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# **Cotton Australia**

**SUBMISSION TO THE**

**IPART REVIEW OF BULK WATER PRICES**

**November 2005**

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# 1 EXECUTIVE SUMMARY

## 1.1 Cotton Growers willingness to pay

Irrigated cotton growers have demonstrated that they are willing to pay fair and reasonable costs for delivering irrigation water to the farm. This position is contingent on:

- The use of a transparent process to determine any relevant charges.
- Costs should be born equitably by **all** water users including the community, environment and agriculture.
- Charges should be determined by an independent body and,
- Where possible charges imposed by irrigation water service providers should be contestable in the market place.

## 1.2 The National Water Initiative

Cotton Australia through its membership of the National Farmers Federation, NSW Irrigators Council, Queensland Farmers Federation and as the representative of the cotton growers of Australia, supported COAG's 2004 agreement on the National Water Initiative.

The cotton industry believes that the NWI should be comprehensively implemented by all state jurisdictions. This implementation should be overseen by the Federal Government and be done in consultation with the community. Unfortunately, while the irrigation sector has been keen to move ahead with many of the NWI commitments, particularly in relation to water markets and trade, water use efficiency technology adoption and innovative solutions to environmental flow management, the NSW state government has chosen to only consider the pricing principles agreed to under the NWI.

## 0.0 DNR and SWC Submissions to IPART

- Both DNR and State Water have chosen to use the NWI as an excuse for raising prices to an extreme level.
- The proposed price rises are in direct contravention of the stated objectives of the NWI, which indicates that "*perverse*" impacts must be avoided, as too, should "*monopoly rents*".
- The last determination made by IPART indicated that most cotton growing valleys are already operating at full cost recovery.
- Cotton Australia sees no justification for the payment of a declared 7% annual dividend by SWC to NSW Treasury. This figure is unrealistic economically and morally reprehensible as it exploits the monopoly position in the market that SWC holds.
- No social, economic or environmental study has been completed to investigate the impact of any of these price rises.
- Both DNR and SWC show a complete lack of willingness to ensure that operational costs are shared equitably by all water users and not just the irrigation sector.

#### **1.4 Recommendations in relation to DNR submission**

Cotton Australia calls on IPART to:

- In order to determine the real cost and service delivery equation investigate and report on how and where the money that DNR attributes to Water Resource Management is actually being apportioned.
- Reject the DNR contention that water users should pay for the development of water policy and planning activities
- Require DNR to develop a mechanism to clearly and transparently articulate where funds are being spent in relation to water resource management.
- Require DNR to communicate back to industry the outcomes and progress of programs being funded as part of the water resource management obligations of the Department.

#### **1.5 Recommendations in relation to SWCs submission**

Cotton Australia calls on IPART to:

- Ensure that SWC can demonstrate their financial cost effectiveness in the way in which they conduct business by requesting a comprehensive cost benefit analysis of all its operations
- Request that the NSW government immediately invest in a comprehensive socio-economic study to investigate the impact of its proposed pricing regimes
- Reject the argument made by SWC that a leap towards upper bound pricing is required
- Ensure that the SWC is made to run its business within the requirements of the laws of occupational health and safety and only pass on fair and reasonable, costs derived in a transparent manner, to **all** water users.
- Demand the SWC work with DNR to develop water charging mechanisms that can equitably re-coupe the costs of operation from all customers as defined by them as *“irrigation corporations, country town water supply authorities, farms, mines and electricity generators, /...../ stock and domestic users and is responsible for delivering environmental flows on regulated rivers”*

## **2 Cotton Australia**

Cotton Australia is a private, not for profit company that represents the interests of Australian cotton growers. There are around one thousand (1000) farmers in Australia who grow cotton. The majority of these farmers contribute to the operations of Cotton Australia via a voluntary levy.

