## Submission to the Productivity Commission Inquiry

# Market mechanisms for recovering water in the Murray Darling Basin

Thank you for the opportunity to provide a submission to the Market mechanisms for recovering water in the Murray Darling Basin Inquiry. I would like to address, albeit briefly, two issues of concern that I believe should be of significance in the Commission's investigations.

First is the consideration of the extent of demand for 'environmental water'. Market mechanisms work on the basis of supply and demand. In most environmental markets, governments step in to provide the demand as a consequence of the public good nature of the goods and services being bought. Free-riding on the part of individuals is seen to be a sufficiently strong incentive to render ineffective a decentralised demand generation system of the type common in the Australian market economy. The concern is however that governments are entering the market without adequate knowledge of what they are buying and the strength of the community's preferences for that good. First, the biophysical information relating water purchases to environmental outcomes is mostly poorly defined. Second, there have been only a small number of community demand estimation studies that have focused on the environmental benefits of rivers. Those that have been done appear to have been side-lined in the policy deliberation as political imperatives (ie rent seeking pressures) have held sway. A good example was the Living Murray project for which an environmental valuation study was commissioned alongside an analysis of the environmental impacts of increased water flows. Before the results of either study were gathered, a federal decision was taken regarding the extent of the funding to be allocated for water recovery.

**A precursor to the design of the form of the market designed to recover water for environmental purposes is the determination of the extent of the demand for that water. Environmental valuation studies should be carried out as part of that determination**.

Second is the design of the entities used by government to represent the demand for environmental water in the market. The standard practice has been for governments to appoint their relevant department as the purchasing entity with subsequent management of the purchased asset left to another department or agency. The consequences of this type of arrangement are of concern for a number of reasons. First, market power is concentrated with the government department responsible for purchasing the environmental water. Second, the incentives for the government agency to maximise the environmental benefits achieved for a given budget are weak. Third, where multiple levels of government are involved in purchasing environmental water (eg state and federal) along with private sector interests (eg water trusts), coordination of purchases and subsequent management is uncoordinated and

potentially wasteful. An alternative structure of demand representation in the market is through private water trusts. Government could call for tenders from appropriately structured trusts to receive funds to be used in securing environmental benefits in specified river systems. Tenders would be competitive and judged in terms of management skill to achieve stated goals, including coordination capacity. Such a structure would have the added advantage of providing a mechanism for tapping into community preferences for riverine environmental protection that lie above the community average as represented by taxpayer contributions and as identified through environmental valuation studies.

**The establishment and operation of private sector, competitive environmental water trusts to act in water market on behalf of the wider community of people who enjoy the environmental benefits of rivers should be investigated.**

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