagement and philanthropy as an important means of providing social and financial support to those many Tasmanian households in genuine need.

4.4. Better Data on the Nature of Cost of Living Pressures

Our final recommendation concerns the need to collect more comprehensive quantitative data on state-level household income and expenditure patterns. This step is necessary for policymakers and community organisations to develop a more nuanced and reliable understanding of state-level cost of living pressures, how they vary across income

levels, and how they change over time.

While ABS Household Expenditure Survey and HILDA survey data provide general insights into the changing nature of cost of living pressures in Tasmania, the reality is that both instruments are designed to provide national-level analysis. Due to limited Tasmanian sampling it is difficult to provide statistically significant analysis of changing cost of living pressures across income quintiles.

Given the complex and dynamic nature of cost of living pressures, we believe that the Tasmanian Government should consider forming a partnership with relevant research agencies, including the ABS, The Melbourne Institute, and the University of Tasmania. This would enable the development of strategies for increasing cost of living sampling, resulting in the production of reliable and statistically significant analysis.

This task would be made easier by the fact that Tasmania is gaining an international reputation as an innovator in the collection and mass dissemination of climatic and agricultural data through the Sense T project. This technology could be applied to the collection and analysis of key social and economic data such as that related to cost of living pressures.

This recommendation is critical for mitigating Tasmanian cost of living pressures, because it is only through the collection and analysis of appropriate data that we can develop appropriate policy responses to this complex problem and then subject these policies to appropriate evaluation.

Appendix 1

An overview of HILDA survey data and the Cost of Living Pressures in Tasmania

The majority of cost of living research is nationally focused. Furthermore, the majority of published cost of living studies examine aggregate, macro-level data that compares costs in one expenditure category (such as electricity prices) to aggregate price inflation (the consumer price index (CPI)).

However, this method is insufficient for providing detailed insights into household cost of living pressures and how they vary across the socioeconomic spectrum and over time. In order to achieve a detailed understanding, it is necessary to assess changes in both household income and expenditure. For example, cost pressures on low to middle income households have increased significantly over the past five years due to increases in the costs of essential services *and* because household income has remained static or declined (e.g. due to less hours of work or unemployment). Changes in both expenditure and income therefore constitute the source of hidden cost of living pressures not captured by aggregate analyses.

A.1. Expenditure surveys and the rationing and substitution effects

In addition to the above considerations, it is important to note that household expenditure data may underestimate cost of living pressures because of rationing and substitution effects. Rationing occurs when actual expenditure by low income households with few savings and limited access to credit does not increase as quickly as prices – simply because households are forced to limit their spending. Therefore, low income households may be forced to forego winter heating or to purchase less or lower quality food in order to balance their household budget when prices increase. Indeed, the need to ration the purchasing of essential goods and services is a clear indicator of poverty.

Substitution occurs when a household limits spending in one category of essentials (such as health or transport) to meet expenses associated with other necessities of life, such as food or utility bills. For example, qualitative Tasmanian and Australian research has highlighted how low income households experiencing cost of living stress tend to cut spending on food and transport costs in order to pay utilities bills, for fear of being disconnected (see, for example, Anglicare 2009 and 2011a and b).

Although HILDA analysis may not be able to identify rationing as such, significant increases in the cost of essential services provide a clear indication that hardship related

rationing or substitution is likely to be occurring. Such evidence highlights the need to implement policy and regulatory frameworks that limit the impact of increasing utility prices on low income households.

A.2. Methods: Using the HILDA survey to measure cost of living pressures

The HILDA Survey is a large national household panel survey with a specific focus on three key research areas: family and household dynamics; income and welfare dynamics; and labour dynamics (Wooden and Watson, 2007). The survey commenced in 2001, and there are currently twelve available waves of data; the most recent – Wave 12 – was released in January 2014. The reference population for the initial Wave 1 HILDA sample were all members of private dwellings. Using a multi-stage sampling approach, households were selected from a sample of 488 Census Collection Districts (CDs), with the final sample comprising 200-250 households across Australia.