While in many respects Cotton Australia often represents the entire industry, the organisation focuses on representing the needs of cotton growers. The company is managed by a board of directors who are elected by the voting members of the organisation. These members are Cotton Growers Associations, who are located in the cotton growing valleys across Queensland and New South Wales. Cotton is grown in some of the most prosperous and dynamic regional communities in these two states. Catchment communities around the Namoi, Gwydir, Macquarie, and Lachlan valleys as well as around the Darling and Macintyre rivers are all involved in cotton production. Cotton is one of Australia's top five agricultural exports generating around \$1.5 billion dollars a year to the national economy.

## **3 The Australia cotton industry and irrigation**

The vast majority of the Australian cotton crop is irrigated. Although cotton was first grown using seeds brought out with European settlement, the modern cotton industry really only started to develop in the early 1960's. The industry has grown substantially over the last 45 years, mostly due to farmers having access to irrigation water through newly developed government irrigation schemes. The sustainable management of soils and the development of Australian specific cottonseed varieties, including in the last 10 years, varieties derived through the use of biotechnology has also been of importance to the industry.

While much of the irrigated cotton grown in this country uses water allocated to farmers from inland rivers, there is still a large percentage of the crop that uses water from groundwater sources either to grow the crop or supplement surface water supplies.

Over time most farmers have seen the need to manage the inherent variability in water allocations by developing significant on farm water storages and infrastructure. In many cases the development of this infrastructure was a condition attached to purchase of the water entitlement (licence). It is clear that as the cotton industry has grown, so to have the regional communities that it is associated with. Towns like Moree, Narrabri, Gunnedah, Warren, Narromine, Goondiwindi and more recently Hillston, have all benefited from the investments made by private landholders in their districts.

## **4 Commitment to the National Water Initiative**

The cotton industry fully supported the Council of Australian Government's development of the National Water Initiative (NWI). The industry saw the development of the NWI as the first real steps toward developing a nationally agreed approach to the sustainable management of our water resources.

Over the last decade cotton growers have invested heavily in water management technology. Through the adoption of the industry's environmental management system – Best Management Practices Program- and the implementation of water use efficiency programs, cotton growers have achieved significant water savings. This change has largely been driven by private investment built on industry research and technology. Cotton grown in Australia is now seen as a product that is produced under some of the best environmental management practices in the world. Sadly, Government regulation and intervention has in many ways stifled the industry's ability to advance and use technology to manage the resource in a sophisticated and efficient way. It appears that while irrigators are implementing technology, investing in infrastructure and looking for sophisticated water markets all in order to better measure and manage their irrigation allocations, Government regulators have had to be dragged into these endeavours. The NWI has been seen by the cotton industry as a very promising mechanism to change this situation.

## **5 Cotton Australia's position on water pricing**

**Cotton Australia's policy position with regard to water pricing is that the industry:**

- Believes that while recognising variation between catchments and excluding infrastructure costs, water resource management costs should be shared equitably across all water users and that such costs be based on sound and transparent disclosure of those costs; and
- Recommends that water pricing be based on the efficient cost of supplying water and managing the resource, as determined by an independent, accountable and transparent process, removed from government, while including a significant public consultation process.

Cotton Australia has established this policy position after it was developed in consultation with the cotton growers of Australia. This position reflects the sentiment that cotton growers are willing to pay for the reasonable cost of the delivery of water entitlements to their farms. This position is contingent on the fact that the costs associated with the delivery of irrigation water should be made transparent to the customer, and that these costs should be comparable and contestable against the market for delivering this service.

In the context of these remarks, Cotton Australia welcomes the opportunity to provide feedback to IPART in response to the submissions made by the Department of Natural Resources (DNR) and State Water Corporation (SWC) regarding IPART's current review of Bulk Water Prices for 2006 / 07.

