Industry Feedback

qldwater *Collated Industry Comments*

National Water Reform

Response to Productivity Commission Issues Paper March 2017.

April 18th 2017

Contents

1. **Summary**

The Productivity Commission Inquiry Report into Australia's Urban Water Sector (2011) provided insights into challenges facing the sector in Queensland. Since 2011, Queensland has seen incremental improvements in sector regulation and the commencement of voluntary initiatives such as the Queensland Water Regional Alliances Program (QWRAP). However, the lack of federal follow-up and interest in the National Water Initiative more broadly can only be described as a missed opportunity for urban water and sewerage services.

Queensland has a series of unique challenges to address in regional and remote (including indigenous) communities and policy solutions should be the subject of carefully considered and regionally-specific studies. The Issues Paper speculates on themes including economic reform which need to be packaged with reviews of sector governance, financial sustainability including asset investment, levels of service and an appreciation of the broader impacts on local government services to determine viability. In the absence of major regulatory reform, carefully planned and targeted incentivisation is required to address current market failures and the future needs of a sector facing the repercussions of inadequate historical capital investment strategies.

2. **Background**

The Queensland Water Directorate (***qldwater***) is the central advisory and advocacy body within Queensland's urban water industry representing the majority of the State's Water Service Providers, from small local governments up to major utilities including Queensland

Urban Utilities and Unitywater. ***qldwater*** works with its members to provide safe, secure and sustainable urban water services to Queensland communities.

This response to the "Productivity Commission Issues Paper March 2017" reflects ***qldwater's*** views and not necessarily that of its members. While an opportunity to provide input was extended to representatives of its Technical Reference Group, the timeframes permitted did not make it possible to conduct a full consultation process.

The Scope of the inquiry is described in the discussion paper as:

> *In undertaking the inquiry, the Commission should assess:*
> - *progress in jurisdictional adoption of NWI principles*
> *the outcomes to date of the NWI and related water reform efforts, taking account of other drivers of reform*
> - *progress against the recommendations in the National Water Commission's National Reform Assessment 2014, and*
> - *the extent to which the NWI reforms are adequate to support government responses to emerging or changing water management challenges, including in the urban sector.*
>
> *The Commission should also consider:*
> - *the potential and realised benefits of NWI implementation*
> - *the scope for improving the NWI, addressing current and future challenges*
> - *broader water policy issues and the role of the NWI in improving outcomes, in particular:*
>   - *the interaction of water policy with other policy areas such as energy, agriculture, planning, urban supply*
>   - *whole-of-cycle water management*
>   - *provision to regional, rural and remote communities, and*
>   - *the economically efficient provision of water infrastructure.*

qldwater's core business and expertise is in support of urban water and sewerage services, and the responses herein are in limited to the parts of the Issues Paper which specifically deal with those services or other issues which impact on the provision of those services.

3. Specific Comments in Response to Issues Paper

P. 7 Information Request - The Commission welcomes feedback on data and information sources that might be useful

qldwater manages the Statewide Water Information Management System (SWIM) on behalf of its members. SWIM consists of an annual data tool for compliance reporting to the state Department of Energy and Water Supply (DEWS), Bureau of Meteorology (National Performance Report and National Water Account) and Australian Bureau of Statistics (ABS), along with operations and reporting tools supporting individual service providers in data management. Aside from the National Performance Report (NPR) for larger utilities, a voluntary State Benchmarking Report has been produced since 2010/11, and DEWS has commenced production of an Annual Performance Report with its introduction of mandatory Key Performance Indicators for all service providers from 2014/15.

The Queensland Water Regional Alliance Program (QWRAP) is an industry-led initiative to investigate regional collaboration on water and sewerage services. The program is led by the Local Government Association of Queensland (LGAQ) and managed by ***qldwater*** with financial support from DEWS, ***qldwater,*** LGAQ and participating councils. Several reports

have been produced investigating governance, financial sustainability and collaborative models.

P. 7 Developing Future Reform Priorities - Unfinished Business

The section refers to a number of issues of potential relevance to urban water and sewerage management in Queensland, including "ecological objectives," "indigenous objectives" and the "incorporation of all water users into one water planning framework," however the lack of detail makes commentary difficult. A single planning framework would appear to be an impossible objective given the diversity of regulatory and governance models in place nationally.

P. 8 The Efficient Provision of Rural and Urban Water Services….

qldwater agrees that the urban water services component of the NWI is an area least advanced and should be a priority.

