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National Water Reform 2026
Productivity Commission
GPO Box 1428
Canberra ACT 2601

Submitted via website at: https://www.pc.gov.au/inquiries-and-research/water-reform 2026/make-submission/

Submission – Productivity Commission's National Water Reform 2026: Water services reform directions – Interim Update

Dear Commissioners,

WaterNSW welcomes the opportunity to provide a submission to the Productivity Commission's (PC) *National Water Reform 2026: Water services reform directions – Interim update* that focuses on policy and regulatory settings that could support secure, resilient and sustainable water services.

WaterNSW supports the Commission's view of why secure, resilient and sustainable water services matter and the role of water pricing and economic regulation and as summarised below:

> *Sustainable water services matter because short-term decisions can create larger costs and inequalities over time. Delaying maintenance, underinvesting in infrastructure renewal, or overlooking environmental impacts may reduce near-term costs, but can lead to higher future bills, poorer service outcomes and reduced welfare for future generations.*[1]

This submission sets out WaterNSW's recent experience as a bulk water service provider in rural NSW and provides our insights arising from IPART's recent review of charges for WaterNSW's rural bulk water services.

Specifically, IPART's 2026 determination for WaterNSW's rural bulk water services highlights the growing difficulty of balancing customer affordability, efficient cost recovery, infrastructure renewal, regulatory obligations and long-term service resilience. The determination shows that while traditional pricing principles—particularly cost reflectivity and

[1] PC *National Water Reform 2026 Interim update – Water services reform directions,* 2026. Page 3.

user pays— remain critical for economic efficiency, they are increasingly strained where efficient costs are rising faster than the capacity of rural and regional customers to pay.

The review highlighted several interconnected challenges.

Affordability and cost recovery are increasingly in conflict

The absence of a clear long-term funding model for rural bulk water services creates growing tension between efficient cost recovery and customer affordability. As infrastructure ages, climate-related risks increase, compliance obligations expand and customer numbers decline in some valleys, efficient costs continue to rise.

There has been a significant reform agenda in Water, and across the Murray-Darling Basin for many decades, but increasingly so in the past five to ten years. A fundamental flaw in the policy and regulatory design of reforms (at both Commonwealth and State levels), is that the cost of implementing those reforms is almost never considered. As the system operator, our perspective is that Government's often think that the cost will be borne by WaterNSW (and our equivalent operators in other States), and that because we're economically regulated, the cost of reform will be recovered and it's not a matter for Government to be concerned with. Governments never seem to consider the capacity of the end user (or the utility) to pay for the reforms in their design and implementation.

In theory, these costs could be recovered through higher customer prices. In practice, however, attempting to move rapidly toward full cost recovery risks creating a "death spiral", where rising prices reduce participation, shrinking the rural and regional customer base and further increasing costs for those who remain.

The recent WaterNSW Rural Valleys determination highlighted the reality that government contributions will continue to play an essential role in maintaining affordable rural water services, and in particular the cost of implementing ambitious reforms in the sector.

It starts with the regulator establishing long-term efficient costs

WaterNSW strongly endorses the Commission's recognition of the role of independent economic regulation and its emphasis that regulation should be focused on the long-term interests of customers. We also support the submission by the Water Services Association of Australia (WSAA), of which WaterNSW is a member, that sustainable, resilient and affordable water services ultimately depend on prudent long-term investment and the recovery of efficient costs, rather than the suppression of prices in the short term.

The primary role of an economic regulator is to determine the efficient cost of providing services that promote the long-term interests of customers. This is critical because sustainable and resilient water services depend on ongoing investment in infrastructure, capability and compliance. Where efficient investment is deferred or suppressed, the risk to service quality, reliability, resilience and long-term future affordability increase. The literature on this issue is extensive and well established.

At the same time, WaterNSW acknowledges the Commission's observation that economic regulators, including IPART are "*under pressure to limit water bill increases in response to* *broader cost-of-living concerns. In some jurisdictions, governments make this pressure explicit through public directions or requests to regulators, in others, it may be less direct or visible*".[2] Consequently, affordability impacts cannot be ignored in regulatory decision making.

WaterNSW agrees with the Commission that affordability is fundamentally a social objective rather than a basis for systemically suppressing prices below efficient levels. In general, affordability concerns are better addressed through targeted concessions, community service obligations (CSOs) or other forms of government support than through lower average prices for all customers. This inevitably creates tension between economically efficient pricing and near-term affordability objectives.

A critical but often underappreciated role of economic regulation is therefore to explicitly identify the long-term efficient cost of providing services and the prices that would be required to recover those costs in the absence of affordability constraints. Establishing this cost-reflective benchmark is essential. It creates transparency around the true cost of service provision, enables governments and communities to understand the scale of any affordability challenge, and provides utilities, customers and policy makes with greater visibility of future pricing and investment pressures.

Only once efficient costs have been clearly identified should decisions be made about how affordability concerns are addressed and who should bear those costs. Without this transparency, there is a risk that affordability measures simply obscure the underlying cost of service provision, making long-term planning, investment and funding decisions more difficult.

To IPART's credit, this approach ultimately formed the basis of its 2026 Rural Valleys determination. IPART first assessed WaterNSW's efficient revenue requirement and then considered mechanisms to moderate near-term bill impacts for customers. While there may be differing views on the appropriate balance between cost recovery and affordability, the determination demonstrates the importance of identifying efficient costs before considering how affordability objectives should be addressed.

