



7 April, 2003

Ms Deborah Cope  
Acting Executive Director  
National Competition Council  
GPO Box 250B  
MELBOURNE VIC 3001

Dear Deborah,

**Re: MRFF Comments on 2003 NCP Assessment Framework for Water Reform**

We support our peak body, NSWIC's submission and build on it with our regional perspective below. We preface our comments with the statement of a fundamental principle in our view with respect to NCC's value and role: The essence of NCC's role in assessment of State's adoption of CoAG reforms must be based on interpretation of COAG and should be implemented with the intention of determining 'optimal outcomes' from reforms – rather than assessing State's compliance in terms of 'meeting minimal requirements'. The latter has been our observation of NCC's approach on reform issues and in fact NCC's explanation on why NSW has met COAG requirements on issues such as property rights.

We look forward to NCC's feedback on the above principle and on working with NCC to ensure its role is optimised in playing a key part in ensuring reform outcomes are optimised.

The following sections are broken into reform commitments that are to be assessed during the 3<sup>rd</sup> tranche and are in addition to the submission we made in March 2001 on the 3<sup>rd</sup> tranche assessment framework.

**Reform Commitment – pricing and cost recovery**

***Consumption Based pricing:***

Problems with current application of this principle by governments are that:

- Governments have not identified community service obligations by considering environmental requirements and other non-user beneficiaries (eg: flood mitigation) prior to moving towards consumption based pricing. – That is to say other consumers and beneficiaries besides irrigators have not been collated an apportioned appropriate cost sharing ratios;
- Therefore there is incorrect and inequitable application of the principle of consumption based pricing as irrigators are being asked to pay 90 and 100% of different cost components when their consumption is only a portion of the whole.
- There has been a shift by IPART to Impactor Pays rather than Beneficiary Pays principle in calculating water users' share of costs, which exacerbates the impact of the first two dot points on water users.

### ***Full cost recovery:***

We note that the COAG document places the option of deciding against pursuing full cost recovery on an equal level with full cost recovery, provided alternatives are transparent and justified through public benefit tests. NCC's 3<sup>rd</sup> tranche framework must clearly clarify that full cost recovery and the principle of user pays should apply to the portion of the resource/ asset being used as well as take into consideration ability to pay. Full cost recovery cannot be equitably achieved until there is agreement and specification of what portion of total costs, irrigators are responsible for – ie: community service obligations, principle of beneficiary pays etc as was intended by COAG.

Speaking from the Macquarie experience, legislation enabling the construction of Burrendong dam – our main storage, had flood mitigation as a major premise. Considering Dam sharing statistics and the philosophy of cost recovery from a user pays or a beneficiary pays perspective, it is inappropriate to charge irrigators 90% of operation costs and inaccurate to assume the industry can absorb these costs, without severe economic and social impacts. Irrigators in the Macquarie have access to about 28% of the storage capacity of Burrendong Dam. The Dam incorporates a flood mitigation area, which increases beyond the storage capacity to closer to 150%. This means irrigators share of the entire storage including flood mitigation capacity is closer to 19%, which is a long way below 90%. IPART has set guiding cost sharing ratios of 90:10 for operation costs, but this is based on the assumption that those paying use/benefit equivalent of 90%. It seems now that irrigators have figures such as those above, demonstrating fair cost sharing ratios under the beneficiary pays principle, there is a shift to impact pays, to ensure some justification for charging the majority of costs to irrigators.