P. 9 Planning including allocation and sharing of water resources
(Other aspects of the preliminary framework relating specifically to urban water are dealt with below – P.25 reference)

(a) There is limited recognition of sewerage services in the Issues Paper. There are a number of issues which illustrate the disconnect which can exist between planning for growth and sewerage service provision with the environmental regulator typically having limited involvement in planning for major development. With policy objectives of reducing releases to waterways and favouring land-based disposal, this creates a significant costs and tensions in regions where land availability is limited. In addition, encroachment is a significant problem driving major capital upgrades for odour and noise control at sewerage infrastructure sites. Ultimately this leads to cross-subsidisation by existing customers.
(b) There are limited examples of successful community engagement in urban water planning, particularly around infrastructure investment. TOTEX is not always adequately considered in decisions, largely driven by an *ad hoc* historical approach to grant programs.

    By way of example, Queensland has approximately 370 water supply schemes, servicing communities from very small to very large sizes. There are inconsistent levels of service, no recognition of community service obligations, and little structure to the initiatives for capital support funding from other levels of government.

    A successful community engagement program would seek to break the current cycle by critically examining water and sewerage supply upgrade and replacement activities to help communities understand the value of water services, being transparent about levels of service, infrastructure options to deliver that service, and the real impact of choosing each of those options on government and individual customers.

P. 12 The Need to Incorporate Water Quality Objectives Into Water Planning Arrangements.

It is important to reinforce that the cost of capital is the biggest driver of service provision to urban water customers. Source water quality in Queensland is incredibly diverse, with some communities located in the Great Artesian Basin able to source water which requires limited treatment, and others that require complex, multi-barrier solutions. It is a fundamental question driving long-term financial sustainability of communities. Water quality has to be a major driver of strategic greenfield investment (and disinvestment).

There are existing DEWS programs that have successfully focussed on regional water supply security and a well-considered approach to the location of future bulk water infrastructure. More extreme drought and flooding events impact water quality significantly for existing sources, creating new capital challenges. Aside from the immediate issues created by major events, there are longer term quality challenges; e.g. a need to consider methods of iron/ manganese removal from sources which were previously managed with conventional treatment.

The impact of diffuse pollution sources has become conspicuous in Queensland, particularly in catchments of the Great Barrier Reef. The impact on the state's many unprotected drinking water catchments has not received the same level of attention, and the introduction of Health Based Targets to the Australian Drinking Water Guidelines will create major challenges if regulated as intended.

P. 20 Setting Infrastructure Charges

There is no consideration of urban water and sewerage infrastructure charges. Successive state governments in the last ten years have made regulatory amendments to cap what service providers can charge, with the current arrangements calculated on a regulated index. This level of intervention should be questioned.

There is an ongoing process to address pricing inconsistencies in how the state's major bulk water provider, SunWater, deals with urban customers, particularly to improve transparency around how prices are developed. The LGAQ is leading this work on behalf of customers.

P. 25 What policy and institutional arrangements are needed in the urban water sector to improve the efficiency of service provision?

Drivers of Efficiency

Efficiency is determined in part by customer demand (i.e. high water demand may degrade assets faster than low demand), workforce capacity (a skilled workforce operates assets more efficiently) and management skill (determining the emphasis placed on efficiency and productivity). However, external drivers (e.g. water source, topography customer density and population size) are also key drivers. A list of drivers relevant to the Queensland industry was developed in the QWRAP Cost Drivers Report but the list does not prioritise the drivers or determine which can best be addressed through policy levers. However, the

QWRAP paper clearly shows that the complex interactions among these drivers make it difficult to monitor and review efficiency, let alone compare among utilities.

The PC Discussion Paper notes that "urban water supply is presently dominated by large monopoly businesses" and this is true in Queensland in terms of number of connections but not necessarily in terms of number of utilities (Figure 1). The scattered urban population across a large state means that Queensland utilities service over 370 public supplies, some up to 100 km apart, and 88% of which are potable. Two thirds of the potable services supply towns with fewer than 1000 residents. Half service fewer than 500 people. Sewerage services are present in fewer towns but are equally widespread geographically.

