

**SUBMISSION TO IPART**

**NSW Water Pricing**

*April 2001*

On 3 April, DLWC made its submission to the *Independent Pricing and Regulatory Tribunal* (IPART) on bulk water pricing for the period 2001/02 to 2003/04. The DLWC submission covers the cost of providing bulk water, *related regulatory services* and *resource management*. Its rationale is:

1. Full cost recovery and the removal of cross subsidies (54% now up to 83% in 2004)
2. Payment by the “*beneficiaries*” of the services (expressed as cost sharing ratios between Government of behalf of the general community and consumers)
3. Changes spread over time, with a maximum increase of 20% per year for the next three years

Current prices recover a portion of the following costs:

- A. DLWC’s total operating costs
- B. A renewals annuity
- C. DLWC bulk water service resource management costs

The submission argues that a portion of the following costs should also be recovered:

- D. A return on new capital investment (7% of the value of replacement and refurbishment expenditure)
- E. An annuity for environmental and safety compliance costs (50% user share)
- F. Water use compliance costs (50% user share)
- G. A share of water management planning and annual implementation programs and reporting (50% share for strategic river management, 70% share for strategic groundwater management)
- H. Metering and monitoring costs for unregulated rivers (90% user share)
- I. Capital costs associated with unregulated and groundwater services (90% user share)

If this pricing schedule is adopted, total costs of \$104.4M would be met by water users (\$56.7M) and Government (\$47.7M). according to DLWC, this still leaves water users \$9.1M short of paying for full cost recovery at the percentage share of costs proposed by the Department.

*We submit that DLWC, in seeking the inclusion of items D. to I. above, is supporting a radical change to the long-established basis of rural water pricing. This involves conferring on water users the status of sole beneficiaries, with a further, almost total erosion of Government community service obligations. With the resultant significant increases in prices, which were not built into the cost of inputs when original investment decisions were being made, it is likely that the viability of significant sections of the irrigation industry will be severely eroded.*

***Water pricing as a mechanism for combating environmental degradation***

The DLWC submission states that a key driver of COAG’s February 1994 Water Reform Framework is “*the need to stem the widespread natural resource degradation caused by inappropriate pricing practices for bulk water*”. It states that “*the economic efficiency argument for ensuring that bulk water prices reflect full costs is equally compelling on environmental grounds*”. Further, “*full cost recovery is an incentive to reduce water extraction*”.

The principle that ecological degradation will be contained by allocating water services to those users who value them most needs very careful consideration. On the surface, it seems to be reasonable if community aspirations are not taken into account. However, most irrigation industries

tend to be cyclic in their profitability, but can only produce if they undertake the necessary capital expenditure. The infrastructure of one industry is not easily transferable to others, and locational suitability is also a determining factor. The concept of efficient water use through pricing mechanisms requires that water should be very mobile, whereas in practice there are considerable constraints in this regard.

To illustrate this, the following case study provides some insight.

*Changes associated with the phasing out of the tobacco industry on the Upper Macintyre & Dumaresq Rivers & Macintyre Brook, & the downstream development of the cotton industry*

The tobacco industry was moderately profitable for many years. Since its demise, viable alternatives have been hard to find. This is due to a combination of circumstances including infrastructure, scale of production, availability of capital, markets, technical expertise and support services. However, slow progress is being made with diversification into peanuts, various field crops such as corn, pumpkins, melons and potatoes grown on contract, and an embryonic move into permanent plantings of stonefruit, apples and grapes. High tech centre pivots and drip are gradually replacing the old flood and hand-moved sprayline systems, so that water use efficiency is improving and the cost of inputs is being contained. Given time, the area has a high chance of developing into successful horticultural production with a "clean green" image providing a significant market advantage. However, if water price increases outstrip the growth in profitability, the opportunity will be lost.

The cotton industry downstream, from which a profit can still be made in most years, has been acquiring most upstream allocations that become available. In the extreme case, all upstream water would move downstream. The emerging potential would be lost, there would be less farmers with reduced profitability through being confined to dryland activities, and towns such as Inglewood, Texas and Ashford would experience serious decline. Residents have clearly indicated that they are opposed to having this happen at all costs.

Similarly, cotton is not without its problems. At \$A500 per bale and the dollar at 50c US, the cost of production is 2.2 bales per acre, compared with an average yield of 3 bales. There is a potential profit of some \$400 per acre.

