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**MIA COUNCIL OF HORTICULTURAL
ASSOCIATIONS**

SUBMISSION TO

**IPART REVIEW OF BULK WATER
PRICING 2001/02 - 2003/04**

Response to:
Department of Land & Water Conservation
Submission (April 2001)

11th May 2001

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Executive Summary

- That the Council of Australian Governments water reform initiatives form a package of reforms underpinned by the introduction of tradeable property rights to water. Water pricing change should only follow the introduction and implementation of secure tradeable property rights to water as well as an adequate response from DLWC in regard to **IPART**, **NCC** and **CoAG** requirements for reforms in the areas of efficiency, transparency, consultation and institutional reform.
- Horticulture Council proposes that all beneficiaries of water management be identified and included in cost distribution analysis.
- a Horticulture Council feel that it is clear that State Water is not actually separate from DLWC, and believe that for NSW to comply with it's obligations under the national reform agenda, State Water should be separate from the rule setter.
- It is necessary to improve the efficiency of water service delivery before considering cost recovery. Simply increasing prices to cover inefficiency and then later introducing reforms to improve efficiency and lower costs would generate unnecessary and unacceptable economic and social costs.
- Horticultural Council maintains that water distribution pricing is not the appropriate mechanism to bring about improved efficiencies and environmental reform.
- Given some responsibility, appropriate support and appropriate reform to achieve a free and open water transfer market, it is clear that the irrigation industry will embrace environmental reform without the need for the heavyhanded approach that some would suggest is necessary.
- The water reform process has been initiated by the State Government and is clearly part of the core funding responsibility of government.
- That the DLWC request for the implementation of positive rate of return on water user funded capital investment should not be granted in regard to capital items financed through bulk water charges.
- That **IPART** set an interim-pricing regime for twelve ~~months~~ to enable the implementation of the NSW Water Management Act, which will define irrigator entitlements for a ten-year period, and to enable DLWC to meet **CoAG** and **IPART** requirements in terms of efficiency, transparency, consultation and institutional reform,
- It is the belief of Horticulture Council that a full socio-economic impact assessment needs to be carried out prior to any decision being made on future water prices. Of necessity this should include close consultation with relevant industry representatives and **CSC's**.

1. Introduction

The MIA Council of Horticultural Associations is the peak body representing approximately one thousand horticultural growers in the Murrumbidgee Irrigation Areas and Districts.

The area of horticulture under production is 22,000 ha and total water allocation is 264,000 ML. Predominant crops are citrus (80% of NSW total production), wine grapes (60% of NSW total production) and prunes (60% of NSW total production).

Horticultural production in the MIA is estimated to have a farm gate value of \$127 million, produced from the twenty two thousand hectares of plantings. Wholesale value of the industry is estimated at \$460 million. Average annual water consumption of the industry is approximately 70,000 to 90,000 ML of High Security water per annum, dependent upon seasonal variations.

As a peak body for horticulture in the MIA, the council has a strong commitment to the sustainable management of our natural resources. Horticulture Council aims to;

- Promote the long-term sustainable development of irrigated horticulture in the MIA.
- Promote and develop the image of horticulture as a professionally oriented and conducted business.
- Play a central role in the development of policy and the resolution of problems; and facilitate the uptake of innovations so that best development takes place, having regard to prosperity, health and care for the environment.

2. Overview

Horticulture Council would like to thank the tribunal for the opportunity to make comment in regard to the upcoming review of bulk water pricing in NSW.

We have a range of specific concerns in relation to the submission, put forward by the DWLC, which we have outlined later in this document. On a more general level, however, we would particularly highlight the lack of consultation from DLWC with Customer Service Committees during the development of their submission. We were of the understanding that CSC's were set up to enhance the level of communication between water users and State Water (DLWC), and to ensure water user contribution to policy and the decision making process. We believe that the lack of consultation with water users has led to the development of a range of principles and decisions on proposed activities that are significantly flawed.