## 6 Comments in Relation to DNRs submission

### 6.1 Water Resource Management (WRM)

Much of the submission provided by DNR attempts to claim that huge price rises are required in order for the Department to cover extra costs it is incurring as a result of the NWI. In Cotton Australia's opinion DNR does a very feeble job of outlining these services, particularly water resource management activities, which are being delivered by the Department. The concept of WRM activities is being abused by the Department to try and encompass as many of its activities associated with staff employment and water management projects. The Department seems unable to accurately reflect the cost of any of these activities claiming that in relation to WRM operating costs:

*“In real terms, costs have ranged between \$40m and \$46m a year”  
pg 12 DNR submission to IPART.*

Further the DNR submission states:

*“WRM costs in 2004 – 05 fell by about \$4m from the previous year, and are \$5m to \$10m a year lower than the cost base assumed by IPART in its 2005 – 06 determination”  
pg 13 DNR submission to IPART.*

The sheer nature of this sort of reporting of costs can only serve to indicate that this department has lost sight of the nature of its business and cannot articulate the real cost of WRM. Yet, in this process it proposes to consider it appropriate to haul these costs over to irrigators. Until the real costs and deliverable services associated with WRM can be accurately articulated, the cotton industry will resist the shifting of these cost over to water users.

The DNR submission refers to extra hydrometric and water quality testing to be implemented. There is evidence to suggest that the services delivered by Government in these areas have in fact been reduced and indeed withdrawn in some areas over the last couple of years. In many cases the services the Department claims to deliver are in fact being shifted off to Catchment Management Authorities, irrigation scheme operators and corporations or individual water user groups.

Cotton Australia would like to convey the clear message that cotton farmers run efficient, sophisticated businesses that rely on precisely apportioned financial practices. It is for this reason that the industry looks upon the confusing and ambiguous financial accountability demonstrated by DNR with such dismay.

The industry would find it hard to believe that IPART could have any confidence in the manner in which DNR has presented the costs of its operations.

## **6.2 Costs associated with policy and planning**

The DNR submission contends that costs have increased substantially since irrigators were granted a water right in perpetuity, as part of the NWI. Cotton Australia believes that the Department is attempting to shift the cost of doing Government business over to the water user. This concept is in contradiction to the intention and stated objectives of the of the NWI which clearly states that;

### *(Paragraph) 67 Cost Recovery for Planning and Management*

*67. The States and Territories agree to bring into effect consistent approaches to pricing and attributing costs of water planning and management by 2006, involving:*

- i) the identification of all costs associated with water planning and management, including the costs of underpinning water markets such as the provision of registers, accounting and measurement frameworks and performance monitoring and benchmarking;*
- ii) the identification of the proportion of costs that can be attributed to water access entitlement holders consistent with the principles below:*
  - a) charges exclude activities undertaken for the Government (such as policy development, and Ministerial or Parliamentary services); and*
  - b) charges are linked as closely as possible to the costs of activities or products.*

*(Page 14 Inter-governmental agreement on the National Water Initiative)*

It is ludicrous for DNR to attempt to shift the cost of government policy making onto water users. Essentially developing and implementing policy is what Governments are designed to do, on behalf of the wider community. No other Government Department has this unique opportunity to shovel their operational costs over to one community sector.

Cotton Australia believes it is reasonable for water users to pay for the real and fair cost of the delivery of water to the farm. The concept of irrigators paying for government reforms brought about by governments themselves, is a grab for money and exploits the fact that farmers are the price takers in primary production and cannot possibly pass these costs on.



## **7 Comments in relation to SWC's submission**

### **7.1 Cotton Australia's position in relation to SWC**

Cotton Australia has and does support the position taken by the NSW Government to establish a separate corporate entity to manage the water delivery systems in NSW. When the SWC Act was passed through the NSW parliament the cotton industry believed in the principle that State Water would develop to become an efficient business focused on providing cost effective services to its customers. The industry still believes that this is indeed the goal that SWC should be trying to achieve. On reviewing the information provided by SWC to IPART, the cotton industry is fearful that State Water is being viewed by government as a source of revenue rather than service provider to the water users. State Waters' customers are not just irrigation farmers. The corporation's website states,