#### **Other concerns:**

- 1) Annuity for upgrading or refurbishing water supply infrastructure. DLWC is currently proposing that irrigators pay 100% of an annual rate of return designed to enable upgrades when necessary. The rate of return proposed is 7% - equivalent to that of 90 day Commonwealth bank bonds in the money market. Our concerns with the State's interpretation of COAG and the 3<sup>rd</sup> tranche assessment framework are: It now appears that irrigators are expected to fund 90% of the Total Asset Management Plan –ie the upgrading construction of new infrastructure and then pay 100% of the ongoing upgrade/ renewal costs through an annual rate of return. –there's not much cost sharing when irrigators pay 100%. Again NCC needs to clarify in the 3<sup>rd</sup> tranche assessment framework, the need to share annuity and TAMP costs across all users/ beneficiaries, so IPART, DLWC and irrigators have some clarity in the guidelines.
- 2) Recovery of costs to water agencies of mitigating environmental problems. The cost sharing ratio currently proposed by DLWC is that irrigators pay 50% of Water Management Planning costs. Maybe this is based on the premise that irrigators cause 50% of current environmental problems with river systems. Irrigators have no input into DLWC's Water Management Planning priorities, budget or expenditure. There is no avenue open to irrigators for identifying the need for increased efficiencies / outsourcing of work. Water Management Planning aims to deliver environmental outcomes and sustainable planning. Again NCC must provide direction on cost sharing of Water Management Planning and whether it is fair that any of this cost be shifted to irrigators.
- 3) We have read in various government and NCC documents that pricing may be used as a tool in natural resource management. We see this as inappropriate given that interferences or externalities in the market should not be addressed through 'artificial price increases'.

Considering NCP's market based principles of water reform, to introduce externalities raises market failure as well as equity issues that NCC should be convinced are addressed before pricing is considered as a tool in resource management.

### ***Community Service Obligations:***

It is critical that States demonstrate that they have undertaken public benefit tests to identify cso's and that NCC can provide direction in this regard. The towns directly downstream of Burrendong dam suffered severe and regular flooding in the 50's prior to the dam's construction and so flood mitigation is an important use of the storage which delivers benefits not only to irrigators but to urban residents and businesses. Currently the NSW DLWC approach is to achieve full cost recovery of operation and maintenance of infrastructure through irrigators, even though irrigators are possibly:

- 1) minor stakeholders in terms of proportional share of the dam
- 2) minor stakeholders in terms of benefits flowing from having the dam
- 3) incapable of bearing cost increases of 100's of % over a 5 or even 10 year period.

### **Reform Commitment: Institutional Reform**

#### ***Institutional Role Separation:***

Again NCC needs to provide much more clarity and some strict guidelines in this area as we are unsure whether the current arrangements deliver efficient, transparent, accountable and independent service delivery. The latest 'separation' of State Water from the old DLWC may not be the most efficient means of achieving institutional separation, despite the independence associated with 'physical' separation. For instance we are aware that State Water has problems gaining access to required information for reporting to customers on expenditure and costs from DLWC's database, so how is this going to be improved when the two bodies are completely separated? A sensible approach for NCC to encourage with regard to Institutional Separation would be to consult with State Water, customers and government to develop the goals and key COAG requirements from separation and then come up with an appropriate pathway to achieving separation – such as progressing the 'ring fencing' concept, rather than what appears to have been a 'knee-jerk' response to meeting a reform commitment.

The COAG intent: "As far as possible, the roles of water resource management, standard setting and regulatory enforcement and service provision should be separated institutionally" needs to be clarified by NCC to determine what is acceptable and what is required for delivery and regulation to classify as institutionally separated.

As customers of the delivery body, it is clear to us that DLWC still retains the clear power of authority over most aspects of State Water's business – for instance it is still DLWC as far as we know, rather than State Water, that is responsible for making pricing submissions to IPART.

## **Reform Commitment: Allocation and Trading**

### ***Water Allocation:***

We remind NCC that the term 'allocation' is incorrect in reference to 'entitlements'.

It should be appropriate for NCC to also incorporate the aspects of COAG which indicated that where there was a need for structural adjustment or compensation to assist through the process of reducing over allocations, that this be adequately addressed by State Governments. That is NCC should be asking to see verification that public benefits tests have been undertaken in rectifying over allocations, and that States are addressing impacts on individuals, regions and industries. We understand NCC cannot provide direction on how structural adjustment needs are met, but surely it was the intent of COAG that if these needs were identified, that they were met, so NCC can assess whether public benefit tests are occurring and whether States are demonstrating intent to mitigate impacts.

### ***Water property rights:***

We are still unable to see how NCC through the assessment framework, plans to distinguish between the reform process and the destination in terms of a trading market for water, once reforms are complete, the way COAG clearly separates these two scenarios. While we see strong statements about the need for absolute certainty of ownership, once entitlements are settled, there is no follow-on statement which indicates that once a business is operating in this new market, their entitlement can't be removed unless it is bought or compulsorily acquired with appropriate compensation.