3. Specific Comments in relation to DLWC Submission to IPART in April 2001

3.1 Pricing Framework

3.1.1 Compliance with CoAG's Strategic Water Reform Framework

Institutional Reform/Property Rights

Horticulture Council note with interest the submission's reference to the DLWC's "commitment to the CoAG water reform process". Also clearly outlined within CoAG guidelines is the requirement for the implementation of secure property rights to water and requirements for reform in the areas of efficiency, transparency, consultation and institutional reform of bulk water service delivery. We would query DLWC's commitment to these aspects of CoAG reforms and would suggest that it rather 'picks and chooses' those aspects of the reform process which suit it. It is clear to the irrigation community that the selective use of CoAG recommendations will continue in

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favour of the implementation of revenue raising devices, before any real attempt is made at true water reform.

The Murray-Darling Basin Ministerial Council approved a timetable for water market reforms on March 24th 1994. This timetable identified a number of key water reforms including the implementation of defined and secure property rights. The suggested completion date for this process was 1st July 1996. The NSW Government stresses the urgency of all other water reforms as being a requirement of the CoAG timetable, yet it appears acceptable that property rights is not treated with such urgency.

Recommendation: That the **Council** of Australian Governments water reform initiatives form a package of reforms underpinned by the **introduction of tradeable property rights** to water. Water **pricing** change **should** only follow the **introduction and implementation** of secure **tradeable** property rights to water as **well** as an adequate **response** from **DL WC** in regard to **IPART, NCC** and **CoAG requirements** for **reforms** in the areas of **efficiency, transparency, consultation** and **institutional** reform,

3.1.2 Medium Term Pricing Proposal

Beneficiary Pays

The 1998 Determination (pages 29 and 30), is confusing in that it submits that the general community is the primary beneficiary of water reform, however bulk water users should be called on to meet costs which result from additional obligations flowing from reform. This appears inconsistent with the adoption of beneficiary pays principles.

We **submit** that it is entirely consistent to **recognise** that current irrigators should not be called on to meet the present costs of fixing outcomes of past Government programs, including expansion in water use, development and production. They should equally not be called on to meet costs that are more appropriately apportioned to the benefit of future generations.

This submission notes that the Tribunal (1998 Determination page 25), **recognised** that current and future (*community*) generations would enjoy longer term benefits from sustainable resource management. On that basis, the Tribunal preferred beneficiary pays as a more practical way of sharing costs of bulk water services.

The impacts of the new regime of environmental flows, which are either in place or planned for all valleys, including winter releases of storage inflows for non irrigation purposes, has not been addressed in any comprehensive manner in the price reform process undertaken by the Tribunal.

The new regime clearly means less water available for irrigation diversion, and thus less water available on which costs apportioned to irrigators can be recovered. Under the Tribunal process the parties had a prior determination on cost shares, and in many instances the cost shares reflected access shares relevant to pre regime conditions.

As outlined in a NSW Irrigators' Council publication "Benefits of Irrigation and Rural Water Use in the Murrumbidgee", October 1995 there are a range of benefits, and beneficiaries, of water regulation, other than just irrigators. The publication points out that rural water and irrigation infrastructure provides assured water supplies and provides significant benefits to a whole range of 'quality of life' issues for the community. Particular positive aspects include (but are not limited to);

- Creation of major recreational assets, in the form of storage lakes and, on a lesser scale, the permanent pools above regulating weirs;

Assured water supplies for agriculture and industry, resulting in economic and social stabilisation of rural communities; employment opportunities in agriculture, commerce and industry, the generation of positive and progressive community attitudes to local development;

- A more diversified and assured supply of agricultural produce for national markets associated also with more stable prices for such products
- A marked contribution to regional development and population decentralisation;
- Controlled use of water for environmental enhancement;
- Flood mitigation benefits;
- Facilitating construction of town water supply and sewerage schemes in rural centres and improving reliability of supply;
- Power generation facilities using water released from storages for downstream use with the corresponding saving in the use of fossil fuels.

Recommendation: **Horticulture Council** proposes that all beneficiaries of water management be identified and included in cost **distribution analysis**.

