

Introduction

NSW Irrigators' Council welcomes the opportunity to comment on the Draft Report on Bulk Water Prices prepared by IPaRT and recognises the fact there has been a number of significant policy shifts in the Report.

The annual cap of 15% on real price increases for bulk water from regulated rivers is welcomed as is the acknowledgment that the majority of regulated valleys will be at or close to full cost recovery at the end of the three year pricing structure.

IPaRT's acknowledgment of the inadequacy of the information provided in the initial DLWC submission is reflected in the price increases that were largely based on information provided through the independent consultants – PricewaterhouseCoopers and ACIL Consulting. In NSW Irrigators' Council's opinion there are a number of issues that have not been addressed in this regard particularly the DLWC commitment to implementation of internal benchmarks and identification of efficient costs – *without transparency there can be no accountability.*¹

NSW Irrigators' Council expressed a view in its initial submission that it supported an interim Determination from IPaRT to allow for the implementation of a Working Group to deal with a number of outstanding reform issues. NSW Irrigators' Council acknowledges that some of these matters have been dealt with in this Draft Report but also believes that further work is required in this area, particularly on the implications of the 'impactor pays' principle and we have suggested a preferred way forward on this issue.

¹ A S Watson, *Conceptual issues in the pricing of water for irrigation*, 1995, p.67.

Timing of Determination

NSW Irrigators' Council notes that IPaRT have indicated that this Determination will take effect on 1 October 2001. Given that this will necessitate two billing runs (and administratively for State Water could cost more than is actually collected) then NSW Irrigators' Council recommends that this Determination take effect on 1 July 2001.

Incentives for Ongoing Delivery of Efficient Costs

IPaRT have undertaken a review of DLWC's performance in relation to the information requirements for a medium term pricing path outlined in previous Determinations. NSW Irrigators' Council does not concur with a number of the conclusions reached by IPaRT² and is also concerned that IPaRT has placed too much faith in DLWC's commitment to implementing internal efficiencies on an ongoing basis.

*"That work is ongoing, and the Tribunal expects that DLWC will issue State Water with an operating authority and a water access authority, effectively ring fence State Water's operations from rest (sic) of DLWC and establish sound, transparent service agreements between State Water and DLWC."*³

NSW Irrigators' Council reiterates its original position that IPaRT should list State Water as a standing reference in Schedule 1 of the Independent Pricing and Regulatory Tribunal Act (1992) in order to allow for an annual review and critical assessment of DLWC compliance to previously established efficiency standards and outcomes.

DLWC have indicated through their past responses to IPaRT Determinations that they will undertake only the minimum requirements (at best) to satisfy their obligations and seem unwilling to align their 'wish list' of services that they submit to IPaRT with their actual annual performance.

Legacy Costs Principle

NSW Irrigators' Council endorses the principles of 'legacy versus forward looking costs' as proposed by IPaRT in the Draft Report. We also agree that previous cost allocation attempts were a hybrid approach of 'impactor pays' and 'beneficiary pays' principles and that the cost allocation process required greater clarity. However, the question must be raised about the emergence of 'new information' and why irrigators/water users should continue to be held responsible for poor decisions of the past.

There are two specific elements of the new approach that require mention as indicated below.

For example, poor management practises in the past have seen insufficient maintenance carried out in the prior years which means that present bulk-water users may have been asked to pay for corrective rather than preventative maintenance. The

² NSWIC, *Submission May 2001*, Appendix 1.

³ IPART, *Draft Report on Bulk Water Prices*, October 2001, p.7

Tribunal does not intend to charge current bulk-water (sic) users for these costs that are a legacy of previous inefficient maintenance practise.

Where the community wishes to raise standards above the levels set a 1 July 1997 the Tribunal believes that bulk water users should not be burdened with increased costs that are a legacy of a change in community standards. Similarly, if DLWC undertook work to repair the environment to a standard above that of 1 July 1997 the Tribunal believes these costs should not be borne by bulk water users but by the community generally.⁴

Having stated a position on this matter NSW Irrigators' Council does have some concerns about State Water's works programs and the administrative implications of cost allocations under the legacy cost approach.

Impactor Pays Principle

The proposed 'impactor pays' principle suggested by ACIL and adopted by IPaRT for the purposes of this draft report is not clearly defined nor are the implications clearly enunciated by either IPaRT or ACIL.

NSW Irrigators' Council is concerned that because of the ambiguity in the ACIL definition and their reliance on water management committees as the decision-making forum then it is most unlikely that the cost allocation issue will be successfully resolved before the next pricing determination in 2004. Without a clear pathway and understanding irrigators/water users could face significant price increases from 2004 onwards.