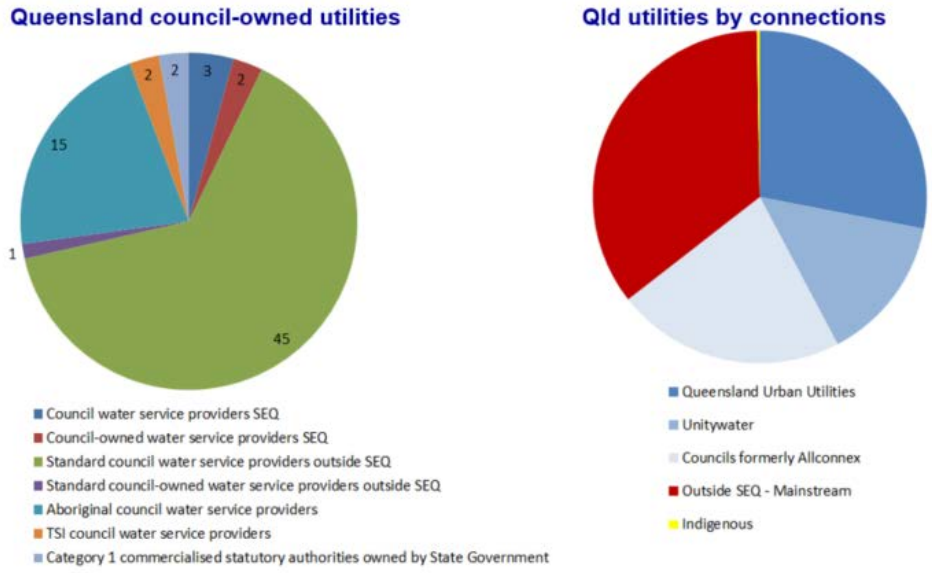

Figure 1: Number and type of Queensland communities and distribution in terms of size (number of connections) showing that over 60 regional utilities service around one third of the urban population.

This diversity makes it difficult to compare utilities in terms of efficiency. It has been suggested in past reviews that alternative institutional arrangements (e.g. aggregation and regionalisation) may not only improve the ability to assess efficiency, but also access economies of scale (and thus further improve efficiency). Unfortunately, this suggestion is easy to make but is unlikely to be achievable. The population distribution of Queensland, one of the world's largest sub-national jurisdictions, means that it has a significant number of regional urban communities serviced by public utilities (Figure 2). The question of how to services these

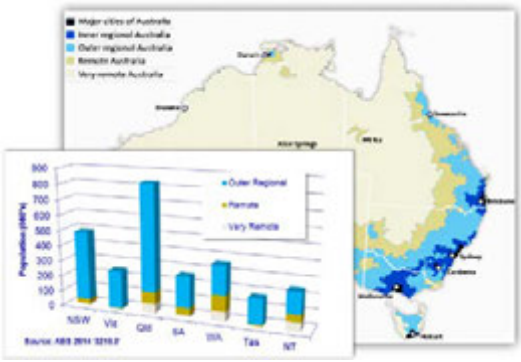

Figure 2. 'Remoteness structure' showing the large population outside major cities and 'inner regional' Queensland.

communities efficiently goes beyond simplistic comparisons, but may also provide a limit for the ability of aggregation and microeconomic reform to generate efficiencies (see e.g. the QWRAP Review of Sustainable Models).

Often efficiency studies have used the volume of water produced as an index of productivity. This is an absurd metric for an industry charged with providing safe, secure and sustainable supplies, as opposed to increasing sales volumes of water (not to mention the conflicting need to manage water demand). For local governments, success of council services, including water and sewerage, may be even broader. Councils often act as if the wellbeing and stability of their communities should be maximized (including e.g. local employment). This approach does not necessarily maximise financial efficiency but should at least be recognised as a rational attempt at "efficient use" of water and sewerage assets for broad community benefit. At the very least, water sector reform should be considered in light of the impact it would have on small, regional and remote communities.

The Inquiry could be more specific on what efficiency or productivity means for Australia's small regional communities. Alternatively, the importance of this requirement could be reduced and emphasis instead placed on decision-making on infrastructure investment as it is a far more important determinant of the cost to serve as discussed below.

Efficiency through improved decision making on capital investment

The quality of decision-making across the asset lifecycle has the potential to have the biggest impact on efficiency of service provision. This is because up to 90% of the cost to provide services is driven by capital decision making because the assets selected drive ongoing operational costs, depreciation and debt. Effective asset decision-making requires quantification of the full lifecycle cost of service provision and this can be difficult for long-lived assets as it must consider the full cost of planning, acquiring, operating, maintaining, monitoring, renewing and disposing of an asset.

It is often acknowledged that institutional barriers and perverse funding incentives act against whole-of-lifecycle planning. In Queensland decision-making is primarily driven by local requirements (including regulatory standards) and the availability of state (or federal) funding. This can lead to perverse outcomes particularly if the political imperative is to spend available funds and build infrastructure to meet (sometimes ambitious) growth targets regardless of current need. This problem has been exacerbated in Queensland through funding processes with no strategic oversight and *ad hoc* and politically-motivated funding rounds. These processes do not select infrastructure based on optimal TOTEX nor fit-for-purpose outcomes as they are commonly driven by contemporary political exigencies.