3.2 Bulk Water Operations

In our opinion IPART has been misled by the Department's apparent willingness to segregate the water business from other operations. Irrigators in this valley have consistently put the proposal to IPART that separate valley management is the only way in which we will be able to define the boundaries and get control of the costs.

State Water has simply created another layer of bureaucracy along with the overheads that naturally follow. At every step in the process an administrative / overhead charge is added to the equation.

IPART expressed concern at previous hearings that not every valley was in a position to consider the separation at this point in time. The fact is that not every valley needs to be separated at once. There is absolutely no reason why each valley cannot separate from the State Water business as expertise system that existed ten years ago.

Horticulture Council would also query the DLWC commitment to achieving efficiency levels. As water users we are not confident that we are not being 'over serviced' or charged for services we do not require. Nor are we confident that we are paying for it's being delivered efficiently.

Recommendation: **Horticulture Council** feel that it is **clear** that **State** Water is not **actually** separate **from DLWC**, and **believe** that for **NSW to comply** with it's **obligations** under the **national** reform agenda, **State** Water **should be separate** from the **rule** setter.

Recommendation: **It is necessary to improve the efficiency of water service delivery before** considering cost recovery, **Simply** increasing prices **to wver inefficiency** and then Jater **introducing** reforms to **improve efficiency** and Lower **costs would** generate unnecessary and **unacceptable** economic and **social costs**.

3.3 Resource Management

We would refute suggestion that the implementation of full cost recovery will contribute to the achievement of ecological sustainable outcomes. The most likely outcome of the implementation of higher bulk water prices would be to further reduce farming businesses profit margins (already suffering under low commodity prices for citrus and lowering returns for wine grapes) thereby threatening irrigators' financial capacity to implement, often expensive, on-farm water use efficiency measures.

It is not fully appreciated by the external critics that the impost on irrigators of additional resource taxes through the bulk delivery charge will directly affect their ability to fund **onfarm** environmental works. It is agreed that there is a need to address wider catchment issues. However, the on-farm works are absolutely critical if we are serious about achieving **longterm** sustainability of the Murray-Darling Basin.

Both the Government and the communities throughout the State have committed vast amounts of resources and capital to the formulation of Land and Water Management Plans. These plans will serve as the blueprint for sustainable production over the next thirty years.

The MIA & Districts Land & Water Management plan was finalised late in 2000 after almost eight years of exhaustive study into all environmental, social and economic issues. There is no doubt that the plan will in some cases prescribe significant changes to current practices, usually at significant cost to individual irrigators. With relatively low levels of government subsidisation for horticultural on farm activities, further reductions in profitability resulting from increases in bulk water prices will further reduce the likelihood of success for this strategy

Non-discriminate price increases for water distribution, which bear no relationship with the efficient costs of delivery, will directly affect the ability of irrigators to change **onfarm** management practices/systems that aim to increase water use efficiency.

Within the MIA, horticultural irrigators have been increasing water use efficiency despite public misconceptions that the irrigation industry is wasteful with a scarce resource. Areas under permanent horticultural production in the MIA are currently approximately 22,000 hectares. **ABS** data from 1992/93 indicated an area of 12,000 hectares under production. During this period of horticultural expansion total water consumption in the **industry** has actually reduced from an average of 95,000 ML per annum to between 75,000 and 90,000 ML per annum, suggesting outstanding improvements in water use efficiency, almost wholly funded by horticulturists themselves.

Leading international water economists have also discredited the theory that increasing water price leads to improve water use efficiency.