At risk of repeating the same issues we have raised in recent years, irrigators need more security than currently provided and from a market perspective, a market that promotes trading and enables the appreciation of water as a valuable and secure asset requires that changes in an individual's entitlement must occur through the usual buying and selling exchange that makes markets work.

The Lower Macquarie Groundwater Sharing Plan is one example of how the State Government approach to establishing property rights is largely superficial. The Plan sets out to deliver security – however the amount of existing entitlements that are secure for the life of the 10 year plan is as little as 10 to 15% for some irrigators. Firstly there have been massive cuts – up to 80% agreed to in the Plan (these are non-compensable and agency staff admit that the structural adjustment package on offer is not designed to cover all impacts caused by the cuts). Secondly, to remove any exposure to compensation during the plan, bounds for change during the plan were insisted on. This means irrigators can lose further entitlements within the bounds of the plan that will therefore be ineligible for compensation. All the Water Sharing Plans have clauses related to boundaries for change, which were presented on the basis of fully defining security, but operate in a way that delivers a minimal to zero exposure to compensation for the government during the 10 year plan.

We also add our concerns about the complete uncertainty surrounding the 10-year planning period for water users. The system has essentially been designed to enable Governments to reduce irrigators' entitlements before, during and after the 10 year plans without compensation and yet NCC has determined that NSW has largely met minimum requirements with respect to the establishment of property rights apart from a couple of transitional issues.

Some points regarding sections of the assessment framework that we would appreciate further consultation and then clarification from NCC on:

- NCC needs be **specific** about the optimal outcome with respect to the intention of 'long term' tenure.
- Re compensation: NCC needs to provide stronger clarification about the intent of COAG with respect to maximising national income incorporating environmental sustainability and that where individuals regions or industries are impacted by adjustments in access and use conditions that it sees compensation would be appropriate. If the success of reforms is contingent on their implementation, then NCC should be providing directions to States in this regard.
- NCC has stated earlier that rights need to be specified in terms of their nature and ownership – this does not equate to rights being defined within a management system, as is the current approach in the NSW Water Act. Management must be separate to ownership, to ensure its focus on how to best manage the resource. From a previous NCC paper "Arbitrary or non-transparent changes to rules....are unlikely to be consistent with well defined property rights". We see that having property rights dependent on the Water Management Planning process and with the Minister maintaining the right for final say are both problematic with respect to the above point.
- Separation of Ownership and Management: Refer to the following discussion on separation of ownership and management.

COAG spoke of the need to define property rights in terms of ownership, volume, reliability, environmental flows and tenure. NSW Government has legislation, which provides a maximum of 10 years depreciating security for irrigators. The answer, which can deliver the necessary security for both environment and irrigators is to separate the 2 key concepts of ownership and management...

<b>Management = access</b>	<b>Ownership = property rights</b>
<p><b>What:</b></p> <ul style="list-style-type: none"> <li>• Conditions of management must not be set for lengthy timeframes if they are to be flexible to accommodate environmental needs.</li> <li>• Management includes access and use conditions, reliability conditions, off-allocation rules, supply conditions, use of environmental flows etc.</li> <li>• The State Government has focussed debate over rights on the time period of fixed access and use conditions. This is so costs to government of future environmental management are limited and is contrary to the above management principles</li> </ul>	<p><b>What:</b></p> <ul style="list-style-type: none"> <li>• Ownership of water rights is necessary if irrigators are paying the full price of water, are competing for it in the market and require certainty of their investment for future development.</li> <li>• Ownership is an alternative approach to providing use and access rights with limited timeframes.</li> <li>• It is based on the concept that the whole community pays for environmental management through State Government's purchase of water for the environment on the open market.</li> </ul>
<p><b>How - the linkages:</b></p> <ul style="list-style-type: none"> <li>• Valley management plans are the means of determining appropriate management conditions and also for adjusting conditions where necessary over time.</li> <li>• Many management conditions can be varied without impacting on the irrigator's water asset.</li> </ul> <div data-bbox="119 1052 790 1317" style="border: 1px solid black; border-radius: 50%; padding: 10px; margin-top: 20px;"> <p>If more water is needed for the environment, management conditions such as allocation or reliability need adjusting, which will impact on the irrigator's asset</p> </div>	<p><b>How - the linkages:</b></p> <ul style="list-style-type: none"> <li>• If ownership is established through a property right, banks will lend, irrigators can plan for development and the environment has complete access to water through flexible management conditions and the Government cheque book</li> </ul> <div data-bbox="885 1070 1492 1288" style="border: 1px solid black; border-radius: 50%; padding: 10px; margin-top: 20px;"> <p>Ownership is impacted when management conditions are varied that affect an irrigators' allocation or reliability.</p> </div>
<p style="text-align: center;"><b>Example:</b></p> <p>It has been identified that 50,000 ML more water is needed for the Macquarie Marshes each year. This means there would be a ledger style transaction shifting this amount across from irrigator's share of the dam to environment's share; a reduction in irrigators asset. So the system works when the environment is able to participate in the market as a buyer for this water, backed by Treasury as the financier.</p>	
<p style="text-align: center;"><b>Why Separate?</b></p> <ul style="list-style-type: none"> <li>• Separating management and establishing ownership provides certainty for future environmental needs and for irrigators. If management conditions aren't separated from ownership there cannot be flexible conditions to meet environmental needs without compromising irrigators' security.</li> <li>• The alternative which is now the reality via the Water Act: a fixed timeframe of use and access management conditions, during which the State Government pays for changes necessary for the environment. And after this irrigators would lose their rights and have to pay which is neither equitable nor environmentally and economically sustainable.</li> </ul>	