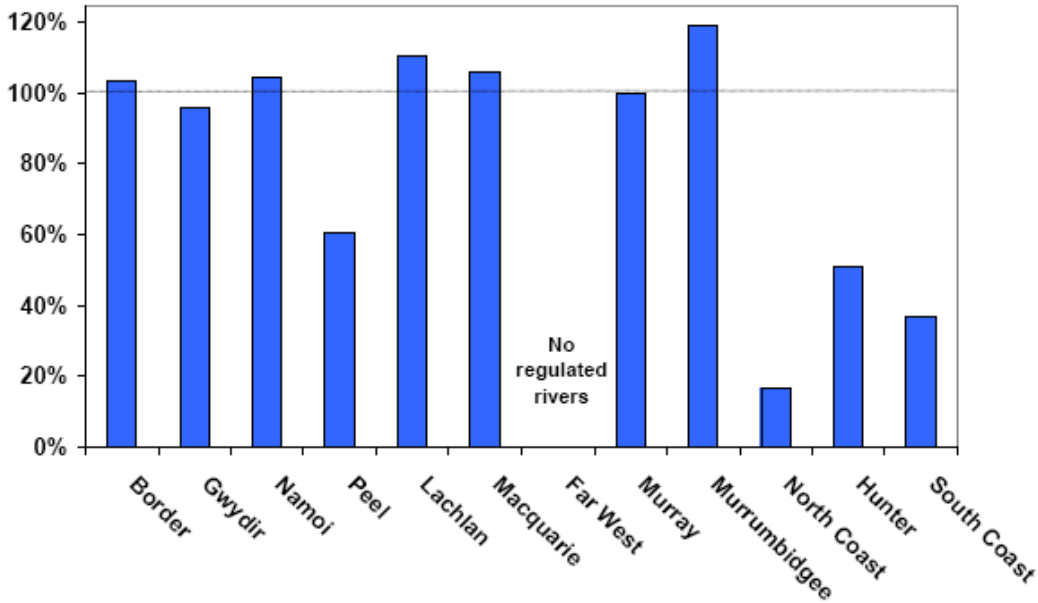
*“State Water delivers water to irrigation corporations, country town water supply authorities, farms, mines and electricity generators, /...../. It also provides water for stock and domestic users and is responsible for delivering environmental flows on regulated rivers.”*

Contrary to the list of customers outlined above, SWC seems intent on recovering all of its costs of operation from just one customer, the irrigation sector.

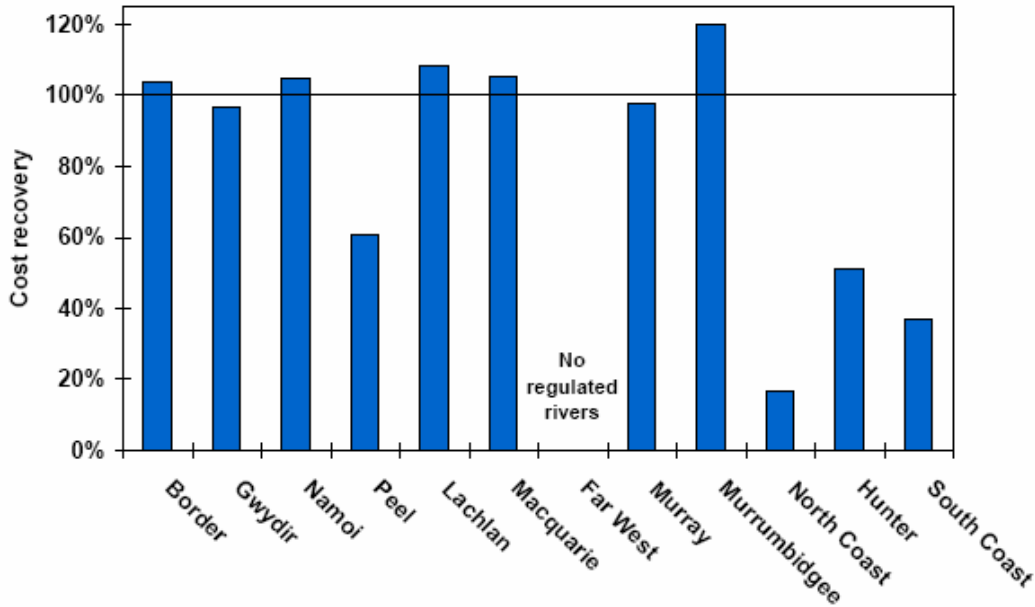
### **7.2 The move towards upper bound pricing.**