If the dollar rose to 80c US, the return per bale would be \$A312, with the cost of production now being 3.5 bales. A profit of \$400 per acre becomes a loss of \$250 through currency fluctuation alone. There are several other variables, among them:

- the price in \$US, which is often lower than it is now
- the banning of ULV endosulfan which requires the use of more expensive insect control
- the cost of increasingly stringent environmental management
- and of course, the price of water

If cotton loses its gloss, and there are no other broadacre alternatives, it is doubtful whether the water would move back upstream in the short term, because the impetus will have been lost, the infrastructure gone, and the potential irrigators moved away.

The dynamics of the above situation, which is not an isolated case, indicate quite conclusively that the pure economic rationalist approach as a tool for environmental protection is not appropriate for bulk rural water supplies.

*We submit that water pricing must not be used as a tool for combating environmental degradation. There are other existing methods for achieving this in its own right, notably extraction limits (caps) and flow management planning.*

***Separation of the operational and resource management/regulatory functions***

The submission states that, in response to the COAG framework, the establishment of State Water as a separate commercial business unit of DLWC has separated operational functions from resource management and regulation. This is claimed to minimise conflicts of interest, and achieve increased operational efficiency and greater accountability.

It is manifestly obvious that DLWC is still fully in control of State Water, and intends to keep it that way. The Department has not established transparent service agreements with State Water for the collection of monies and the delivery of services relating to its resource management and regulatory functions. It does not permit State Water to operate an autonomous set of accounts; revenue and costs are handled through the central DLWC accounting system. There is no transparency with regard to the Government's payment of community service obligations (CSOs). It is impossible for State Water to operate realistic accounts for each valley, but this is the base unit for water pricing.

*We submit that State Water must be separated entirely from DLWC so that it is no longer under the direct influence, if not control, of the regulator.*

***Recovery of the ongoing strategic management and compliance costs for rivers and groundwater***

This has been paid for over the last four years by the NSW Government through the water reform package. It is now proposed that surface water users pay a 50% share of water management planning and implementation costs because "long term sustainability of this environmental resource" is of direct benefit to them. This includes unregulated users, for whom "services have expanded under the water reform package". Unregulated users will also be expected to pay 90% of unregulated river metering and monitoring costs. For groundwater users, a 70% share of the cost of groundwater strategic management is proposed.

It can equally be argued that the benefits of long term resource sustainability transcend by far the direct benefits to users. Just as roads, bridges, railways, ports etc were established to facilitate commerce and trade for the public good, dams and other water supply infrastructure were established by Government as a regional development initiative. Until recent times, users were not required to contribute in this area. To make them do so from now on is a regressive measure that has very serious consequences for the role of future Governments in establishing supportive environments for citizens to go about their business. To take this debate to its logical conclusion, are we to pay tax of various sorts AND pay for all individual services from Government on top of this?

Water users did not request the widespread and complex resource management activities that are now taking place. Many of us are, however, contributing to the detriment of our businesses, and often in our own time and at our own expense. In general, there is an unsatisfactory level of information and analysis informing the debate, the processes being used are dysfunctional, and, where outcomes are being achieved, they are questionable. It is a frustrating process for those involved, and now we are being asked to pay for the privilege of our participation. No-one wants to be there, but we are deeply concerned about the consequences of our absence. People with a variety of motives would then be making decisions about water use when, as non water users, they really know nothing about it.

In our view, the role of Government is to maintain professional natural resource management agencies whose staff are well trained, experienced in the real world, and have a balanced approach which is informed by effective consultation with stakeholders. The planning could be done in a much more efficient and cost-effective way, with widespread acceptance of the results. As it stands, Government is leading us into an expensive, ineffective planning process that will not result in

widespread community acceptance and support. There is little wonder that we don't see the value or equity in contributing to the cost.

*We submit that the cost of ongoing strategic management and compliance should be borne by Government on behalf of the whole community, because it is they who are the beneficiaries. By their productive activities, water users are accruing benefits for the community which would otherwise be unavailable from any other source.*

### **Bulk water costs**

These are made up of operating costs and asset costs. The latter involve:

- A renewals annuity of State Water infrastructure assets
- A compliance annuity for other components of the infrastructure reflecting costs associated with raised standards and environmental requirements
- A renewals annuity for Border Rivers Commission assets
- Depreciation charges for other DLWC bulk water and State Water assets
- A return on capital for State Water assets acquired since 1 July 1997

For the Border Rivers, the costs are shown below.

