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Submission to the Independent Pricing and Regulatory Tribunal

Review of Bulk Water Prices from 2006/07

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INTRODUCTION

Border Rivers Food & Fibre is the peak body for eleven affiliated water users associations whose members operate some 600 irrigation enterprises on the New South Wales and Queensland sides of the Border Rivers catchment.

In a good year the gross value of irrigated production is $350–400 million. There is direct and indirect employment for over 3,000 people, a significant percentage of the workforce in a catchment with a population of about 60,000. The towns of Inverell, Glen Innes, Ashford, Tenterfield, Stanthorpe, Inglewood, Texas, Yelarbon, Boggabilla, Goondiwindi, Toobeah, Talwood, Boomi and Mungindi are strongly dependent on the economic activity generated by irrigated production.

As a long term member of *NSW Irrigators' Council*, *Border Rivers Food & Fibre* has input into Council's submissions and strongly supports the current submission to *IPART*. We also share the views of similar organisations such as *Gwydir Valley Irrigators' Association*.

In this short submission, we wish to highlight our major concerns about the water charges proposed by the *Department of Natural Resources (DNR)* and *State Water*. Price increases of well over 100% would mean an increase of about $13,000 in an average annual water bill. Particularly at this time such an increase will be extremely difficult to absorb.

Even if the charges are only implemented in part, the future viability of the irrigation industry and its associated communities in the Border Rivers will be severely compromised. We urge IPART to reject proposed new water pricing elements and to keep to an absolute minimum increases in existing elements of the price structure.

PRICE INCREASES WILL MAGNIFY ECONOMIC HARDSHIP

A combination of factors associated with the history of development, water reform process, market conditions, operating costs, the economic climate and seasonal conditions is decimating the profitability of irrigated production in the Border Rivers.

- Water availability per enterprise has decreased in inverse proportion to the level of development
- Water sharing plans associated with the water reform process have reduced access further
- Cotton at $330/bale is below the cost of production, in stark contrast to prices up to $600 in the past
- Operating costs have continued to rise at or above CPI, with fuel in particular having a large impact
- The high dollar has impacted on export earnings
- We are experiencing the worst drought in living memory, with cumulative flows in the Darling River during the last 4 ½ years well below any other sequence in the past.

The combination of severely constrained production and unfavourable terms of trade is pushing irrigated producers closer to the edge. Equity is being eroded as borrowing to stay in business increases. The proposed change of over 100% in water charges is a two-edged sword: it would increase the cost of production *and* convey a strong message that the government is much more interested in its own short term revenue position than it is in the long term viability of irrigated producers and their communities.

THE PRICING PRINCIPLES ARE FLAWED

Under the impactor pays principle, the government has turned its back on community service obligations (CSOs). This is despite the fact that irrigators and associated businesses have been arguing consistently for many years that water use for productive purposes has very significant whole-of-community benefits. The department's current claim for licence holders to pay 85% of water resource management costs is not, as self-righteously claimed, based on conveying proper price signals – it is a blatant grab for cash from what is increasingly becoming a seriously disadvantaged sub-set of society.

A return on capital (rate of return) is based on the same dishonest motives. It is offensive in the extreme that public infrastructure built for public benefit as part of regional economic development initiatives is now considered to be 100% 'owned' by government and treated as a private asset that, if sold, could produce cash for investment at market rates of return. If this is the case, why is the same argument not applied to roads, bridges, schools, hospitals etc? A cynic might conclude that voter demographics plays a large part in this. While governments generally are increasingly commercializing 'their' assets, they are doing so on a highly selective basis. The result is that some groups are contributing more to government revenue so that other groups can be subsidised, a very dangerous precedent in a so-called liberal democracy. Irrigators have strong grounds for feeling disenfranchised.