Cotton Australia is very concerned that SWC is using the NWI as a reason to push up prices associated with water delivery. As stated earlier in this submission, cotton growers are prepared to pay the fair and reasonable cost of the service offered by State Water in delivering farmers' water allocation to their property. This fair and equitable cost must be reflected in pricing patterns across all water users, not just the irrigation sector.

**Figure 3.1 State Water regulated rivers estimated cost recovery levels 2004/05**



**Figure 3.2 DIPNR regulated rivers estimated cost recovery levels 2004/05**



[Extract - *IPART Bulk Water Prices Determination for 2005 / 06 Report nos 8 and 9 pg 13*]

As demonstrated above, IPART reported in its determination in August of 2005 most irrigation valleys where cotton is grown are indeed at, or very near full cost recovery (2004/05). There appears to be absolutely no justification for any significant price rise beyond this point. The SWC submission contends that a further price move is required to achieve upper bound pricing as required under the NWI. In regards to this issues the NWI states:

*[Paragraph 66 Inter-governmental agreement (IGA) on the National Water Initiative]*

*In particular, States and Territories agree to the following pricing action:*

*Rural and Regional*

*v) full cost recovery for all rural surface and groundwater based systems, recognising that there will be some small community services that will never be economically viable but need to be maintained to meet social and public health obligations:*

- a) achievement of lower bound pricing for all rural systems in line with existing NCP commitments;*
- b) continued movement towards upper bound pricing for all rural systems, where practicable; and*
- c) where full cost recovery is unlikely to be achieved in the long term and a Community Service Obligation (CSO) is deemed necessary, the size of the subsidy is to be reported publicly and, where practicable, jurisdictions to consider alternative management arrangements aimed at removing the need for an ongoing CSO.*

This should be viewed in context with the previous IGA established in 1994, which stated that

*“continued movement towards upper bound pricing for all rural system, where practical.”*

The NWI establishes a desire for water markets to move towards upper bound pricing. Under no circumstances does the agreement indicate that water markets **must** immediately instigate upper bound pricing. The agreement establishes that any move should be done only when *“practicable”*. Practicable means that it must be feasible as well useable. The table provided by SWC in their submission, as extracted below articulates the impacts of unconstrained prices on customer bills.

**TABLE 10.7 IMPACTS OF UNCONSTRAINED PRICES ON CUSTOMER BILLS  
(% CHANGE)**

% change from previous year						
TOTAL BILL	2006/07		2007/08		2008/09	
	HS	GS	HS	GS	HS	GS
Border Rivers	178.9%	112.2%	1.5%	1.5%	-5.4%	1.4%
Gwydir	265.5%	146.2%	1.9%	1.9%	-2.1%	4.5%
Namoi	144.1%	102.5%	3.4%	3.4%	-1.5%	5.3%
Peel	377.5%	102.0%	5.2%	5.2%	6.1%	18.5%
Macquarie	249.7%	117.0%	1.9%	1.9%	0.0%	6.9%
Lachlan	193.3%	58.5%	3.4%	3.4%	-0.1%	6.6%
Murrumbidgee	23.2%	-5.1%	1.6%	1.6%	2.5%	0.3%
Murray	84.4%	72.5%	6.0%	6.0%	5.1%	4.6%
North Coast	3979.2%	1196.7%	4.1%	4.1%	12.3%	-1.3%
Hunter	323.4%	132.6%	2.0%	2.0%	-1.8%	5.0%
South Coast	781.3%	484.3%	1.2%	1.2%	2.1%	-1.3%