The overall Wave 1 sampling frame is reasonably representative of Australian households. However, there are some issues with the ‘representativeness’ of HILDA, in that women are over-represented but migrants of a non-English speaking background, Indigenous Australians, and unmarried couples are under-represented. HILDA collects data from all members of each sample household over 15 years of age, and follows them unless they cease to participate. The sample may include children born to or adopted by members of responding households; new members of a household as a result of ‘household composition changes’; and new members of a household from overseas who arrived in Australia after 2001. All members of a sample household, including children from Wave 1 onwards, are designated as Continuing Sample Members (CSM). All others who join the household in Wave 2 onwards are designated as Temporary Sample Members (TSMs). TSMs may become CSMs if they are new household members arriving in Australia after 2001 or they have a child with a CSM. In the event of household dissolution, the HILDA sample only follows the CSM(s).

Within each sampled household, data are collected at both a household and individual level using a range of survey instruments. In Wave 1, there were four instruments administered: (1) Household Form (HF); (2) Household Questionnaire (HQ); (3) Person Questionnaire (PQ); and (4) Self-Completion Questionnaire (SCQ). From Wave 2 onwards, the PQ was replaced by two instruments: the Continuing Person Questionnaire (CPQ) for members interviewed in the previous wave and the New Person Questionnaire (NPQ) for new members. The HF records details about the composition of the household, and the HQ asks about children under the age of 15 and household wealth. The HQ is administered to one household member. The PQ is administered to every member of the household over the age of 15 and records various sorts of information, including: socio-demographic details; education and employment status; health; and relationships. This study draws data from the SCQ, which contains questions about annual household expenditure.

Like all research strategies, the HILDA survey approach has many strengths and some limitations. The strengths include that repeating surveys on an annual basis with a clearly defined cohort of participants provides a clear insight into how cost of living pressures change over time. In contrast, the ABS Household expenditure survey (which is the basis for most existing research including the 2011 Tasmanian Cost of Living Study) relies on the data generated from expenditure surveys conducted every six years - which is then adjusted based on how the price of a given category of expenditure changes from year to year. The obvious limitation with this method is that consumption patterns (being price elastic to varying degrees) alter as prices change. Put simply, as goods become more expensive we purchase less of them. This is especially true of low income households.

The limitation with both approaches is the small sample sizes once data is disaggregated across five income quintiles. In this sense the HILDA data presented in this report is indicative rather than being representative in a formal sense. Hence, some of the anomalies identified above can be attributed to the fact that the number of Tasmanian respondents included in this study fluctuates between 300 to 500. However, when combined with other formal studies on cost of living pressures in Tasmania and the growing anecdotal evidence (see, for example, DPAC 2011a), we believe the data presented provides a clear indication of the broad cost of living trends facing Tasmanian households.

A.3. HILDA classification of expenditure categories: Discretionary versus essential expenditure

There is an ongoing debate within the cost of living literature regarding the classification of discretionary and non-discretionary (essential expenditure). Some items are clearly discretionary, such as holidays, entertainment, restaurant meals, and new vehicles. However, it is much more difficult to categorise money spent on groceries, fresh food, clothes, and education. All of these items are necessities, but households have a good deal of choice and discretion about how much they spend on each category. Indeed, survey research consistently reveals that under some circumstances high income households spend a greater proportion of their income on these 'essential' expenditure categories than low income households by purchasing gourmet food, private education, and private health services. As a reflection of these debates, we have adopted a broad definition of essential expenditure items (defined in Table A.1).

Table A.1. Classification of essential and non-essential expenditure for HILDA analysis.