Similarly, a return of capital (depreciation) is a private sector construct that has been conveniently adopted by government. Irrigators are prepared to pay a fair share of the efficient cost of storage and delivery of the consumptive component. This includes the cost of maintenance and refurbishment of infrastructure, the quantum of which depends on many variables such as age, quality of construction and materials, stresses endured, and the effectiveness of the maintenance schedule. An objective total asset management approach is a much sounder methodology than the adoption of an arbitrary percentage rate of depreciation.

New elements of water charges are State Water dividends to Treasury and tax on 'profits'. The reality for a water service provider is that, because of the variable nature of the commodity being 'sold to customers', in good water years there will be an excess of income over expenditure, while in bad years the reverse will be true. The ability to retain earnings and offset them against future shortfalls is an essential element of this type of operation. Dividends and tax severely compromise this ability. The ultimate irony is that, when shortfalls occur, debt financing will be required to cover them. Treasury Corporation as the lender, having benefited from 'profitable' years, also collects the interest on loans made during 'unprofitable' ones. The ingenuity of government in extracting dollars from a long-suffering population has surely scaled new heights.

Separation of the service provider from the regulator is not providing the expected benefits.

This is graphically illustrated by the State Water proposal that a long term usage figure of one standard deviation below the 100 year average be adopted for pricing purposes. This would mean discounting of actual water use by some 20%, with a corresponding arbitrary increase in charges of the same magnitude. This breathtaking act of bastardry would be larceny on a grand scale. It would result in all water used being charged for at a rate based on only some of the water actually used.

State Water claims that this is necessary to control risk because "*... there is considerable variability in water availability year to year and the WSPs generally exaggerate the variability on availability. There are also limitations in using an Average (a measure of central tendency) water sales.*" This lame and almost unintelligible excuse sends a very clear message that State Water, having been placed in a high risk situation by government as discussed above, is hell bent on transferring the risk onto its customers because it sees its own survival as more important than theirs. It is proof positive that the government has no idea about operating in a commercial environment: sound customer relations are the mainstay of any successful business.

People who have worked in senior management positions in private and public sector organisations advise that they are not equivalent. The fundamental flaw in the model adopted for government owned corporations is demonstrated by the following comparison.

ISSUE	Government Owned Corporation, resource based	Private Corporation
Ownership	Limited shareholders, single ownership	Many shareholders, multiple ownership
Accountability	To the general public, through Ministers	To shareholders
Assets	Public	Private
Competition	None	Full
Motivation	Emotional: voter driven	Objective: organisation-driven
Profits	Removed, to fund other government activities	At least partially retained to enable growth
Financing	Funds accumulated for anticipated future commitments	Debt used
Debt	Financed by government	Competitively financed
Sales philosophy	Reduce sales, charge more	Increase sales, charge less

The corporatised State Water is headed towards failure if, as a monopoly service provider not exposed to competition, it is forced by its political masters to operate on a commercial basis modeled on the private sector. The fallacy that public and private corporations are equivalent is a massive flaw on the government's philosophy that will result in a great deal of grief in years to come.

THE REAL COST OF USING WATER IS BEING IGNORED

Irrigators are genuinely concerned that the government does not fully appreciate the implications of the water pricing proposals for the future viability of irrigated production.

In isolation, an increase in water charges may not be the straw that breaks the camel's back. It is just one component of the overall cost of making productive use of water. However, this cost has been escalating over time without any ability to recoup it through higher prices for products. In fact, our terms of trade are in decline, and this is coinciding with the worst drought in living memory. The cumulative impact is an insidious decline in the viability of our enterprises that may at some point reach the stage where a water allocation becomes a liability. The losses will be universal for producers, our communities, governments and the economy in general.

Governments, under the auspices of the COAG water reforms and the National Water Initiative, are quick to remind water users on every occasion that "*if water is priced properly people learn the value of water and conserve it as the valuable resource it is*". The implication that irrigators don't value it and don't conserve it is simply not true. They would be out of business if it were. They are totally committed to water use efficiency in all its dimensions, and invest a lot of time, effort and money on continuous improvement. The gains over time have been impressive and will continue into the future provided that the resources to pursue them are available. An increase in price will not lead directly to one drop of additional water savings. It will simply make it harder to finance savings in the future.