At the local scale, the local government decision-making on infrastructure can benefit communities. Good decision-making requires making trade-offs. Often, difficult trade-offs need to be made between the cost of delivering the services and the desired service outcomes. The impact of changing service outcomes on the cost of providing services must be understood and communicated to customers and local governments are often best placed to have this dialogue with their communities and examine trade-offs in the context of broader regional planning. However, this process is typically dominated by very local and

temporally limited decision-making meaning the trade-offs may not consider broader (e.g. regional or state-wide) needs or the long-term needs of current and future generations.

The inquiry could place emphasis on the importance of infrastructure planning and decision making and recommend regional, state-wide and national prioritisation of strategic capital planning in partnership with local communities (who best understand local needs and acceptable levels of service).

Efficiency through innovation

Innovation is still a key need for the sector which is naturally conservative, particularly under political governance (either state or local government) because of the predominant political apathy regarding the sector. In Queensland, innovations are developed across numerous utilities and sharing and spreading new approaches can be difficult. For this reason, ***qldwater*** holds regular regional forums and annual regional tours of members (with key QG agencies participating). It has also held annual innovation days for the last three years as well as convening events focused on specific technologies.

Regional sharing is facilitated through the Queensland Water Regional Alliances Program (QWRAP) which also encourages private sector participation in order to increase diversity of inputs and foster innovation. The PC 2011 Review showed that PPPs and outsourcing were more common in other Australian jurisdictions than in Queensland and this is likely still the case although alliancing and outsourcing arrangements have changed in SEQ over the past several years. There is also a large degree of unreported outsourcing and PPPs in regional Queensland where small utilities often rely on consulting firms and other private sector providers for some or all aspects of their management of water and sewerage services. As an example, several councils in western Queensland employ engineering firms to manage their entire water and sewerage portfolio. This fosters sharing capacity and innovations around a region and importing ideas and innovations from other areas and other sectors.

The Inquiry should encourage innovation already occurring within the industry and mechanisms to increase spread and uptake of innovations as a mechanism to improve efficiency. Participation of the private sector could be encouraged for the purposes of introducing and developing innovations and a more thorough review the extent of current PPPs be undertaken. However, the issue of full privatisation of the sector should not be recommended for the reasons discussed below (see P.25 – Competition).

Efficiency through institutional change

The drivers for institutional change are described at length in the Infrastructure Australia (PWC 2010), NWC 2011 and PC 2011 reviews which also recommended alternative models. While the alternative models recommended in the PWC 2010 review and by some subsequent commentators and reports published by Infrastructure Australia are short-sighted in the Queensland context, the recommendations of PC 2011 review have been regarded as valuable and more realistic. The need for fit-for-purpose change reflecting the recommendations of the PC 2011 review were examined in detail in the QWRAP Review of Sustainable Models.

Indeed, the Queensland Water Regional Alliances Program was developed partly in response to the PC 2011 recommendations and has progressed successfully through three changes in Queensland Government. The background and progress of the Program were summarised in 2016 in the QWRAP Progress Update (and see also http://www.qldwater.com.au/QWRAP). The QWRAP program is seen as a powerful mechanism to prepare for and encourage institutional change including regionalisation, corporatisation and to increase private sector participation. However, substantive voluntary change is unlikely in the absence of a real threat of mandatory restructuring or incentives external to the industry.

If institutional change is recommended in the current PC Inquiry then the optimal model(s) for a large and dispersed state such as Queensland need to be considered. The PC 2011 Review found that models needed to be fit-for-purpose at a regional level and that large state-wide models could be subject to diseconomies of scale. This raised the question of the optimal size for water and sewerage utilities (which is also addressed in the QWRAP Scoping Paper and the QWRAP Review of Sustainable Models). These reports reviewed the academic literature investigating optimal size of water utilities and found the results to be mixed. While there are some papers that interpret data (loosely) to mean that there is a turning point at 90,000 connections, even these papers present data that shows that there is always mixed performance with high-performing utilities occurring at a range of sizes. This is not because size is not important but rather, because it is only one of a large number of cost drivers that impact efficiency of water and sewerage services.

The QWRAP review of Cost Drivers and Financial KPIs provides an initial list of major cost drivers and shows that many are extrinsic to the business (particularly customer density, water source and compliance costs) and are also difficult or impossible to influence (regardless of institutional type or size). The real answer to the question of optimal size is that it depends on the specific circumstances of the communities being served (e.g. the size and density of service areas) and most tellingly, on the governance and management skills and focus within the utility.

The Inquiry should not focus on the absolute size of a utility but should emphasise how small communities (and poor customers) should be cross subsidised (e.g. through CSOs) to level the playing field and how the industry can be best structured to attract and retain appropriate management and governance which is a primary determinant of efficiency. Such recommendations could be agnostic to the specific ownership model so long as governance is appropriately compartmentalised.

P.25 What approach should be taken to price regulation in the urban water sector? Is there a need for greater consistency in price setting approaches across different jurisdictions? Do current pricing practices promote investor confidence?