Limited information constrains targeted affordability responses

A central issue is the absence of a clear long-term funding model for rural bulk water services. Ageing assets, climate-related risks, compliance requirements, environmental obligations and digital investment are increasing costs, while some valleys in the Murray-Darling Basin face declining customer numbers. Because many costs are fixed, higher prices can quickly intensify affordability pressures and risk a "death spiral" in which reduced participation further increases costs for remaining customers.

While these investigations provided useful insights, they also exposed a broader challenge: there remains limited evidence and research on customer profitability, resilience and adaptive capacity across different industries and regions. Without sufficiently granular information, regulators have few practical options for addressing affordability concerns.

[2] PC *National Water Reform 2026 Interim update – Water services reform directions,* 2026. Page 7.

Consequently, IPART adopted annual price caps of 10 per cent plus inflation—an approach broadly consistent with the alternative pricing pathways proposed by WaterNSW. While effective at limiting immediate price impacts, price caps are ultimately blunt instruments that spread support broadly rather than targeting those most affected. More sophisticated affordability mechanisms will require significantly better information and stronger collaboration between governments, regulators and utilities.

Affordability constraints limit future tariff reform

The determination also highlights a less obvious consequence of persistent affordability pressures. As average prices increase in real terms, the capacity to pursue tariff reform becomes increasingly constrained.

Even where tariff reform may improve economic efficiency, changes inevitably create both beneficiaries and adversely affected groups. When affordability is already a primary concern, there is limited scope to impose additional price increases on any subset of customers, even where doing so would enhance long-term pricing efficiency. As a result, the ability to implement meaningful tariff reform becomes progressively more difficult.

Regulatory decisions cannot be separated from policy decisions

The determination also demonstrates the practical challenges created by the interaction of government policy, regulatory obligations and economic regulation.

Formally, the responsibilities of participants are clear. WaterNSW delivers bulk water services, IPART determines efficient prices, sector regulators establish compliance requirements and governments set broader policy objectives. In practice, however, new regulatory requirements, environmental obligations, government-directed initiatives and licence conditions frequently create costs that must ultimately be funded through the regulatory process. These new regulatory and policy obligations rarely consider costs and benefits, how they interface with each other and how they should be funded i.e. customer v government.

This creates a situation where pricing decisions increasingly become proxies for broader policy questions regarding who should bear these costs—customers, governments (viz: the taxpayer). These questions extend beyond the traditional scope of economic regulation and require a more integrated approach across government.

IPART recognised the need for broader reform

In its final determination, IPART acknowledged that the long-term sustainability of the rural water sector cannot be resolved through a pricing determination alone. It identified three interrelated challenges requiring broader review:

- increasing costs driven by ageing assets, regulatory obligations, environmental requirements, digital investment and climate-related pressures;
- growing affordability constraints affecting irrigators, local water utilities and regional communities; and

- the need for a sustainable long-term funding model that clearly defines the respective roles of customers and government.

Accordingly, IPART recommended that the NSW Government undertake a comprehensive review of the regional and rural water sector to establish a more sustainable long-term framework than can be achieved through periodic pricing determinations.

A determination with no clear winners

The 2026 determination highlights the difficult trade-offs involved when affordability, sustainability and resilience objectives collide and there are no clear winners.

- Customers in many valleys face annual price increases of up to 10 per cent plus inflation.
- WaterNSW reduced its workforce by around 25 per cent in response to the 2025 determination and continues to face significant pressure to manage rising costs while maintaining service resilience and renewing ageing assets within constrained revenue settings.
- The NSW Government is required to make a larger contribution to bridge the gap between efficient costs and customer charges.

The determination demonstrates that there are rarely simple solutions in an environment of rising costs, affordability constraints and increasing investment requirements to support the renewal and maintenance of aging assets built some 50 plus years ago at a materially lower real cost, often with the regulatory asset values written down to keep prices low. Regulatory decisions alone cannot resolve these structural challenges. Long-term sustainability will require earlier cost discovery, better evidence on affordability impacts, clearer funding arrangements and stronger collaboration between governments, regulators and utilities.

A sustainable framework will need clearer roles for customers and government, earlier discovery of emerging cost drivers, better assessment of affordability impacts and more integrated policy and regulatory decision-making.

Key lesson

The central lesson from the Rural Valleys determination is that achieving affordable, sustainable and resilient water services is a shared responsibility. Importantly, this begins with the regulator transparently identifying the efficient long-term cost of providing services and establishing a cost-reflective base against which affordability challenges can be assessed. As cost pressures intensify, successful outcomes will depend on closer collaboration between governments, regulators and utilities to understand emerging cost drivers, assess affordability impacts and determine how the costs of essential services should be shared.

Governments also need to take more accountability for the volume of regulatory and policy change that is always additive, and which is rarely subject to regulatory impact statements that consider the funding approach, or the capacity of water users (nor the utility) to pay for the reforms.

Greater transparency, earlier cost discovery and a more coordinated approach to long-term funding will be critical to avoiding blunt economic regulatory responses, and for ensuring rural and regional communities continue to receive safe and reliable water services at prices they can afford.

WaterNSW support's the Commission's review into this important matter. We would appreciate the opportunity to discuss our perspectives and experiences in more detail. In the meantime, we can be contacted via OfficeoftheCEO@waternsw.com.au.

Regards,

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