Business Council of Australia

SUBMISSION

National Water Reform: Issues Paper

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The Business Council of Australia is a forum for the chief executives of Australia's largest companies to promote economic and social progress in the national interest.

About this submission

This is the Business Council of Australia's submission to the Productivity Commission's National Water Reform issues paper.

This submission reiterates the key areas for reform that the Business Council outlined in its submission to the 2014 triennial assessment of water reform progress in Australia. For example, the Business Council continues to support the development of regulatory frameworks in water markets that can pave the way for private investment in water assets, as occurs, for example, in France and the United Kingdom. The sale of public water assets to the private sector, within appropriate regulatory settings, can improve operational efficiency and allow governments to reinvest the proceeds in new infrastructure projects. It is also vital that jurisdictions continue to remove unnecessary regulatory restrictions so that water markets can properly function.

Finally, the Business Council suggests that all future reviews of Australia's National Water Reform progress also looks at how jurisdictions are adapting their water resources to the effects of climate change.

Key recommendations

The Business Council recommends that the Productivity Commission identify opportunities for national water reform in the following areas in its draft report to be released in September 2017:

- Put in place regulatory frameworks that will enable greater private investment in water assets. Where feasible, Governments should examine opportunities to sell public water assets to private investors to realise efficiencies in management and to release capital for reinvestment in new infrastructure projects.
- Complete pricing reforms in the rural water sector, extend full and independent economic regulation to all urban water utilities, and pursue options for granting more pricing flexibility to water retailers.
- Regulatory restrictions to the effective operation of the market, such as restrictions on water trading, should be reviewed with a view to removing any unnecessary restrictions.
- Implement more streamlined major project planning approvals to support more efficient investment in new water projects.
- The measures that jurisdictions have in place to deal with the effect of climate change on their water resources should be, for the first time, examined as part of the 2017 National Water Reform review.

Key issues

Getting the regulatory settings right

Australia has a long and proud track record of promoting competition and harnessing productivity in segments of the economy that were once considered the sole purview of governments. Over the past 25 years, regulatory reform in areas such as electricity and telecommunications have paved the way for the privatisation of assets, while ensuring the interests of consumers are protected from monopoly pricing.

In this respect, water is no different to other utility services and Australia needs to look no further than England and Wales to see that the privatisation and regulation of the water market is well overdue in Australia. Commencing operation in 1989, Ofwat is the economic regulator of the water section in England and Wales. Using a range of regulatory tools, such as direct price regulation and annual service performance rankings, Ofwat have ensured that private companies can efficiency manage water assets, while also ensuring consumers are provided with high quality water at affordable prices.

There is nothing to prevent a bold regulatory reform agenda being undertaken in relation to Australia's water assets. Such an agenda is a pre-requisite to obtain public confidence in the privation of Australia's water assets.

Private investment in water assets

There remains significant scope for pursuing benefits from more private investment in Australia's government owned water businesses.

In December 2013, Infrastructure Australia released a paper that discussed the benefits that state governments could obtain by privatising some its assets and reinvesting the proceeds of these sales into new infrastructure investments that are sorely needed across the nation. Infrastructure Australia's analysis conservatively estimated that the equity value of commercial infrastructure assets held by Australian governments is over $100 billion, and many of these assets could be transferred to the private sector relatively quickly.[1]

In relation to water assets, Infrastructure Australia identified the following publically-owned assets as suitable for transfer to the private sector:

- Sydney Water in New South Wales
- Melbourne, South East, City West and Yarra Valley Water in Victoria
- Ben Lomond, Cradle Mountain and Southern Water in Tasmania
- WA Water in Western Australia
- SA Water in South Australia

In July 2015, former chairman of the Australian Competition Consumer Commission Mr Graeme Samuel explained why governments should privatise their water assets:

[1] Infrastructure Australia, 'Balance Sheet Impacts of Sell to Build', December 2013, p. 1

> *There is no logical reason why governments need to own the maintenance companies that maintain the supply of water to customers.*
>
> …
>
> *They don't need to own the companies that install the pipes, they don't need to own the pipes, they don't need to own the dams – they can all be owned by the private sector under carefully constructed contracts which properly allocate the risks between the government and the private sector.*[2]

The Business Council concurs with Mr Samuel and Infrastructure Australia on the benefits to be derived from privatising publicly-owned water assets. Major private investors, such as large superannuation funds, are looking to invest in long-lived assets with positive and stable returns on investment.

The benefits of this approach to the community are twofold. First, there is a potential efficiency dividend to be gained from further privatisation and the sale of corporatised water assets due to the private managerial expertise of the asset. Second, the sale of government-owned water utilities can provide funds to governments for reinvestment in other new infrastructure projects to better the lives of members of the community (the Box below provides the recent example of the sale of electricity assets in New South Wales).

Privatising electricity assets in New South Wales

In late 2015, the New South Wales Government announced that a private consortium had won the bid for the 99-year TransGrid lease after offering to pay $10.2 billion. This was followed in late 2016 by the $16.2 billion lease of 50.4 per cent Ausgrid to a separate private consortium of investors. The final stage of this privatisation process will involve the lease of 50.4 per cent of Endeavour Energy's assets, which is expected to yield about a further $4 billion of the New South Wales Government.

While a primary benefit of the privatisation of the 'poles and wires' segment of the New South Wales electricity sector will be seen in the improved operational efficiency that private sector operators of infrastructure are able to achieve, the benefits of the New South Wales asset recycling program should not be overlooked.