Price setting and full-cost-recovery

The Discussion Paper mentions progress towards full cost recovery (p. 22, 23) as a desired and partly achieved aim. This is true for metro and large regional providers in Queensland. In many other regional communities however, the barriers to achieving full-cost recovery and ensuring sufficient revenue are threefold.

a) Typical urban water bills are higher than those in other states even when prices are not fully cost-reflective. This means any transition to full-cost procing will have a large economic, social and political impact on communities.
b) Full cost pricing would be unfeasibly high for small towns. Of the 370 water supplies in Qld, 88% are potable and two thirds service fewer than 1000 people. This means postage stamp pricing or cross subsidisation is necessary to make such supplies affordable to local residents (thereby artificially raising prices in neighbouring large communities).
c) Internal cross-subsidies are common in small towns to eke out insufficient revenue from water rates while in others, water rates can subsidise other council activities. Transparency is limited and any attempt to increase it is politically unpopular at local, state and national levels. Indeed, a key (but unstated) reason for regionalisation or horizontal aggregation is to seek economies of scale that will support small communities at the cost of their large neighbours.

The NWI seeks continued movement towards upper bound pricing in metropolitan areas while in rural and regional areas: "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". In the latter case the size of the CSO "is to be reported publicly and, where practicable, jurisdictions to consider alternative management arrangements aimed at removing the need for an ongoing CSO". A number of Queensland communities do not recover revenue sufficient to cover OPEX, let alone depreciation, capital costs and return on capital.

Making these cross subsidies transparent is a critical need but is hindered by a long history of water and sewerage services and their customers both taking each other for granted. This is not because the service is not valued but rather because it is considered so essential that it is taken for granted. The result is that revealing the true cost of urban services could well shock many communities and their politicians. Real charges would be unaffordable and CSOs would be inequitable across the state. This further reduces political appetite for full transparency. Simply recommending that FCP and improved transparency is needed is therefore insufficient to drive change.

The Inquiry could provide recommendations on how to achieve this difficult transition for small communities without financial incentives, particularly if cross subsidies are to be 'limited' (as implied at p. 20 of the Discussion Paper). Conversely the need for changed price setting in large communities would need strong justification.

Independent price regulation

For urban water in Queensland independent price scrutiny has taken place in South East Queensland through the Queensland Competition Authority, however the process is currently under review as it is considered by many to be unwieldy and overly expensive. The combination of local governments now operating water retail and distribution and sewerage services (Gold Coast, Logan and Redland City) and discrete distribution-retail entities (Queensland Urban Utilities and Unitywater) in SEQ has contributed to the need for

a review. Local governments set prices outside SEQ, and there are regulatory provisions for pricing oversight for larger councils which have not historically been triggered.

The recent Harper Review recommended "State and territory regulators should collectively develop best-practice pricing guidelines for urban water, with the capacity to reflect necessary jurisdictional differences" followed by full implementation of the NWI (see p. 53). Pricing reform with centralised price setting appears to solve a number of problems at face value but needs deeper analysis given the market failures unique to the water and sewerage sector. There are several reasons provided for independent price setting. The NWI, PC 2011, NWC 2014 and Harper Review state that pricing reform is critical to economic efficiency and distinguish the need for "(a) independent economic regulation and (b) the institutional separation of service providers from the regulatory and policy functions of governments because of the natural monopoly and market failures". Institutional separation is discussed elsewhere in this response and this section focusses on independent regulation.

The Harper review found that cost reflective pricing may "increase incentives for the private sector to invest in water infrastructure. This would allow the market to better address issues related to meeting increased demand." (p.59). The hope of the Harper Review and of many reports from Infrastructure Australia (e.g. PWC 2010) appears to be that chronic under-investment in infrastructure might be remedied by setting more realistic prices to entice private sector capital. While transparent full-cost pricing and CSOs should be the ultimate aim for the sector, such recommendations are essentially pointless without close examination of the barriers to achieving this holy grail for all public service utilities. Firstly, the recommendations ignore or avoid the political and financial problems caused by current cross-subsidisation (discussed above). But there are many other barriers.

Some of these are recognised by the Harper Review which noted (p. 204):

- that PWC 2010 states for FCP, "phased implementation is a justifiable policy";
- "Major 'overnight' changes to water prices would impose a considerable economic shock on individuals and businesses, whose capacity to change water-use behaviour in the short term is limited";
- "institutional inertia and the lack of political acceptability and public understanding of reforms are also impediments to progress";
- the PC 2011 review "considered that equity issues are best dealt with outside the urban water sector through, for example, taxation and social security systems"; and
- previous advice shows that nationally consistent principles in relation to competition and private sector participation in the water market would be required in any case.

