

OUT18/8306

Dr Peter Boxall AO
Chair
Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop, NSW, 1240

Dear Dr Boxall

Review of Rural Water Cost Shares

Thank you for the opportunity to make a submission to the Issues Paper for IPART's Review of Rural Water Cost Shares. This submission is made by the NSW Department of Industry – Lands and Water Division (DoI) which includes the Natural Resources Access Regulator (NRAR).

DoI establishes the rules for managing surface water and groundwater to ensure its long term sustainability for water users and water dependent ecosystems. NRAR is the newly established independent regulator responsible for efficient, effective and transparent compliance and enforcement of the rules to maintain public confidence in natural resources management legislation.

Establishing how costs are shared between water users and the NSW Government is an important step in setting maximum prices for rural bulk water services. As outlined in our attached submission, we support IPART continuing to use the impactor pays principle for undertaking this task. This principle is currently applied within DoI for program evaluation purposes and in the NSW Biosecurity Strategy.

While many factors will influence regulated water prices during IPART's next price review, it will be important to consider the impact on water users of any changes to user cost shares arising from this review. It is also important that the cost sharing framework be amenable to any changes to activities or responsibilities arising from the establishment and maturity of NRAR and the implementation of the Water Reform Action Plan announced by the Government in December 2017.

There would be administrative costs and challenges involved in changing from cost sharing based on activities to cost sharing based on services. There should be no change to a service-based approach unless the benefits exceed the costs. Given the amount of reform currently underway and the need for certainty for water users, we consider that any transition to a service-based framework should not commence until after the next pricing determination.

Thank you again for the opportunity to provide comments in response to the issues paper. Our primary contact for this submission is John Smith, on 0439 496 861.

Yours sincerely



Liz Livingstone
Deputy Secretary Lands and Water

Response to issues for stakeholder comment

Cost sharing principles

1. Do you agree that WaterNSW and WAMC's costs should be allocated between water customers and the Government (on behalf of the broader community) using the impactor pays principle – ie, those that create the need for the cost to be incurred should pay the cost?

In general, prices and charges for water should recover the full efficient costs of providing services to water users. However, there are also economic grounds for sharing costs between water users and the NSW Government (on behalf of the broader community). In IPART's last determination for WAMC, the water users' share of total efficient costs was around 72% over the four-year determination period (2016-2020), with 28% funded by the NSW Government.

We support IPART continuing to use the impactor pays principle to allocate costs between water customers and the NSW Government. The impactor pays principle helps to ensure prices are cost-reflective, and therefore promotes economically efficient outcomes. The impactor pays principle is consistent with the Productivity Commission's findings and is currently applied in a cost recovery framework used by the NSW Department of Industry (DoI) for program evaluation purposes and in the NSW Biosecurity Strategy.^{1,2,3}

2. Do you agree that the NSW Government's share of WaterNSW and WAMC's regulated costs should be limited to where:

- **there are genuine legacy costs (ie, costs that are unavoidable regardless of the ongoing provision of services to current and future customers), and/or**
- **it is not practical or cost-effective to recover costs from other users (ie, impactors other than water customers subject to regulated prices)?**

In previous pricing determinations, IPART has excluded certain legacy costs from regulated prices. We agree that regulated water customers should not pay for unavoidable legacy costs, for example the cost of remediating environmental damage from past users. Including these costs in setting maximum bulk water prices would not send appropriate price signals to water users. There is no economic efficiency reason for including such costs in regulated prices, as they will not change regardless of water users' consumption.

We also agree with IPART's proposed funding hierarchy. Under this framework, water customers do not pay for costs imposed by other water users who are not subject to regulated prices, for example recreational water users. In these instances,

¹ Productivity Commission, *Cost recovery by government agencies*, Inquiry Report No. 15, August 2001, available at <https://www.pc.gov.au/inquiries/completed/cost-recovery/report>.