The New South Wales Government has allocated $73.3 billion to urban and infrastructure investment over its budgets to the year 2018-19 and to fund this ambitious building agenda, the New South Wales government will draw on the money it has received for the lease of these electricity assets. This means that New South Wales citizens will benefit from greater investment in transport, health, education, housing, electricity and water.

In December 2015, a joint report from Infrastructure Partnerships Australia and the Water Services Association of Australia found that over the next five years urban water agencies such as Sydney Water and SA Water will need to make multi-billion dollar investments to ensure their assets are properly maintained and incrementally expanded to handle

[2] The Australian Financial Review, '*Private water after power, says former ACCC chair Graeme Samuel*', 26 July 2015

Australia's population growth.[3] With such large capital investments needed, now is the time for state governments to commit to privatising their publically-owned assets and reinvesting this money into much-needed new infrastructure projects.

Investing in the water assets of northern Australia

The $500 million Water Infrastructure Development Fund was established to facilitate greater investment in water infrastructure nationally. This fund includes a dedicated component of $170 million that was earmarked for northern Australia.

Applications for the first round of feasibility study funding closed on 21 January 2016, however the Business Council is unaware of any projects being identified as feasible as a result of this work. Up to 17 million hectares of land in the north have soils which are potentially suitable for agriculture, but there is only water sufficient to irrigate about one tenth of that area.[4] In its discussion paper, the Productivity Commission should examine whether there are barriers that may be preventing private investment in water assets in northern Australia.

Water markets and pricing

The overarching objective of water policy should be the efficient and safe provision of water in a manner that maximises community net benefits. A prerequisite for the efficient provision of water is an effectively operating water market. Such a market should:

- provide appropriate price signals to end-users
- have clearly established water property rights
- have consideration of both supply and demand-side options in managing and meeting the demands of water consumers
- be technology and source neutral, subject to environmental and health considerations
- allow for the trade of water resources between users to ensure that water flows are allocated where they are most valued
- have regulatory frameworks which support the achievement of the objective of efficient provision of water and maximisation of community net benefits.

In many respects, the best means of addressing affordability concerns is through making improvements to the efficiency of our water markets. In this regard, the Business Council continues to supports the seminal view of the Productivity Commission from 2011, which stated that 'although access and affordability are important issues, distorting prices is not the best way to deal with them'.[5]

The Productivity Commission has previously noted that there is merit in providing more flexibility for retailers in their pricing of water and encouraging them to offer multiple service offerings (subject to certain conditions).

[3] Infrastructure Partnerships Australia and the Water Services Association of Australia, *'Doing the important, as well as the urgent: Reforming the urban water sector'*, November 2015, p. 18

[4] Australian Government, *White Paper on Developing Northern Australia*, p.40

[5] Productivity Commission, '*Productivity Commission Inquiry Report: Australia's Urban Water Sector*', August 2011, p. XXVII

The Business Council is supportive of more flexible pricing on the grounds that this will lead to a more efficient allocation of water over time as a result of more appropriate price signals.

Streamlined project approvals

Streamlined major project planning approval regimes will support more efficient investment in the new water assets that will be needed to service Australia's future population growth. The recently released Business Council report *Competitive Project Approvals* sets out a best practice model for major project planning approvals that state and territory jurisdictions can adopt to make it easier to invest, while maintaining Australia's high standards for environment and community protection.

The model is highly consistent with recommendations set out by the Productivity Commission in its report in 2013. The Business Council considers this review provides an opportunity for the Productivity Commission to encourage the Council of Australian Governments (COAG) to implement the best practice model.

Removing unnecessary regulatory provisions

The Business Council is pleased that the Productivity Commission intends to review some of the unnecessary restrictions that currently impede the operation of water markets. A useful first step would be to analyse the current regulatory frameworks that apply within each jurisdiction.

For example, the Issues Paper has identified the kind of restrictions that hinder the operation of efficient water markets:

- Restrictions on trading water from rural to urban use.
- Incompatible water registries can make interstate trade more cumbersome than it would otherwise be and this can discourage market participation, and
- Excessive termination fees can prevent worthwhile trades from occurring by reducing the net proceeds to the seller.

A regulatory stocktake is needed to ensure policy-makers are aware of where such restrictions are still in place and the effect such restrictions are having on preventing water from moving to its highest value use.

Factoring in climate change to water management

Adaptation is the principal way to deal with the impacts of a changing climate. It involves taking practical actions to manage the risks that are arising from climate change. In relation to water management, measures to prevent water scarcity and soil erosion are examples of adaptation policy measures that have been proven to alleviate the effects of climate change. National leadership and assistance is of vital importance in the context of developing sound adaptation policy frameworks.

In the content of National Water Reform, the Productivity Commission is well-positioned to assess how Australia's jurisdictions are managing their water resources in the context of climate change. By examining the ways that state and territory governments are proactively managing the effects of climate change on their water resources, the

Productivity Commission will be able to ensure best practice approaches can be more widely adopted throughout Australia.

Summary

The continued implementation of water reform in Australia has never been more important. With an infrastructure deficit facing all jurisdictions across Australia and productivity in need of a kick-start, transforming Australia's water sector has the potential to provide large benefits to governments and consumers alike. The Business Council looks forward to engaging with the Productivity Commission throughout 2017 on this issue.

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