NSW Irrigators' Council urges IPaRT to recommend, as part of its Determination, the formation of an 'implementation working group' which would include all legitimate stakeholders – DLWC, State Water, NSW Treasury and irrigators. This group would be charged with examining the implications of the 'impactor pays' principle on the State Water works program, the TAMP and the allocation categories proposed by ACIL and would be responsible developing a negotiated outcome to subsequent pricing Determinations.

The 'impactor pays' principle also raises some interesting issues for irrigators/water users when attempting to deal with (and pay the impact cost of) broader catchment problems such as dryland salinity.

Water Property Rights

The adoption of an 'impactor pays' approach to cost sharing arrangements for natural resource management also raises the vexing issue of property rights. NSW Irrigators' Council would argue that the issue of property rights has not been adequately resolved in NSW.

The NSW legislative framework (Water Management Act 2000) has been put in place with a compensation clause that provides for 'buy-back' of water for the term of the relevant Water Management Plan (10 years) with no compensation available if a

⁴ IPART, *Draft Report on Bulk Water Prices*, October 2001, p.31

subsequent ten year plan diminishes that entitlement (or if water is lost prior to the signing of the current plans).

Little progress has been made in NSW on the definition and implementation of secure water property rights for users, which provide for security of the asset (no asset removal or impairment without government commitment to 'buy-back') and security over the asset (via a register and adequate description of the asset). It is also apparent that the NSW Government wants to ensure adequate allocations to the environment before implementing a property rights regime that will adequately deal with compensatory measures for any future diminution of those rights.

The Productivity Commission in a staff research paper stated that the clarification of property rights is an important step in determining whether the 'impactor pays' or 'beneficiary pays' principle should be adopted as the basis for cost sharing.

If property rights are well-defined – such that individuals have a responsibility to ensure a certain environmental standard – failure to meet that standard breaches this responsibility and may be considered to impose external costs on the community. In principle, the 'impactor pays' principle should be adopted to internalise external costs and promote efficient outcomes.⁵

Adoption of the 'impactor pays' principle in this case effectively implies a change in property rights.⁶

While the 'impactor pays' principle can be used to internalise the costs of biodiversity loss, governments may choose not to apply it in all cases because:

- *it may not be technically possible or cost effective to identify and charge impactors...*
- *adoption of the 'impactor pays' principle is considered to impose excessive burdens on resource users⁷*

NSW Irrigators' Council welcomes IPaRT's acknowledgment (through the adoption of the 'impactor pays' principle) that water property rights need to be strengthened in NSW. The fact that this issue is not specifically mentioned by IPaRT in its Draft Report is a glaring omission and should be acknowledged in the Final Determination to ensure the proper implementation of the 'impactor pays' principle (or sufficient caution with pricing if adequate rights are not in place).

It is disappointing that the assumption made with the 'impactor pays' principle is that all impacts from irrigators/water users are negative. NSW irrigators are currently in the process of finalising water sharing plans for their valleys that clearly identify and provide for additional environmental flows. The cost of these additional environmental flows are being borne by irrigators/water users, yet this is not recognised either by ACIL or IPaRT.

⁵ Productivity Commission, *Cost Sharing for Biodiversity Conservation: A Conceptual Framework*, 2001, p.25

⁶ Productivity Commission, *Cost Sharing for Biodiversity Conservation: A Conceptual Framework*, 2001, p.26

⁷ Productivity Commission, *Cost Sharing for Biodiversity Conservation: A Conceptual Framework*, 2001, p.28

Cost Recovery

NSW Irrigators' Council notes that the proposed price increases will result in an increase in the level of cost recovery from 61% in 2001 to 73% in 2004 but seeks clarification as to whether these are total costs or assigned costs. Quite obviously, the level of recovery in regulated valleys will be significantly higher and in some cases will be close to full cost recovery based on the cost recovery framework IPaRT have adopted.

NSW Irrigators' Council is concerned that the issue of full cost recovery, whilst it has been identified by CoAG as the centrepiece of its reform agenda, will continue to be driven by forces other than economic. This scenario is increasingly likely under the 'impactor pays' principle adopted by IPaRT in its Draft Report.

As a principle, NSW Irrigators' Council is not opposed to the concept of full cost recovery provided that its implementation is based on a clearly defined policy that includes a full assessment of the benefits and costs of such a policy and that recognises the need for a continued demonstration of a commitment to recovery of 'efficiently delivered' (and necessary) costs.

MDBC Costs

IPaRT have acknowledged that the apportionment of MDBC costs needed to be addressed and has attempted to do so in a somewhat adhoc basis based on recommendations from ACIL and DLWC. NSW Irrigators' Council believes that this methodology requires further analysis and should also be dealt with by the suggested 'implementation steering group' to ensure a more robust allocation process for subsequent Determinations.

Peel Valley

NSW Irrigators' Council is disappointed that both IPaRT and DLWC (in its initial submission) have failed to adequately address the 'ability to pay' in the move towards full cost recovery in all valleys in NSW.