More detailed points relating to the assessment framework:

- **Who Pays?** The issue of who should pay for water is not addressed by NCC (again refer to earlier comments about changes to ownership being a market issue to be resolved through market processes of buying and selling). This question needs to be addressed both for equity reasons and to ensure pursuit of reforms is sustainable. Senator Hill has said to irrigators in the past that it is unsustainable to expect irrigators to fund the entire cost of environmental needs. Property rights is the market based mechanism for sharing the cost across the community – ie: the environment is a paying player in the market, with the community providing funds through the State Government. This removes the market failure scenario of having one player in the market with unlimited, free supply of the good. We refer NCC to the current Federal Environment Standing Committee Inquiry into the Private Costs to Landholders of Public Good conservation. It is not enough to set about only meeting NCP commitments in water reform – also need to be mindful of principles of public good and equity in sharing costs of public good conservation across the whole community in how the market for water is set up to operate. There is an additional debate not addressed in NCC's clarification of property rights and that is to provide direction on who should pay for environmental water. It is a question that is decided by default if irrigators aren't given strong, long term property rights.
- **Bankable security:** We note that NCC specifies that legal rights and bankability are important aspects of property rights. The current NSW Water Act provides a short term security– 10 years, which because of its time frame means the value of the right declines over time. We refer you to the Financial review article p5, 27<sup>th</sup> Feb 2001 – “managers have been asked to ‘review our loan portfolio and identify and accounts with balances over \$200,000 where we are reliant on the value of the water allocation licence attached to the property to secure our facility’. And a further point on p11 of the Background paper– “If governments decide that lending institutions should continue to treat water rights the same as before the separation from land title, tenure and register procedures should be put in place to ensure the newly created water rights have the same level of risk”. Shouldn't NCC be able to make some stronger clarification with regard to this point? It is a characteristic of the irrigation industry that businesses are highly geared and being able to borrow money is critical, so if the key aim of NCP in water reform is to maximise national income and productivity, bearing in mind environmental needs, it should follow that the level of security or greater than prior to reform. It is noted that long term or perpetual licences do not address security needs for irrigators as these aren't bankable – they do not guarantee delivery of or payment for not delivering certainty about reliability and access.
- **Duration:** We note that NCC refers several times to ‘the long term’ sense...this requires further clarification as we believe a depreciating 10 year right is short term and will act as a constraint on trade, investment and sustainability of the industry. NCC must ‘make a call’ on timeframes for property rights. A fundamental point about ownership in property rights is omitted on p7 of the Background paper when it is stated that ... ‘license holder must be able to form a reasonable expectation about the physical quantity of water that the entitlement will deliver over time’. Bankable security comes from knowing that the right has a redeemable value if the entitlement is reduced ie: it can only be reduced via purchase.