Expenditure Classified as Essential	Expenditure Classified as Non-Essential
Groceries	Meals eaten out
Clothing and footwear	Hobbies, sports, gambling & entertainment
Education fees	Alcohol
Electricity bills	Tobacco
Furniture	Home repairs and renovations
Health care	Holidays and holiday travel
Fees paid to health practitioners	New cars and other vehicles
Motor vehicle fuel & repairs	Private health insurance
Other heating fuel	TVs & other home entertainment equipment
Medicines	Used motor vehicles
Telephone and internet charges	Whitegoods
Public Transport and Taxis	Computers and related equipment
	Other residual categories

References

- Australian Bureau of Statistics. 2013a. "6401.0 Consumer Price Index, Australia, Sep 2013." Accessed November 22, 2013.
<http://www.abs.gov.au/ausstats/abs@.nsf/mf/6401.0>.
- Australian Bureau of Statistics. 2013b. "5506.0 Taxation Revenue, Australia 2011-12." Accessed November 22, 2013.
<http://www.abs.gov.au/ausstats/abs@.nsf/Latestproducts/5506.0Main%20Features%202011-12?opendocument&tabname=Summary&prodno=5506.0&issue=2011-12&num=&view=>.
- Alessandrini, M. 2010. "Political Chronicles Tasmania January to June 2010." *Australian Journal of Politics and History* 56 (2): 666-671.
- Anglicare. 2009. "Hard Times: Tasmanians in Financial Crisis." Available from:
[http://www.anglicare-tas.org.au/docs/research/Hard times full report.pdf](http://www.anglicare-tas.org.au/docs/research/Hard%20times%20full%20report.pdf).
- Anglicare. 2011. "The Cost of Essentials in Tasmania." Available from: <http://www.anglicare-tas.org.au/docs/research/tasmania-together---cost-of-living-indicator-for-tasmania.pdf>.
- Anglicare. 2011. "The Price of Poverty: The Cost of Living for Low Income Earners." Available from: [http://www.anglicare-tas.org.au/docs/research/The price of poverty the cost of living for low income earners.pdf](http://www.anglicare-tas.org.au/docs/research/The%20price%20of%20poverty%20the%20cost%20of%20living%20for%20low%20income%20earners.pdf).
- Anglicare. 2012. "Cost Essentials in Tasmania." Available from: <http://www.anglicare-tas.org.au/docs/research/tasmania-together---cost-of-living-indicator-for-tasmania.pdf>
<http://www.anglicare-tas.org.au/docs/research/tasmania-together---cost-of-living-indicator-for-tasmania.pdf>.
- Aurora Energy. 2011. "Annual and Sustainability Report 2010-11." Available from:
[http://www.auroraenergy.com.au/Aurora/media/pdf/about_aurora/annual_report_2011/Aurora AR 2011.pdf](http://www.auroraenergy.com.au/Aurora/media/pdf/about_aurora/annual_report_2011/Aurora_AR_2011.pdf).
- Aurora Energy. 2013. "Energy to Respond: Annual Report 2012-13." Available from:
http://www.auroraenergy.com.au/Aurora/media/pdf/about_aurora/annual_report_2013/Aurora-Energy-Annual-Report-2013.pdf.
- Australian Council of Social Service. 2013. "Bold Action For A Fairer Future: Federal Election Statement 2013." Available from:
http://www.acoss.org.au/images/uploads/ACOSS_2013_election_statement_16pp_FINAL.pdf.