Irrigators are routinely accused of playing politics with water prices. However, it is not about politics, it is about survival. Politicians are fond of pointing out that irrigators receive preferential treatment with low rural water prices. On this count there is a vast difference between high security water stored in dams for urban and industrial use, treated and available at the turn of a tap, and water that flows in rivers after rainfall that is only useful if significant private money is spent to capture, store and distribute it. The scale of water use is also very different. The impact of price rises on urban water users is measured in dollars, but for rural water users it is thousands or tens of thousands of dollars. Urban water mainly benefits the direct user, whereas rural water use provides wide-ranging benefits.

The true cost of rural water actually involves the following components:

- Capital costs: if the money invested in water licences was invested elsewhere (say the stock market) it would earn perhaps 7%. The annual capital cost of a megalitre of water valued at $1,500 is therefore in the order of $100.
- Infrastructure costs: pumps, pipes, channels, storages, filters, spray units etc are required to take water from a river and apply it to crops. A typical broadacre furrow irrigation development costs about $5,000 per hectare to enable about 6 ML/ha of water use. Based on the same 7% rate of return, the annual cost associated with infrastructure is approximately $60 /ML.
- Water charges for the full recovery of storage and distribution costs associated with government irrigation schemes: in the case of the Border Rivers there is a fixed charge of $4.18/ML for an allocation of 265,000 ML even though it is rarely available, and a variable charge of $4.85 for water actually used (on and off allocation), which over the last 10 years has averaged 162,000 ML. There is also a $13.89/ML Pindari Dam levy. This translates into an actual cost of $25.41/ML for water used, which rises even higher when on farm evaporation is taken into account.
- The cost of energy (diesel, electricity) required to pump and reticulate the water: a middle of the road estimate is $50/ML.
- Labour costs associated with watering crops, estimated at $4.50/ML.
- The costs associated with regulatory compliance: workplace health and safety, land and water management plans, infrastructure certification, dam spillway safety etc: say $10/ML.
- Local government rates: these are considerably higher for land with "irrigation potential", and may add another $5/ML.

This analysis shows that water costs an astonishing $250/ML to use. This is nearly 40% of the cost of production of cotton, the most profitable crop in the last 30 years in our valley. The current market price of $330/bale is about $70 below the cost of production, all of which justifies the earlier assertion that water allocations can become a liability. If it is no longer possible to use water profitably, what are the consequences? Every additional impost makes it harder to survive. If increases of over 100% are approved, what will be the final straw?

We have consistently argued that public infrastructure is for public benefit, and its provision and maintenance is a legitimate community service obligation of government. The same logic applies to water resource management charges: the whole community benefits. Irrigated production in the Border Rivers is potentially a $400M gross per annum business with over 5,000 direct and indirect employees in a population of some 60,000. Ask the locals if they want governments to price irrigators out of business. Even urban dwellers recognise the stupidity of this. Four people interviewed in Latrobe

Terrace, Paddington at 4.00 pm on Thursday 22nd July 2004, when asked if home owners or farmers should have to pay for water, responded as follows:

- *"No, everyone should have access to water without having to pay for it"*
- *"No, especially not farmers, as it would affect their livelihood and income greatly"*
- *"No; we pay enough taxes and rates already, so we shouldn't have to pay for water"*
- *"Farmers definitely shouldn't have to pay. They do it tough enough already. Home owners should have to pay based on personal wealth and income levels"*

We are not whingeing farmers, we are ordinary people who just want our enterprises and our communities to survive and prosper. Which advisers are providing Ministers with information like this? Its an odds-on bet that it is not happening. Our interpretation, which those same advisers will no doubt pass off as cynical and self-serving, is that the fine rhetoric about valuing and conserving water is a convenient smokescreen for an unconscionable grab for cash. We are paying taxes *and* we are paying for the services they are supposed to provide.