- **Compensation** - P8 of the Background paper: "While change is sometimes necessary, it should be based on a sound public benefit or environmental justification and involve appropriate consultation". We see a major flaw in NCP in water reform, which is referred to in this paper; that is, while there is no mechanism to ensure State Governments pay adequate structural adjustment funds to those affected during reform and enshrine rights that have a dollar value for the new market (NCC has the power to deliver this part), the public benefit test is unbalanced. We are convinced NSW currently does not undertake full public benefit tests, as they have avoided costs of implementing reforms. Noted on p 10 that 'It is NCC's view that compensation is not a COAG requirement and is the purview of governments'. This may be the case, but how NCP works on the ground will mean that without compensation there is a market failure which will lead to NCP failures & this is the jurisdiction of NCC.
- **Exclusive nature of right:** "...specification of the right should theoretically include all relevant costs and benefits arising..." Currently irrigators are unable to capture all the benefits arising from their water entitlements as they have had their water title separated from land title and the water title has not been secured to reflect the same certainty through the Water Act. Therefore it has lost value in terms of providing security as an asset to borrow against. Also in terms of the environment share of the resource, without the need for the Government to purchase environmental water in order to accrue environmental benefits, this statement is not consistent... market failure as specification of environmental rights does not include costs of purchase, except within a 10 year timeframe. There may be other ramifications of this market failure where one participant in the market has the power to access water for free from others in the market every 10 years. For instance it may lead to a lower value than would otherwise be achieved and this may have implications for trading. The public benefit test hasn't taken place to consider impacts of a weaker property right...p9 "Jurisdictions should show 3<sup>rd</sup> party effects have been adequately considered, and that where water property rights have been altered or amended that this leads to a net community gain".

## **Reform commitment: environment and water quality**

### ***Provision for the environment:***

#### **1) ARMCANZ principles**

- there is a lack of framework, capability, resources and possibly intent to monitor impacts of environmental flows currently. NCC needs to emphasise this point as part of its assessment process
- there is also a lack of commitment to the approach of adaptive management, based on identifying and then setting about understanding how to protect our environmental assets. Instead it is 'easier' for State Government to set hydrological and not ecological goals – eg: 10% more environmental flows, assuming this will deliver a '10% closer to natural conditions' outcome with no focus on active and adaptive management. (nb: the Macquarie Water Sharing Plan is an exception to this state-wide approach, as our community pushed for a community driven, active management focus, rather than arguing about how many more megalitres should be taken from irrigators for the environment.



## 2) Stressed or over-allocated rivers or aquifers

It is important for NCC to record the words in COAG regarding structural adjustment in rectifying over allocation situations. There is no other body apart from NCC to ensure 'balanced implementation to achieve NCP goals and it is a fact that there will be impacts of rectifying over-allocations which are a result of past government policy. Why shouldn't NCC also state what COAG has to say about recognising that there may be a need for structural adjustment?

### ***Integrated Resource Management:***

It is concerning that the NAP funding process is structured so as to vest power and funds through the State Government rather than going directly to catchment bodies. Catchment Management Boards have not been given skills, structure, power, resources and accountability to make investment decisions. There is no relationship between the Catchment Blue-print targets and government funding.

There is no explicit working relationship at between vegetation, river, groundwater and catchment plans and integration is virtually non-existent at present, apart from at the superficial 'target-setting' level. We suggest consulting with Catchment Management Board chairs as a group who are informed about the pro's and con's of the existing framework in which they operate.

### **Reform Commitment: public consultation and education**

The irrigation industry is 'consulted' regularly, about regulatory and policy changes. However we feel it's a "DAD approach – decide, advise, defend" on the government's part. Governments use the word consultation when they may mean education or information. The intent of consultation should be to express ideas, collect feedback and consequently revisit the most suitable approach. In short, irrigation stakeholders are convinced that the current mode of consultation delivered by the State Government is not genuine, but their demonstration that they are meeting COAG requirements by conducting public meetings and allowing submissions.

With respect to SWMOP and the Water Sharing Plan process as an example, our River Management Committee was asked to respond in relation to whether our Plan complied with SWMOP targets, NOT as to whether our Committee agreed or wanted to comment on the SWMOP targets. We note that the SWMOP feedback process was offered about one month before our final recommendations regarding the Water Sharing Plan were due.