- Australian Energy Regulator. 2013. "Annual Report on the Performance of the Retail Energy Market." Available from:
<http://www.aer.gov.au/sites/default/files/801%20AER%20Performance%20Annual%20Report%20FA%200.PDF>.
- Chester, L., and A. Morris. 2011. "A New Form of Energy Poverty is the Hallmark of Liberalised Energy Sectors." *The Australian Journal of Social Issues* 46: 435-459.
- Crouch, C. 2009. "Privatised Keynesianism: An unacknowledged policy regime." *British Journal of Politics and International Relations* 3(11): 382-399.
- Department of Premier and Cabinet Tasmania. 2009. "A Social Inclusion Strategy for Tasmania." By Professor David Adams, Social Inclusion Commissioner. Available from:
http://www.dpac.tas.gov.au/data/assets/pdf_file/0005/109616/Social_Inclusion_Strategy_Report.pdf.
- Department of Premier and Cabinet Tasmania. 2011a. "A Cost of Living Strategy for Tasmania, October 2011." Available from:
http://www.dpac.tas.gov.au/data/assets/pdf_file/0015/152070/A_Cost_of_Living_Strategy_for_Tasmania.pdf.
- Department of Premier and Cabinet Tasmania. 2011b. "Cost of Living in Tasmania: Companion Report 1 – The Data, October 2011." Available from:
http://www.dpac.tas.gov.au/data/assets/pdf_file/0017/152072/Cost_of_Living_in_Tasmania_-_Companion_Report_1_-_The_Data.pdf.
- Department of Premier and Cabinet Tasmania. 2011c. "Cost of Living in Tasmania: Companion Report 2 – Impacts and Responses, October 2011." Available from:
http://www.dpac.tas.gov.au/data/assets/pdf_file/0018/152073/Cost_of_Living_in_Tasmania_-_Companion_Report_2_-_Impacts_and_Responses.pdf.
- Department of Premier and Cabinet Tasmania. 2011d. "Cost of Living Indicators for Tasmania: Final Report." (Prepared by NATSEM.) Available from:
http://www.dpac.tas.gov.au/data/assets/pdf_file/0003/152256/NATSEM_-_June_2011_-_Cost_of_Living_Indicators_for_Tasmania_Final_Report.pdf.
- Department of Premier and Cabinet. 2012. "The State of Local Government: Presentation May 3, 2012."
- Eccleston, R. 2004. *The Thirty Year Problem: The Politics of Australian Tax Reform*. The Australian Tax Research Institute, Sydney.
- The Grattan Institute. 2012. "Putting the Customer Back In Front: How To Make Electricity

Cheaper.” Available from:

http://grattan.edu.au/static/files/assets/7a8390e0/178_energy_putting_the_customer_back_in_front.pdf.

The Grattan Institute. 2013. “Renovating Housing Policy.” Available from:

http://grattan.edu.au/static/files/assets/b8ea6c12/800_Renovating_Housing.pdf.

Local Government Association Tasmania. 2013. “Headworks Charges: A Necessary Impost.” Accessed November 18, 2013.

<http://www.lgat.tas.gov.au/webdata/resources/files/MR%20-%20Headworks%20Charges%20-%20a%20necessary%20impost%20-%2010.10.13.pdf>.

McKim, N. 2010. “Greens Tasmanian State Election Campaign Launch, March 2010.”

Accessed November 18, 2013. <http://mps.tas.greens.org.au/2010/03/greens-election-campaign-launch-speech-and-announcements/>.

Organisation for Economic Cooperation and Development. 2013. “Framework for Statistics on the Distribution of Household Income, Consumption and Wealth.” Available from:

<http://www.oecd.org/statistics/302013041e.pdf>.

PerCapita. 2011. “Just Get Over It: The Cost of Living in Australia.” Available from:

http://www.percapita.org.au/dbase_upl/Just%20Get%20Over%20It_Final.pdf.

Property Council of Tasmania, 2013. “Developer Costs Need to Come Down.” Accessed November 27, 2013.

<http://www.propertyoz.com.au/tas/Article/NewsDetail.aspx?p=16&id=8091>.

Queensland Council of Social Service. 2013. “Cost of Living Report: Can Low-Income Households Afford a Basic Standard of Living? Issue 3, 2013.” Available from:

https://www.qcross.org.au/sites/default/files/QCOSS_CostOfLiving_Report_Final_Web.pdf.

South Australia Council of Social Service. 2013. “Cost of Living Update: No. 15, June Quarter 2013.” Available from:

http://www.sacoss.org.au/online_docs/130815%20Cost%20of%20Living%20Update15_Communications.pdf.

Tasmanian Chamber of Commerce and Industry. 2013. “Business call for urgent review of head-works’ costs.” Accessed November 13, 2013.