We would be glad to see the government turn its attention to issues that really matter. Taking on the Woolworths/Coles monopoly that is turning our fruit and vegetable growers into peasants teetering on the brink of poverty would be a good start. Advocating terms of trade under which environmental performance, or lack of it, is recognised and compensated for, would also be a very positive move. We can't survive when a box of Chinese apples lands in this country for less than the cost of freight from the producing area to the city. Some serious cost/benefit analysis would provide pointers on how the best overall economic performance can be achieved.

In the Border Rivers and surrounding catchments we have some of the most productive farming country in the world. We should be working together on ways to ensure long term sustainability while maximizing the benefits of this country to the region, the state and the nation. If current trends continue for long enough, we are at risk of ending up with an eroding wasteland inhabited by weeds and feral animals. Country, once disturbed, must be managed. Management requires people. People require sustenance, and actually aspire to a decent quality of life.

We are disheartened by our continuing failure to get decision-makers to wake up and listen properly. Despite being totally apolitical – we have a well-established track record of dealing with the government of the day and concentrating on solutions rather than problems – we are still caught up in the political machinations surrounding this issue. No doubt when the crunch comes anyone and anything but government will get the blame.

NSW IS GUILTY OF SELECTIVE IMPLEMENTATION OF THE NATIONAL WATER INITIATIVE

We draw to IPART's attention the selective application of the provisions of the National Water Initiative by NSW with regard to water charges.

Massive increases are being proposed on the basis of full cost recovery of upper bound costs. If IPART approves the Department of Natural Resources and State Water submissions, this will result in price increases for general security water (on and off allocation) as follows: Border Rivers 112.2%, Gwydir 146.2%, Namoi 102.5%, Peel 102%, Macquarie 117%, Lachlan 58.5%, Murrumbidgee -5.1%, Murray 72.5%, North Coast 1,196.7%, Hunter 132.6%, South Coast 484.3%.

The Department proposes a user share of 85% of total water resource management costs, an increase from 65% in the 2001 IPART determination. By adopting the principle of impactor pays in its narrowest sense, the government is abrogating its community service obligations to the greatest possible extent, despite the self-evident fact that the benefits of irrigated agriculture flow on to the whole population and not just licenced water users. To compound the impact, the Department is also seeking an increase of some 25% in water resource management charges at a time when most of the major water sharing plans have been developed and implemented. Nowhere in the Department's submission is there any consideration of ability to pay, or any analysis of the impacts on the viability of regional, state and national economies and social wellbeing.

The separation of the service provider and regulator sees State Water reorganized in the mould of a private sector corporation. Thus new elements of its pricing structure are:

- A return ***on*** capital (rate of return on infrastructure);
- A return ***of*** capital (depreciation);
- Tax on profits;
- A dividend to Treasury from after tax profits; and
- Interest on Treasury loans taken out to cover losses.

State Water has also made the astounding decision to base water use (Part B) charges on usage that is *one standard deviation* below actual recorded usage, passing this off as a 'responsible' risk management strategy. The new imposts and the sleight of hand with regard to usage result in a massive escalation in the 'cost of efficient service delivery'.

The NWI water pricing provisions are being cynically manipulated to increase revenue. By claiming a commitment to the full recovery of upper bound costs, NSW is rapidly moving away from any community service obligations. The NWI is doing rural and regional communities no favours in this regard.

CONCLUSION

In their submissions both the Department of Natural Resources and State Water have demonstrated their self-serving lack of regard for the wellbeing of NSW irrigators and their communities. Deluding themselves into believing that governments own resource-based assets and have a right to apply them for their own commercial benefit illustrates just how incompetent they have become in the management of public affairs. The concept of natural resources belonging to everyone, with governments having a stewardship role in looking after them for the common good, has been totally abandoned.

Border Rivers irrigators reject the water pricing proposals of the Department of Natural Resources and State Water. We submit that IPART should base its ruling on the one defensible principle, full recovery of the efficient cost of storing and distributing the consumptive component of the water resources of NSW.

Submitted by:
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