A paper presented by Ian Carruthers - University of London - to the FAO Conference on water charges held in Rome (1986) contained the following comments -

"First and foremost irrigated agriculture has to be profitable to farmers. Increasingly it seems likely that Government induced economic distortions will be reduced but they are unlikely ever to be eliminated. In many situations irrigation is becoming more profitable because of innovation in irrigation itself and the complementary advances in agricultural technology. This will continue with scientific progress. Not all irrigation projects are likely to be profitable. In many arid zones a backlog of investment including rehabilitation needs, land levelling and a lack of drainage is likely to preclude profitable irrigation. In such circumstances major change to increase farmer payback is likely to fail. This does not necessarily mean that the project should be phased out. Irrigation might still be the least costly development investment. Unprofitable schemes may be accepted

for complex but legitimate social and political reasons. In any event, the least-cost system of ensuring effective if not efficient irrigation of good and bad schemes is likely to require profits for the farmers. Furthermore, waste will be minimised if farmers have high value-in-use for irrigation water. It is high value water not high cost water that prevents waste. Farmer profitability is thus the first criterion for success.

Horticultural Council proffers the view that the temporary and permanent transfer market (non-corrupted) will drive water use efficiency. As water becomes scarcer, and its capital value increases, the incentives for reducing water use will be created by the potential value of water savings on the transfer market. This view is supported by CoAG reforms, which state that ***"The major goal of water resource management is to achieve the highest and best value of the limited resource for community benefit whilst ensuring that use of the resource is ecologically sustainable"***.

Dr Roy Green, President of the Murray Darling Basin Commission appears to support this principle when making the following statements regarding the MDBC Cap, in a presentation to a recent Queensland Farmers Federation Conference, ***"The Cap also means that increased water efficiency to make the best use of a scarce resource by the irrigation industry is vital. Investing in water use efficiency gives returns to users through reduced cost of water, and also the potential to raise funds by trading any excess water saved through improved efficiencies"***

He goes on to state that ***"Given that the water resource is highly committed in the Basin, the only way that enterprise growth can occur is via a water market. This will enable water to be delivered to its most productive use. At the risk of sounding like an economist, the existence of a water market exposes the opportunity cost of water. Is the water more valuable in producing a crop, or not being fully used in a certain year, or is it more valuable as a traded commodity? A well-developed water market means that landholders can decide whether to use, sell or buy water. The price fluctuates according to supply and demand. With more efficient use of water via improved irrigation technology and water distribution, there is then potential to further realise the economic value of water, by trade."***

It must be noted that there is a need to distinguish between the capital value of water and the cost of distribution of that water. This distinction is critical when considering mechanisms for driving improved efficiencies.

Recommendation: Horticultural Council maintains that water distribution pricing is not the appropriate mechanism to bring about improved efficiencies and environmental reform.

Recommendation: Given some responsibility, appropriate support and appropriate reform to achieve a free and open water transfer market, it is clear that the irrigation industry will embrace environmental reform without the need for the heavy-handed approach that some would suggest is necessary.

It is somewhat ironic that the DLWC is charging water users for the development and implementation of policies and programs that are designed to take more water away from consumptive use and back to the environment.

Clearly the water reform process has been initiated by the State Government and therefore is part of core responsibilities of the DLWC. If they consider that past management of the allocation system was inadequate then they have a responsibility to fix it using their own resources not those of the water users.

As normal, DLWC have provided absolutely no breakdown of the water reform costs. We are aware of some of the programs being funded from the package and frankly they represent an absolute waste of valuable resources.

Recommendation: *The water reform process has been initiated by the State Government and is **clearly** part of the core funding **responsibility** of government.*

3.4 Costs & Revenues

Positive Real Rates of Return

Reference to positive real rates of return are confusing given that the previous reference to the requirement for full cost recovery, including capital expenditure, which would mean that the investment in the infrastructure will come from the users through the bulk water pricing structure

The issue which needs to be raised in respect of this unreasonable claim include is the total lack of justification for charging a rate of return when users provide the funds up front via an annuity and the account is in credit i.e. no government funds are required.

The Tribunal has proposed (1998 Determination, page 2 especially), that future prices will include a commercial return on any new investments. Irrigators agree that those who receive the service and request the asset should pay, but only once.

In terms of the current push to seek a rate of return on new investments, it is necessary to seek out who is providing the capital, otherwise comparison with competitive economic entities is unsound.

DLWC claims that they must be expected to consider the opportunity cost of funding refurbishment or replacement of assets into the future..