<http://www.tcci.com.au/News-Media/Latest-News/Business-call-for-urgent-review-of-head-works%E2%80%99-cos>.

Tasmanian Council of Social Service. 2010. “The Intersection of Emergency Food Relief and Food Security.” Available from:

<http://www.tascoss.org.au/Portals/0/Publications/TheIntersectionofEmergencyFoodReliefandFoodSecurity-MHerzfeld-Updated.pdf>.

Tasmanian Council of Social Service. 2011. "Comment on Draft Water & Sewerage Industry Regulations 2011." Accessed November 18, 2013.

<http://www.tascoss.org.au/Portals/0/Policy%20%26%20Research/TasCOSS%20response%20to%20Draft%20Water%26Sewerage%20Pricing%20Regulations%20Mar11.pdf>.

Tasmanian Department of Treasury and Finance. 2010. "State Tax Review – Discussion Paper." Available from: <http://www.sro.tas.gov.au/domino/dtf/dtf.nsf/v-statetax/73B7D5DE96BB697BCA2577EC0001624C>.

Tasmanian Economic Regulator. 2011. "Review of the Interim Pricing Order for the Tasmanian Water & Sewerage Sector: Updated advice to the Treasurer." Released March 2011.

Tasmanian Economic Regulator. 2013. "2013 Aurora Pay As You Go Price Comparison Report." Available from:

[http://www.economicregulator.tas.gov.au/domino/otter.nsf/LookupFiles/132872_2013_APAYG_Price_Comparison_Report_-_Final.PDF/\\$file/132872_2013_APAYG_Price_Comparison_Report_-_Final.PDF](http://www.economicregulator.tas.gov.au/domino/otter.nsf/LookupFiles/132872_2013_APAYG_Price_Comparison_Report_-_Final.PDF/$file/132872_2013_APAYG_Price_Comparison_Report_-_Final.PDF).

Tasmanian Economic Regulator. 2012. "2012 Price Determination Investigation – Regulated Water and Sewerage Services in Tasmania." Available from:

[http://www.economicregulator.tas.gov.au/domino/otter.nsf/LookupFiles/2012_Final_Report_Water_Sewerage_Price_Determination_Investigation.pdf/\\$file/2012_Final_Report_Water_Sewerage_Price_Determination_Investigation.pdf](http://www.economicregulator.tas.gov.au/domino/otter.nsf/LookupFiles/2012_Final_Report_Water_Sewerage_Price_Determination_Investigation.pdf/$file/2012_Final_Report_Water_Sewerage_Price_Determination_Investigation.pdf).

Tasmanian Liberals. 2013. "Majority Liberal Government to act on headworks charges, create up to 500 new jobs." Accessed November 19, 2013.

<http://michaelferguson.com/2013/10/majority-liberal-government-to-act-on-headworks-charges-create-up-to-500-new-jobs/>.

Tasmanian Parliament. 2013. "Hansard: Wednesday 13 November 2013 – Part 1 – Pages 1-25." Accessed November 28, 2013.

<http://www.parliament.tas.gov.au/ParliamentSearch/isysquery/b8a8810c-03de-4946-a05d-fd66648b565d/1/doc/>.

Tasmania Together Progress Board. 2012. "Tasmania Together Progress Report 2012." Available from:

http://www.tasmaniatogether.tas.gov.au/data/assets/pdf_file/0020/172352/TTPR_2012_Progress_Report_full.pdf.

TasWater. 2013. "Concessions and Rebates." Accessed November 18, 2013.

<http://www.taswater.com.au/Your-Account/Concessions-and-Rebates>.

Western Australian Council of Social Service. 2013. "2013 Cost of Living Report." Available from:

http://www.wacoss.org.au/Libraries/P_A_Cost_of_Living_Cost_of_Living_in_WA_Papers/WACOSS_Cost_of_Living_Report_2013.sflb.ashx.

Wooden, M., and Watson, N. 2007. "The HILDA Survey and its Contribution to Economic and Social Research (So Far)." *The Economic Record* (83: 208-231).