² See Smith H, and Webster S, *A Principles-Based Cost-Recovery Framework for Government Program Resourcing Decisions*, Economic Papers, Vol. 36, No. 3, September 2017, 275-288.

³ NSW Government, *Biosecurity Strategy 2013-2021*, Appendix A, available at https://www.dpi.nsw.gov.au/data/assets/pdf_file/0005/467699/NSW-biosecurity-strategy-2013-2021.pdf.

if it is not practical or cost-effective to recover costs from these other water users then it would be funded by the NSW Government. IPART's proposed hierarchy for cost recovery is consistent with the DoI's cost recovery framework and the NSW Biosecurity Strategy noted above, under which there is a preference of cost recovery from 'risk-creators' (analogous to impactors) over beneficiaries, and beneficiaries over the NSW Government (taxpayers).

Current cost sharing framework

3. Do you agree with the current cost share ratios (listed in Appendix C)? Should the list of activities and/or cost share ratios be amended? If so, how and why?

We consider it is timely to review the cost share ratios outlined in Appendix C of the Issues Paper.

The list of activities may need to be amended given potential changes arising from the establishment of NRAR and implementation of the Water Reform Action Plan. DoI has been consulting with stakeholders on arrangements for water take measuring and metering, transparency measures, management of environmental water and floodplain harvesting. To support the implementation of the Water Reform Action Plan, amendments will be required to the *Water Management Act 2000* and *Natural Resources Access Regulator Act 2017*. The NSW Government has released the draft *Water Management Amendment Bill 2018*, as an example of the mechanisms that could be enacted to enable key elements of the reform. The Bill that will be introduced into Parliament later this year will reflect the final policy positions developed through consultation.

We understand that any changes to activities and/or expenditure arising from these reforms would be assessed during IPART's next pricing reviews.

6. Do you agree with our proposed approach to reviewing the current cost sharing framework?

We support IPART's proposed approach to this review to achieve the objective of cost sharing that is transparent, cost-reflective and practical. IPART's proposed approach involves:

- reviewing the current list of activities and amend as necessary
- reviewing and where necessary updating the current cost share ratios for the activities, and
- considering alternative cost sharing frameworks, such as a service-based approach.

Service-based cost sharing framework

7. What are the potential challenges and barriers to moving to a service-based approach?

IPART states it is considering moving to a service-based cost sharing framework because it may be more amenable to the impactor pays principle, and therefore more transparent and cost reflective. While IPART has preliminary views on services provided by WaterNSW for cost sharing purposes, it notes that further work is needed to delineate and define the surface and groundwater services provided by WAMC.

As DoI uses an activity-based accounting system the main challenge in moving to service-based cost sharing is likely to be how costs are allocated from existing activities to services. Depending on how WAMC's services are defined for cost sharing purposes, changes may be required to accounting systems, reporting and data collection processes. The complexity of allocating costs from activities to services may not necessarily result in cost sharing that is more transparent or cost-reflective.

8. Are the benefits of moving to a service-based approach likely to exceed the costs?

It is not clear whether the benefits of moving to a service-based approach would exceed the costs. However, as noted above there would be administrative costs of adopting a service-based approach and any benefits are uncertain.

9. Would there be merit in transitioning to the service-based approach over time?

There should be no transition to a service based approach unless it can be shown that the benefits of moving to a service-based framework exceed the costs.

Given the amount of reform currently underway and the need for certainty for water users, we consider that any transition to a service-based framework should not commence until after the next pricing determination. The upcoming pricing determinations would continue to use an activity-based approach with refinements to activities as necessary.

Key information requirements

11. Is there any other information we should consider in our review and assessment of the current activity-based cost sharing framework?

12. Is there any other information we should consider in our review and assessment of the proposed service-based cost sharing framework?

We are not aware of any additional information that should be considered in reviewing and assessing the current activity-based cost sharing framework or the proposed service-based framework.