

MICROECONOMICS AT WORK EXERCISE

DETERMINANTS OF AGGREGATE ECONOMIC ACTIVITY

REFERENCE: ‘Let’s pay more for water’ (by Tony Harris), *Australian Financial Review*, 10 December 2002, p.54.

CHAPTER RELEVANT TO THIS EXERCISE: Chapter 2.

OVERVIEW

The main contention of this article (written by a former NSW auditor-general and columnist for the *Australian Financial Review*, and prompted by the recent release of a Senate committee report on urban water management) is that Australian governments have been responsible for ‘massively underpricing’ water. This has resulted in the wasteful use of water by consumers. One measure of the extent of the underpricing is that Sydney Water (the government enterprise charged with supplying water to urban consumers), for example, made a net profit in 2000-01 of just 1.5 per cent of its net assets (this indeed being a further *cause* of waste). The Senate committee was aware of these issues but also expressed some sympathy with the ‘underpricing’ of water because they regarded it as a ‘fundamental necessity of life’.

QUESTIONS

1. Explain the concept of a ‘market price’ of water supplied to urban consumers.
2. How and why have consumers historically been supplied with water at less than market price?
3. How valid is the argument that because water is a ‘fundamental necessity of life’ it should be supplied to consumers at less than market price?
4. Explain the statement: ‘Because Australian governments massively underprice water, it is likely that many consumers are wasting it’.
5. Is the use of water on urban gardens necessarily inefficient or wasteful?
6. What is the significance of the observation that the return to capital (the ratio of net profit to net assets) of Sydney Water was 1.5 per cent? What is the connection between this and the observation that 10 per cent of Sydney’s filtrated water is ‘lost before it reaches customers’?
7. What consequences might you expect from, say, a doubling in the price of water?