<b>Item</b>	<b>Regulated River</b>	<b>Unregulated river</b>	<b>Groundwater area</b>	<b>Total</b>
Total bulk water costs 2003/04	3,067,000	248,000	154,000	3,470,000
Bulk water full cost recovery revenue 2003/04	2,155,000	143,000	114,000	2,412,000

Our major points of contention lie with:

- A justification of operating costs:
  - We have not been supplied with a satisfactory explanation of how direct valley costs have been derived, and the apportionment of head office and regional costs
  - We have not had the opportunity to discuss this in detail with DLWC or State Water
- The compliance annuity:
  - Standards (eg dam construction for one in a million year floods established by the Dam Safety Committee) often bear no relation to commercial risk profiles, and if adopted, should be paid for by Government
  - The cost of environmental requirements imposed by Government for reasons other than sustainable production should not require a user contribution
- The rate of return:
  - This is contrary to the principle of public infrastructure for public good, and does not recognise the flow-on benefits of irrigated agriculture to communities, States and the nation
  - The money raised would disappear in the "black hole" of consolidated revenue, and not be accrued and used for future irrigation infrastructure development

*We submit that:*

- *Bulk water costs have not been justified for the Border Rivers, partly because accurate valley-by-valley accounting is still beyond the capacity of DLWC*
- *Inclusion of the compliance annuity and a rate of return is manifestly excessive and unfair*

### **Proposed bulk water prices**

Higher prices are proposed by DLWC to be progressively phased in over the three year period. Maximum increases would not exceed 20% per annum. Tariffs would be adjusted for inflation in 2002/03 and 2003/04 according to annual CPI increases.

**Proposed regulated prices for the Border Rivers**

2000/01		2001/02		2002/03		2003/04					
Fixed charge		Usage		Fixed charge		Usage					
High	Low	High	Low	High	Low	High	Low				
4.53	3.03	3.53	4.84	3.32	4.25	5.16	3.62	4.97	5.47	3.91	5.69

Average fixed increase 9% pa, average usage increase 17% pa

**Proposed unregulated prices where there is no metering and monitoring**

<i>Entitlement charges (\$/ML) – no metering and monitoring</i>		
2001/02	2002/03	2003/04
2.23	2.68	3.21

Average increase 20% pa

**Proposed unregulated prices in valleys with metering and monitoring**

<i>Two part tariff in valleys with metering and monitoring (\$/ML)</i>					
2001/02		2002/03		2003/04	
Entitlement	Usage	Entitlement	Usage	Entitlement	Usage
1.23	1.00	1.47	1.20	1.77	1.43

Average fixed increase 20% pa, average usage increase 20% pa

**Proposed groundwater prices**

<i>Two part tariff (\$/ML)</i>					
2001/02		2002/03		2003/04	
Entitlement	Usage	Entitlement	Usage	Entitlement	Usage
0.50	0.25	0.60	0.30	0.73	0.36

Average fixed increase 20% pa, average usage increase 20% pa

With these levels of increase and no clear indication as to when full cost recovery would be reached, water users are faced with many years of price increases at levels greatly above the increase in the cost of other inputs. It can be predicted with a high level of certainty that commodity prices will not rise accordingly. Thus the potentially devastating erosion of margins will continue. Water use will decrease as people leave the industry, and prices will have to rise again in a self-perpetuating cycle.

If the agenda of the Government is to reduce extractions, then the current water pricing philosophy is well on the way to achieving this. Unfortunately, it will also reduce employment, gross domestic product, export income and the viability of rural and regional communities. As the primary managers of the land, rural producers will not generate sufficient profits to invest in good land management practices. The Government's objective of achieving sound environmental outcomes will fail.

*We submit that this is a critical issue for Australia. It must be debated comprehensively in the national interest. Never before has there been such a continuously high level of alienation of the people of rural and regional Australia from their Governments. It is one of a number of seemingly innocuous issues; Governments will treat it lightly or ignore its consequences at their peril.*

**CONCLUSION**

With regard to water pricing, the people who make the critical decisions are Minister Amery, Director-General Bob Smith, and Deputy Directors-General Susan Kemp and Chris Guest. It is obvious that their thinking is being heavily influenced by COAG and National Competition Policy, which are once more showing how detrimental they can be to rural and regional businesses and

communities. In fact, “*irrigation West of the Divide was never set up for full cost recovery*”. The real danger is that the industry, or at least important segments of it, may not be able to survive its imposition. The potential fallout from this is compounded by the threat of reductions in access through the other elements of the water reform process and the Murray-Darling Basin caps.

*We strongly oppose the DLWC submission. There is now a real concern that the Government’s agenda is to put the irrigation industry, or at least significant sections of it, out of business. This can only be to the long term detriment of rural and regional Australia in particular, and the whole country in general. We urge IPART to take a big picture view in determining overall community benefit.*

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