[Extract from SWC submission to IPART Sept 2005]

Provided with this information it remains the role of IPART to determine whether percentage price rises such as 179% on the Border Rivers, 266% on the Gwydir, 250% on the Macquarie or 144% on the Namoi are indeed *practicable, feasible or useable*. This determination must be made while bearing in mind that all these rivers are already returning the full cost for their management to SWC.

Further, using the NWI qualification IPART needs to determine whether these rises are going to generate “*perverse*” impacts on the regional communities and irrigation industries. Cotton Australia is aware that IPART has commissioned ABARE to investigate the farmers’ ability to pay higher prices for water. Before any consideration can be given to supporting the types of price rises that SWC is suggesting, this ABARE report must be considered and a complete social and economic study must be conducted to assess the impacts of these changes. IPART must demonstrate that these changes will not cause “*perverse*” impacts.

### **7.3 Comparisons between lower and upper bound pricing**

The NWI establishes the following definitions:

***lower bound pricing** – the level at which to be viable, a water business should recover, at least, the operational, maintenance and administrative costs, externalities, taxes or TERs (not including income tax), the interest cost on debt, dividends (if any) and make provision for future asset refurbishment/replacement. Dividends should be set at a level that reflects commercial realities and stimulates a competitive market outcome.*

***upper bound pricing** –the level at which, to avoid monopoly rents, a water business should not recover more than the operational, maintenance and administrative costs, externalities, taxes or tax equivalent regimes (TERs), provision for the cost of asset consumption and cost of capital, the latter being calculated using a weighted average cost of capital WACC.*

*[Extract - Page 29 / 30 Schedule B(i) of Intergovernmental agreement on the National Water initiative]*

Any reading of these two definitions can deliver a long debate over the true difference between the two pricing structures. Importantly though, the upper bound pricing definition refers explicitly to the **avoidance of monopoly rents**. Cotton Australia would contend that the types of price rises being described by SWC are indeed striving to deliver a monopoly rent to the Government. The fact remains that SWC is a monopoly, it can propose whatever charges it likes. Until such time as competition is available to measure its performance against, any substantial dividend being generated is clearly a monopoly rent. This evidence suggests that pricing is **already at upper bound levels** and moving further would therefore be in direct contravention of the NWI.

If SWC is to be operated as a corporation then it should be subject to the same market and corporate responsibilities as other businesses. The SWC submission indicates that although at or near full cost recovery (as indicated above) it still cannot reconcile its expenditure against revenue. This can be the only reason for the claim that prices must increase by as much as 4000%. If the corporation cannot deliver its services in a cost effective manner then the organisation should relinquish its role in areas such as metering and monitoring and these services should be put out to tender to the private sector. Market contestability is the only way in which the irrigation industry can be assured the service being paid for is being delivered the most cost effective manner. With SWC operating as a monopoly it is impossible for any fair and reasonable cost analysis to be conducted.

#### **0.0 The payment of dividends**

Cotton Australia does not, in any way, support the proposition that either DNR or SWC should be providing a significant dividend back to Government. The primary function of the Department of Natural Resources is to regulate the allocation and management of the natural resources within the state. There should be no circumstances under which the department should be operating at such a profit that it can provide a net return to Government. The

Department's role is on behalf of all the community and irrigators of NSW should not be asked to inequitably subsidise its operation.

While State Water may be a corporation, its only shareholder is the NSW Government. Any attempt to garner a significant dividend from SWC is really just profit taking by the Government. This would be taking un-fair advantage of the monopoly position that SWC holds. This type of monopoly rent would be seen as totally unacceptable to the cotton industry. If SWC is operating in such way that it can provide a significant dividend, than this should serve to indicate a need to encourage further competition in the market place for water users to obtain services from alternative private sector interests.