Their solution was to develop national bodies such as an Access and Pricing Regulator (see Recommendations 43 and 50) in the hope that "States and Territories refer national water functions to it" to develop a national pricing framework. Then, "all jurisdictions should develop timelines to implement the principles of the National Water Initiative within **six months** of the ACCP developing pricing guidelines" [highlighting added]. This is a nonsense. Given the cost and risk to each jurisdiction it is difficult to see how such a recommendation could ever be enacted voluntarily and there are no national powers to require the change. This leaves incentives as the only remaining lever and given the potential cost of economic regulation and, in particular, achieving full cost pricing, such incentives would need to be substantial.

Private capital to addressing historic under-investment

The assumption discussed above is that that pricing reform will create "incentives for increased private participation in the sector" in order to redress the problem of under-funded water and sewerage assets. The need for greater infrastructure investment and the importance of market-based solutions are both real, but linking them through pricing reform is hopeful at best. Analysis is required on whether cost-reflective pricing is necessary and sufficient to solve ay infrastructure deficit through private funding. This could include analysis of:

- whether the infrastructure deficit is real and if so how large and wide-spread,
- whether a move to cost-reflective pricing is realistic in any useful timeframe without significant state and federal CSO payments and other incentives,
- even if this is achieved, whether FCP would be sufficient to attract private investment to fund an infrastructure deficit in communities other than those that are well-placed to manage the issue themselves.

Once these questions have been answered there should be further examination of whether the market can actually address poor infrastructure planning and under-investment. This must include examination of:

- processes through which the market might be expected to act in both metropolitan and regional Australia,
- whether private investment can be expected to equitably and consistently address the problem (rather than 'cherry-picking' investments and avoiding communities that produce poor returns),
- the degree of regulation and market manipulation that would be required to achieve the above (given they have not evolved naturally through market-based mechanisms in any jurisdiction overseas),
- the real efficiencies available under privatisation and whether they are sufficient to cover the additional dividends required by (mostly foreign) investors,
- all advice recommending greater emphasis on market-based mechanisms to determine where there are conflicts of interest (e.g. from private service providers and their member associations).

Without this analysis, a recommendation for price setting to attract private investors is tantamount the government withdrawing so that water and sewerage charges can be raised to a level that ensures cost recovery with an additional return on capital to provide private returns. This approach, applied to troubled sectors overseas has often been the reason why privatisation of water utilities has failed in other jurisdictions (see e.g. QWRAP Review of Sustainable Models).

The Inquiry could examine some the questions posed above to establish greater dialogue and avoid recommendations that are overly ambitious, based on incorrect assumptions or relevance to only large metropolitan areas. One option would be to test the link between water pricing reform, private investment and under-investment in water assets against the objectives of competition policy espoused by the Harper review, namely to:

"• make markets work in the long-term interests of consumers;
• foster diversity, choice and responsiveness in government services;
• encourage innovation, entrepreneurship and the entry of new players;

• promote efficient investment in and use of infrastructure and natural resources;
• establish competition laws and regulations that are clear, predictable and reliable; and
• secure necessary standards of access and equity" (p.7).
This PC Inquiry would be well placed to undertake this analysis in the context of the water sector and its associated market failures to avoid blind faith in the power of the market and micro-economic reform.

P. 25 Is there a case to increase the involvement of customers in regulatory decision making, as is commencing in Victoria? If so, what is the best way to do this?

Local government ownership of urban water and sewerage services provides a direct link to customers through locally elected representatives, and it is difficult to see merit in an additional process.

Urban customers generally have a poor understanding of the value of the services they receive and what drives costs. Provided taps work and toilets flush, there is little appreciation of treatment processes and particularly the costs associated with building and maintaining a major asset base, greater than 50% of which is buried. A process for establishing a baseline of understanding of these services needs to underpin any broader engagement, and there are a number of utilities (e.g. Queensland Urban Utilities, Unitywater, Cairns Regional Council, Mackay Regional Council, Townsville City Council) with experience in a range of initiatives from customer panels to "apps."

The P.9 reference above briefly describes a process which could be implemented through a higher tier of government with the aim of improving approaches to decision making around future infrastructure. This issue is highly topical, with a recent Queensland Audit Office review criticising asset management in local government, and various state agencies considering responses.

The Newman Government released a state Water Sector Strategy through DEWS in 2014 which included a strategic advisory and expert reference panel as a way of gathering input into proposed actions and policy from a range of stakeholders. The strategy did not survive a change of government, and two years on, a replacement has not been developed. Industry sees the absence of an articulated state direction and support processes as a critical failure.

