Thank you for the opportunity to offer a submission to the National Water Inquiry. The comments contained in this submission represent the views of the authors and should not be attributed to any institutional affiliation.

In an effort to provide some coherence to our submission, comments are compiled along the broad lines of the 'considerations' contained in the terms of reference.

Pricing

The focus on water pricing has been a matter of debate in Australia since the initial water reforms instigated through the 1994 CoAG water reform framework. At a high level those principles still remain sound, although 30 years later it is clear that the devil can often be in the detail of implementation.

In the case of most urban networks, it was presumed that water utilities would operate as natural monopolies when corporatised, at least in capital cities. That provided the platform for economic regulation to be part of the reform process. However, even after 30 plus years, the most recent review by the PC concluded that in "Western Australia, Queensland and the Northern Territory, independent economic regulators do not have the power to set water prices"(PC 2024, p. 2).

Prima facie this could support the view that the other jurisdiction have at least managed to bring prices broadly into alignment with the costs of service provision. Unfortunately, this has not always been the case. Instances of political interference with the economic regulatory processes are clear and range from blanket decisions by water ministers to reduce tariffs at politically sensitive points of time, to sanctioning costly supply actions with scant attention to oversight and the consequences for water and wastewater service consumers.

The nature of the water industry is such that interference of this form can be temporarily absorbed and disguised. If a costly political decision is made (e.g. switch on desalination to provide subsidised surface water to upstream farmers) this is passed through in the next regulatory period to urban households – there is no clear link between the initial poor choice and the 'tab' picked up by customers. Universal cuts to water prices under guises like 'fair water bills' result in deferral of capital projects which are required for the long term sustainability of the network, but won't become obvious to customers immediately.

The point is that the date of the signing of the NWI and its antecedent reform blueprint is not a rationale for rewriting all components brought into the NWA. Some of the unfinished business from the NWI around pricing and economic regulation should be carried into the next phase but with greater attention to reporting and making clear the impacts of political choices on water customers.

Most state economic regulators are required to give attention to affordability when setting (or suggesting) water prices. One way to accomplish this has been the implementation of the building block approach, where the regulator scrutinises proposed capital and operating costs and pairs them back to reduce gold-plating. The lower revenue requirement then results in lower tariffs for all. Nonetheless, the structure of tariffs can be outside the influence of regulation and arguably has not received the same level of scrutiny.

Many jurisdiction retain an inclining block tariff for potable water consumption, partly on the presumption that higher income households will use more water. As our cities become more densely populated it is not always the case that richer households use more water in leafy suburbs. The income of a resident in an apartment in the CBD is likely higher than those living in the suburbs. The presumed distributional fairness of inclining block tariffs and closer attention to tariff structures generally should form part of the next reforms.

Economic oversight and regulatory design

Comments on some aspects of economic regulation as they relate to pricing were provided above. However, the dynamics of economic regulation has also evolved and should be considered in the NWA. Initially, water businesses were largely conceptualised as 'taps and toilets' organisations that were required to meet well-defined standards set by all-knowing health and environmental regulators. In that environment economic regulation reduces to keeping costs to the minimum so that the benchmarks set by others are achieved affordably.

The relationships that have evolved in this space have changed in the last 20 years. First, some economic regulators became aware that the 'rivalry' between water businesses and the economic regulator had effectively squeezed out the views of customers who would ultimately have to pay. Second, customers themselves were becoming more aware of the interface between the activities of urban water utilities, the natural environment and human health. Episodes like drought, COVID (and the testing of sewerage) brought this into sharp focus. Third, climate change is now more prominent as is national population growth, and customers are more informed on these topics. They also have an expectation that water utilities will take responsible actions, beyond taps and toilets.

Against that background, some economic regulators (e.g. ESC and IPART) have made adjustments to their regulatory approach and insisted that water planning place much greater emphasis on the preferences of customers. We welcome this innovation but also caution that understanding customers preferences is no simple task. The techniques used by some utilities would often not pass muster. An unstructured survey asking customers what they would pay is not the same as a carefully designed non-

market valuation instrument. The quality of preference measurement is key to making this evolving approach efficient.

In a related vein, there is very little room - even within the proposed approaches that prioritise customers - to rigorously include risk perceptions. This is especially pertinent in the context of emerging contaminants (PFAS; antimicrobial resistance; etc) and circularity (e.g. wastewater reuse) where the science is developing alongside greater emphasis on customer choice. Under the traditional building block approach and the way discount rates are errantly adjusted upwards to account for speculative project benefits, there is a real likelihood that many actions will be put on hold until the science is definitive. If a regulatory approach genuinely seeks to embrace customer preferences, there should at least be some attempt to bring customers' risk preferences to bear on these types of decisions.

Governance options to improve the overall sustainability of the industry

Since the initial water reform framework of 1994 almost every episode of new reform or review result in calls for water and wastewater to be retuned solely to public control. This of courses misses the point. Water and wastewater services for almost all Australians remains in government hands.

The recent controversies around water/wastewater service provision in the UK has seen the newly elected government in that country return water/wastewater services to some mega-authority. In part this is justified on the basis that economic, environmental and health regulation needs to be more closely aligned. However, the decline in the UK water/wastewater services experienced over recent decades should not be equated to any experiences in Australia. The separation of economic, environmental and health regulation is a model that has served the Australian water-consuming public generally well. As with our observations on pricing, it is the detail that matters within the governance structure.

Given the types of challenges now facing the water sector, it will be important to ensure that new information flows between different regulatory components (i.e. health, environment, economic). It will also be important for utilities to have capacity to process that information and convert it into meaningful and efficient actions. In many cases, water utilities retain a strong engineering culture and some attention to the mix of disciplines expertise and how that is assembled through internal decision making process will be needed.

Regional and equity considerations, including structural challenges faced by regional and remote utilities

The structural challenges of rural and remote communities go well beyond water reform. We nonetheless commend the notion of providing universal access to safe water and arguably this is overdue.

Regrettably, national and state governments of all persuasions have a proclivity to primarily focus on regional communities at times of crises. Drought brings forward subsidies for school children, more road funding or increased mental health services. Few ask why such services were not in place prior to a crisis. Why is there not some universal minimum service provision of public goods given our national wealth?

The commitment to provide safe potable water in remote and regional communities is a step in the right direction and might hopefully be followed by other minimum standards for public goods. Given the current governance of the water sector, it will be important to view such services as public goods and consider funding through general revenue and not cross-subsidies.

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