## **7.5 Dam Safety**

Cotton Australia calls on SWC to ensure all infrastructure associated with water delivery in NSW is maintained at a level that protects the rural communities that live nearby. While the industry believes that dam safety risk assessments should be continually reviewed, there is no justification for moving safety standards to anything above socially acceptable levels of risk. These levels should be determined using Australian standards for acceptable risks. The cotton industry would be prepared to contribute a proportion of costs associated with dam safety upgrades, only after facilities have been upgraded to at least the 1997 (line in the sand) standard. Government should be accountable for 100% of the costs associated with upgrades to this level and the majority of the cost for any movement beyond this level of safety. The irrigation sector is just one user of these facilities and therefore cost should be shared equitably across all sectors of the community who derive a benefit from the structure.

## **0.0 Occupational Health & Safety**

The SWC submission suggests that water users should pay all of the costs associated with costs the corporation incurs due to ensuring the organisations capital assets comply with existing occupational health and safety standards. Essentially SWC is arguing the need for an increase in prices to offset the costs of running the corporation within the law. If the organisation is to really be considered a business, than it must operate in the same manner as other businesses. In this regard the cotton industry accepts the need for water users to contribute to the costs of OHS capital compliance. However, the industry strongly urges IPART to demand that SWC recover these costs from **all** of its customers. SWC identifies its customers as being *“irrigation corporations, country town water supply authorities, farms, mines and electricity generators,/...../ water for stock and domestic users and is responsible for delivering environmental flows on regulated rivers”* [extract from SWC website].

Cotton Australia calls on IPART to demand from SWC the mechanisms by which the corporation intends to share these compliance cost across all of its customers. For too long irrigation has been seen as the easy target with regard to revenue income and it is now time for SWC to establish pricing mechanisms for all customers with government accepting the role as the community and environments representative stakeholder.

All businesses must comply with occupation health and safety legislation, including farmers. Unlike most other businesses, farmers cannot pass on the costs associated with legal compliance on to customers. Traditionally, farmers are price takers and receive the current market value for their commodity with very little ability to negotiate. Consequently many farmers are drowning economically in the ever-increasing legal compliance costs being

transferred down from Governments. Cotton Australia requests that IPART considers this situation when making its determination on this matter.

### **7.7 Pricing for Scarcity**

Cotton Australia does not support any price path that allows either SWC or DNR to receive a scarcity charge. When water is not available for irrigation, irrigated cotton farmers cannot grow a crop and cannot receive any income. The concept of a scarcity charge is an insidious grab for profits that does nothing to address the real issue that needs to be managed.

There are a number of ways in which SWC could ensure that its operating costs are matched by income. In low water years the business should obviously need to conduct less activities in relation to the movement of water. Conversely an open water market, in dry years, will reflect the true cost of available water. In this circumstance the corporation will be in a position to participate in the market and at this higher value ensure it can better offset its operational costs.

The SWC will incur expenses associated with the delivery of water designated for the environment. There can be no justification for these costs to be born solely by irrigators. The volume of water dedicated to environmental management is determined by valley specific water sharing plans. The benefit the environment receives from this water is an investment made on behalf of the entire community. Water sharing plans are designed to ensure that available water is distributed in a sustainable way; a way that allows for prosperous communities and a healthy environment. If these plans are in any way affective then irrigators will be extracting only the amount of water in the catchment that is determined to be environmentally sustainable. Insinuating that irrigators should pay a scarcity charge to fund environmental flows that are required to offset the impact they may have on the environment indicates, that there is no confidence in the science behind the WSP.

The cotton industry is committed to working with catchment management authorities to refine and improve WSP's. Catchment committees that represent the interests of the entire community have developed these plans. If these plans indicate the need for environmental flows then SWC should deliver these flows for the benefit of the entire community and therefore the costs should be born by Government, on behalf of the community.

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