Arguably, the local government water sector in Queensland (and NSW) has stronger ties with its customers than the utilities in other states because of the local government links, the smaller size of most service providers and their co-location with customers. Indeed, this argument is often claimed as a dis-benefit of greater horizontal aggregation of water and sewerage services.

The claim is definitely true for the majority of service providers in Queensland as they are strongly influenced by their communities through council and direct interactions. However, it must be tempered by the fact that real engagement with customers is generally sporadic and desultory because of typical assumptions/apathy when it comes to valuing water and

sewerage services. Water and sanitation are the most essential of 'essential services' and, perhaps for this reason, they are usually taken for granted, under-valued and seldom discussed unless there is a substantive service failure. More work is needed and many utilities are building programs and research to better address this gap (e.g. QUU, Unitywater, Mackay, Townsville) and local governments have numerous programs outside water and sewerage (see e.g. LGAQ).

The Inquiry could increase the importance of this issue (which has been raised in past reviews) and direct attention to successful programs in the water sector and learnings from local government.

P. 25 How can the level of competition in the provision of urban water services be increased?

Competition for the urban water sector is typically referred to in two major forms:

(a) Competition by comparison through industry benchmarking. The P. 7 response above describes a number of tools which enable this, and it is particularly active among larger utilities which set operational targets based on NPR performance in comparison with utilities both within and external to Queensland, and as the DEWS mandatory Key Performance Indicator process matures, it is likely to deliver further benefits.

(b) Increased private sector participation. There is an assumption that pricing reform will create incentives in order to redress the problem of under-funded water and sewerage assets. The need for greater infrastructure investment and the importance of market-based solutions are both real, but linking them through pricing reform is unlikely to succeed. Potential modes of participation include:

    1) private investment (in return for guaranteed dividends through return on capital)
    2) decentralised private water and sewerage enclaves within large metropolitan areas
    3) private-public-partnerships (PPPs) through contracting, outsourcing and alliances and
    4) full privatisation of utilities.

    While full privatisation has been devastatingly unsuccessful in most jurisdictions (see the QWRAP Review of Sustainable Models), PPPs are being encouraged to increase efficiency and innovation. Privately serviced enclaves are plagued with problems but could be beneficial with the appropriate controls. This is a topical current policy debate for DEWS.

P. 25 Do water and wastewater services delivered to regional and remote communities, including Indigenous communities, comply with relevant public health, safety and environmental regulations? If not, what policy remedies might improve performance? and

P.25 Do the processes for determining public health, safety and environmental regulations applying to urban water providers promote cost-effective and targeted regulations? Do the various policy-making and regulatory bodies have clear roles and responsibilities?

This is a broad question with different answers for different utilities and different regulators, and significant information gaps.

DEWS regulates drinking water with additional roles for the Queensland Department of Health (DOH). Every service provider has a Drinking Water Quality Management Plan and a requirement to report incidents to the regulator, as well as in a publicly available annual compliance report. There are few detailed accounts of incidents available publicly, and known issues in many areas of the state. There are no known examples of DEWS exercising financial penalty provisions for breaches.

DEHP regulates sewerage networks, including environmental discharges. While the compliance focus is arguably on coastal service providers, there are frequent examples of compliance actions including penalties for breaches.

Regulatory effectiveness is considered to be mixed, but improving. DEHP regulation is the greatest driver of costs in the sector, reflecting a concerted effort over the last 20 years to address the standard of sewage treatment, especially in Reef and other coastal catchments. A specific example is the progress in the area of offsets for STP discharges. Significant work is needed in this area to improve and protect the health of the Great Barrier Reef and sewerage service providers could play a key role on this recovery effort. Until 2009, STP upgrades were partly supported by dedicated state grants programs, but the discontinuation of this "automatic" subsidy has created challenges for both service providers and regulators, leading to the new "offsets" policy being considered as an incentive aimed at reducing the capital burden. These initiatives are not yet mature enough to be considered effective.

In 2012, the LNP government restructured agencies including a number of larger departments which were presumably originally created to attempt to break down some of the "silos" which exist around water and other natural resource management. There are now in the order of nine state agencies with an interest in water, and the lack of coordination among these agencies is consistently raised by industry as a frustration. It had been hoped that the short-lived State Water Sector Strategy would help address these issues in the absence of an approach to portfolio/ department design which better considered the impact to urban water stakeholders. The situation has arguably worsened since the current Labor government's decision to reduce the number of ministers, meaning that the current Minister for Energy and Water Supply also has responsibility for Transport, Road Safety and Ports and little time for water sector stakeholders.

Economic regulatory solutions are often discussed but are poorly implemented. The Queensland Competition Authority had wide-ranging powers in South-East Queensland until relatively recently. While the SEQ entities are still subject to the QCA's Monopoly Prices Oversight, the longer term regulatory approach is under review. The same Oversight

provisions apply to a number of larger local government entities, however these powers have not been exercised.