The situation in the Peel Valley is a case in point. The unique situation in the Peel Valley where high fixed charges are placing a considerable burden on producers needs to be dealt with by IPaRT in the context of its Final Determination. Watson states that *once on-farm irrigation facilities are in place and the enterprise pattern determined, there is little that can be done to economise on water use.*⁸ Whilst this line of reasoning is somewhat flawed it does identify a key principle in this debate. The market-based approach to resolving the efficacy issues associated with the use of our natural resources is based on the assumption of a perfect market – flexible enterprise mixes and an open and transparent trading environment etc. Unfortunately, in the 'real' world this is not the case.

NSW Irrigators' Council would argue that the existence of a natural monopoly in the supply of bulk water, the physical limitations of the Peel Valley and the limited enterprise options have not been given due consideration by IPaRT in its Draft Report. This is

⁸ A S Watson, *Conceptual issues in the pricing of water for irrigation*, 1995, p.60

evidenced by the fact that IPaRT have suggested that it is not their responsibility to deal with profitability impacts on farmers and that 'impact' should be mitigated through water trading, handing back of entitlements and/or government assistance schemes. This is a poor attempt to deal with a serious issue.

There is no doubt that IPaRT will receive further submissions from irrigator groups on this matter and NSW Irrigators' Council recommends that IPaRT revisit these issues in its Final Determination.

Rate of Return

This has been a perennial issue for NSW Irrigators' Council and whilst we acknowledge the rate adopted by IPaRT in its Draft Report is significantly lower than that identified by DLWC (5% as opposed to 7%) we believe that there are some fundamental questions that have not been adequately answered and as such there is no clear justification for the imposition of a Rate of Return (RoR) cost on irrigators/water users.

Background

In its 1982 Report on Water Resources and Waste Disposal, the Industry Commission argued that since water authorities incur no liability to service a debt on the assets and hence, to pay a rate of return on equity, the inclusion of such assets in the asset base for rate of return calculations would represent "double charging."

*"The Council...encourages jurisdictions to establish price paths to move service providers towards a positive return on all assets over time. However, attaining the lower bound of the CoAG guidelines and thus meeting full cost recovery commitments (clauses 3(d)(i) and 3(a)(i)) does not require prices that include a commercial rate of return."*⁹

In an earlier submission NSW Irrigators' Council used the following analogy to illustrate the confusion surrounding the imposition of a Rate of Return as part of bulk water charges:

If irrigators/water users decided that it was more appropriate to use debt finance to fund part of a capital works program, they would in fact be charged three times (using current logic) – the annuity, the rate of return on that annuity and the interest on the borrowed capital that was being contributed to the annuity that year.

Issues/Questions

Question

Is a Rate of Return a specific CoAG requirement?

Answer

No (see comments above)

⁹ National Competition Council paper on rural Water Pricing, 2001

Question

Are the majority of funds for capital renewal/refurbishment provided by irrigators/water users through the capital or renewals annuity?

Answer

Yes (in the past up to 90%).

Question

Does IPaRT hold the view that refurbishment and replacement expenditure on rural bulk water assets should be capitalised?

Answer

Yes (1998 Determination)

Question

Given that we answered yes to our previous question is there in fact an opportunity cost of capital foregone by Government?

Answer

No (the 10% cost allocation from previous Determinations is in fact the community share).

If government or a private lender is providing all the capital for works done which benefit irrigators/water users directly and which irrigators have asked to be done then it is fair that irrigators/water users pay a rate of return in the form of cost of capital or a dividend plus repayment of that capital. However, when irrigators are contributing the majority of the capital works funding (90% in the past – the full amount of their assigned share) then they should not be forced to pay a rate of return on that capital.

Question

Is there an equity issue for the Government in terms of expecting a return on capital invested?

Answer

NSWIC has previously stated that commercially, owners of capital assets theoretically only have an interest in remaining owners while they receive a dividend comparable with investing elsewhere. Requiring an actual return on capital expended on public assets, assumes governments (taxpayers) are no different to private owners in that regard.

However, IPaRT have stated that pre July 1997 capital investments are sunk costs and post July 1997 refurbishment and renewal expenditure is provided by irrigators/water users through the annuity then it is difficult to understand the justification for a Rate of

Return 'charge' particularly when the actual 'capital' investment has been provided by irrigators/water users.

Question

Why are irrigators/water users being asked to pay a Rate of Return to Government on capital that they have already provided through a capital or renewals annuity?

Answer

Based on the principles outlined here there is no logical reason why this should be the case (non IPaRT costs are not the responsibility of water users and consequently any capital expenditure in this regard does not by definition necessitate a Rate of Return from irrigators/water users).

Question

Where do the funds from the RoR go?

Answer

NSW Treasury as consolidated revenue.

Other Agency Costs

NSW Irrigators' Council fully endorses IPaRT's view on this matter.