In the case of new or replacement irrigation infrastructure, there is no argument that if NSW Treasury is providing the capital, then, an appropriate return on the capital is appropriate.

We submit however, that if irrigators fund replacement costs of existing assets, then any rate of return is effectively a rate of return on those same sunk assets. We also submit that the replacement and refurbishment of infrastructure assets to meet levels of service negotiated with customers is cyclical and ongoing. Irrigators have committed to meeting this efficient cost. The only issue is whether they meet it up front or in arrears.

However in determining what rate of return is appropriate, it is necessary to again review the work in the SCARM report, that there is a general misconception that in respect of full cost recovery, opportunity cost is in addition to finance charges. It clearly is not.

Again the SCARM Report commentary is consistent with the proposition that if irrigators provide funding for new investments, irrespective of whether it is prospective or retrospective through debt repayment, then either an economic rate of return or the finance charges should be paid for but not both.

And it is also argued that there is no economic imperative to seek alternative capital use comparisons, as the irrigator funds would not be available for alternative use and so no return is appropriate.

We conclude that if the current annuity includes due credit for interest earned on irrigator contributions to annuity reserves, and debit for interest charged on funds borrowed for replacement or new works, then the annuity includes the only valid rate of return.

Recommendation: That the **DL WC** request for the **implementation** of positive rate of return on water user funded **capital** investment should not be granted in **regard** to **capital** items financed through **bulk** water **charges**.

3.5 Proposed Bulk Water Prices

In NSW some (limited) progress has been achieved through the development of the NSW Water Management Act, in regard to the implementation of property rights. It is essential that this be in place prior to any attempt to set long term determinations on bulk water pricing.

Although the development process for the Act is now complete, the implementation of its measures is certainly not. Until such time as irrigators are faced with a period of some certainty in terms of irrigation supply, it is impossible to attempt any definitive setting of bulk water pricing for a three-year period. It is anticipated that by December 2001, water-sharing plans will be in place in the Murrumbidgee valley, which should give irrigators a period of 10 years of some surety, with compensation payable for any further reductions in allocations during that period. Only once this plan is in place would it be appropriate to review water-pricing issues for the longer term.

We would further recommend that any long-term plan for the application of increases in water prices, would be premature until the DLWC complies with IPART requirements in the areas of efficiency, transparency, consultation and institutional reform. IPART has also previously recommended the implementation of benchmarking, performance indicators, service agreements and contestability.

Recommendation: That **IPART** set an interim-pricing regime for twelve months to **enable** the **implementation** of the **NSW Water Management Act, which will** define **irrigator** entitlements for a ten-year **period**, and to enable **DL WC** to meet **CoAG** and **IPART requirements** in terms of efficiency, transparency, **consultation** and **institutional reform**.

3.6 Impact Assessment

There is no clear assessment of the expected impact of DLWC pricing proposals on irrigators, who are involved in the production of a broad range of irrigated product. There appears to be no account taken of the current citrus industry crisis in NSW with citrus growers attempting to compete against cheap imports of Brazilian citrus concentrate. Growers are unable to afford to even pick a large quantity of the Valencia crop from 00/01 with prices received averaging \$70/t and picking costs also equally \$70/t. Picking costs are in addition to the large range of other costs of production. There is also no acknowledgement of the sharp drop in wine grape prices in the MIA, of up to 50% for some varieties, over the last two years.

There is a real question of ability to pay in regard to proposals to increase bulk water charges over the next three years. The Pricing Tribunal must seriously consider whether or not the social cost of the creation of economically depressed regions is an appropriate price to pay for increased water use efficiency.

Reduced agricultural viability resulting in higher unemployment rates would generate social costs and would also shift costs to State and Federal government, including additional welfare costs, higher policing costs through social disruption, additional housing support and so on.

Recommendation: It is the **belief** of **Horticulture** Council that a **full socio-economic** impact assessment needs **to** be carried out prior to any decision being made on future water **prices**. Of **necessity** this **should include close consultation** with **relevant** industry representatives and **CSC's**.