Drivers impacting performance include historical under-investment in infrastructure, the size and distribution of service providers and the integration of urban water and sewerage services in many councils. Further economic regulation, without addressing these important considerations would add costs without any hope of delivering benefits.

Since 2008 there has been significant reform of governance arrangements impacting all of Queensland, from local government amalgamations to a series of major changes specifically impacting water and sewerage in SEQ. Service and compliance performance has generally improved over time as these organisational arrangements stabilise, and in many cases significantly improved. However, Queensland has a series of unique challenges to address in regional and remote (including indigenous) communities and policy solutions should be the subject of carefully considered and regionally-specific studies rather than speculation in a brief Issues Paper response. ***qldwater*** welcomes the opportunity for further discussion.

P. 25 What is the importance of integrated water cycle management? Are roles and responsibilities in relation to this clear?

The answer to this question is again mixed. In SEQ, catchment management and bulk water infrastructure and treatment fall under Seqwater's responsibility, with water distribution, retail services, customer management, sewage collection and treatment all the responsibility of councils or distribution-retail entities. Stormwater management remains a council responsibility. There are good examples of collaborative projects but no commitment to a formal approach to integrated water cycle management since the regulatory requirement for Total Water Cycle Management Plans became a casualty of "green tape reduction."

Outside SEQ, councils typically treat drinking water and may or may not manage bulk water infrastructure and catchments. Within councils, the functions of stormwater management are typically separated from drinking water and sewerage management (unless it is a smaller council with all engineering functions controlled by a small group).

Thus roles and responsibilities are universally complicated by governance arrangements.

qldwater acknowledges that increasing growth, water scarcity, and water quality issues will increase the importance of integrated water cycle management, however the regulatory framework last introduced to help facilitate this was fundamentally flawed and nothing has replaced it. Potable reuse will ultimately become an important consideration, however politics (e.g. Toowoomba) and community attitudes have served to defer meaningful discussion indefinitely. The Western Corridor Recycled Water Scheme (including indirect potable reuse options) is part of Seqwater's future water security strategy.

P. 25 How can demand management approaches such as water restrictions and water-use efficiency measures best contribute to the efficiency of urban water services?

There are numerous industry tools able to support demand management efforts for communities and ***qldwater*** maintains a range of options as well as research and other activities through QWRAP supporting emerging needs.

qldwater has always maintained that communities should aim for efficiency rather than conservation, and water use should be considered as an overall level of service issue with communities using what they can afford and access while maintaining water security.

This however has to be considered in light of TOTEX with appropriate charging regimes. If a community seeks support from elsewhere (including other levels of government) for a level of usage which is not efficient or sustainable, then demand management should be a condition of any funding (i.e. community service obligations need to be defined and aligned to funding).

P26 asks whether the NWI is the mechanism for water reform and how to generate impetus.

The NWI is now the only consistent national mechanism to keep the issue of water reform highlighted and is thus essential. However, the lack of constitutional power means that impetus is generated primarily through funding incentives to drive change and these have been lacking for some time, particularly for urban water. Regardless of the institutional arrangements in each Australian jurisdiction, there is need for considered and objective oversight and the NWI and triennial review is well placed to fulfil this role if it is not overly swayed by the interests and arguments promoted by any one jurisdiction.

The 2011 productivity Commission review was instrumental in driving water sector reform in Queensland. While other reports selected a preferred model from one Australian jurisdiction and tried to apply it across all of the others, the PC review considered fit-for-purpose approach that was predicated on agreed outcomes. Rather than a rigid adherence to academic conceptions of market forces and generic rules about productivity across utilities, the review opened the door for better understanding of models that maximised efficiency for diverse communities across the country. This approach allowed and generated the large Queensland response embodied in the Queensland Water Regional Alliances Program.

QWRAP represents a collaboration between state and local governments to investigate optimal models for regionalisation across the state. It has been immensely successful in maintaining this discussion now encompassing 30 councils in five regions representing over 65% of the regional population and over 55% of the area of Queensland. It has grown through two successive changes of State Government and survived local government elections and de-amalgamations.

However, there are limits to the ability of voluntary politically-driven projects to initiate change without the impetus of external drivers. While QWRAP will continue to be successful in bringing councils together as regional Alliances it cannot generate step-change in

institutional arrangements without external incentives for change. This is not necessarily a fault of the Program or the political decisions that underpin it, but rather the uncertain risk of major change entered into without a significant external justification. Unfortunately this means that despite an ongoing increase in strategic regionalisation and collaboration on institutional improvements, significant change will await a significant external trigger.

4. **Contacts and Further Information**

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