We believe that NCC should adopt the OECD guiding principles (outlined below) for its consultation assessment framework and that Governments must implement a community engagement framework that encompasses the OECD<sup>1</sup> guiding principles for citizen engagement and ensures that:

- (a) Information is complete, objective, reliable, relevant, easy to find and understand;
- (b) Consultation has clear goals and rules defining the limits of the exercise and government's obligation to account for feedback and input; and
- (c) Participation provides sufficient time and flexibility to allow for the emergence of new ideas and proposals from the community, as well as mechanisms for their integration into government policy-making processes.

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<sup>1</sup> OECD Handbook *Citizens as partners: Information, consultation and Public Perception in Policy-making*, OECD, 2001, p.15.

## **Conclusions: What is Impeding the Success of National Competition Policy?**

NCC and Federal Government will be aware of the negative attitudes towards National Competition Policy in the community. People are observing that more harm is being done than good, as businesses, regions and entire industries are adversely impacted by reforms. We believe the failures can be summarised into four points and largely relate to the process of implementation rather than flaws with NCP in principle.

1. **State Governments are not undertaking public benefit tests** in implementing reforms; they are not calculating the costs of reform that COAG rightly identified. This means it is no surprise that States have no intent to mitigate any of the impacts on individuals, regions and industries of reform, via distribution of any funds received as part of the Intergovernmental Agreements. Impacts during the reform process are felt first by the following:
  - a) The businesses that will not survive the reforms and so need to be helped into new opportunities and assisted out of their existing industry.
  - b) The businesses that will survive the reform process in the case of water reform, by investing in increased efficiencies and/or additional water resources etc to cope with the reductions in their water entitlements due to over allocation. These businesses should be receiving some compensation for reductions in entitlements to ease them through the reform process, prior to reaching the new and genuine market place where they should have a secure right.

It is noted that COAG refers to 3 levels of impact with respect to the above types of necessary assistance: individuals, regions and industries.

2. **State Governments have enjoyed a relatively 'soft' process in interpreting the intent of COAG** in reform legislation. States have a direct budgetary interest in how COAG is interpreted, for instance with respect to providing property rights for water entitlements. Environmentalists see that property rights will mean no option to improve the environment; this equation only holds if the State Government refuses to accept responsibility for:
  - establishing a genuine market for trading water where rights are exclusive; and
  - the community's role in funding water that is for environmental purposes and hence the public good.

This failure results in a situation where those that survive the reform process will be operating with a significant market failure, with their water assets remaining unsecured in a banking and legal sense, which will have implications for the tradability objectives of water reform. (currently the NSW Water Act provides some security by tying entitlements to the Water Management Planning process, over a 10 year period).

3. **NCC's process has been flawed** in ensuring reform objectives are met through the implementation of National Competition Policy as:
  - It has no jurisdiction to affect the problems raised in point 1): ensuring genuine public benefits tests are undertaken and ensuring States allocate funds to impacted individuals, regions and industries to ease the process of reforms.
  - NCC has not provided adequate clarity to reduce the magnitude of range in interpretation of COAG that States had available in developing legislation through the 2<sup>nd</sup> tranche assessment

framework, as raised in point 2). This failure was exacerbated during the period when NCC had no contact with industry and so did not grasp the adverse impacts of States' uncontested interpretation of COAG. We note that NCC's attempts to involve industry through consultation for the 3<sup>rd</sup> tranche framework provide an opportunity to correct the flaws in process of points 2) and 3), provided our input can make a difference.

4. The consultation process is not currently designed to be fully inclusive. There is a difference in the outcome of consultation depending on the intent. We believe the only way for communities to feel empowered in the process of making decisions about natural resource management, reforms and the necessary changes, is for them to be involved right up to and including the decision making process. We refer to earlier comments about consultation and the OECD guidelines for community engagement

Unless the 3<sup>rd</sup> tranche process can address the 4 summary points above, we hold concerns for the future of our industry and for the outcomes of NCP. We look forward to a stronger input from NCC during the 3<sup>rd</sup> tranche and for the opportunity to discuss the comments made in this submission (nb we would be happy to work through NSWIC in terms of any NCC consultation process).

Yours sincerely,

**Macquarie River Food and Fibre**

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