Submission to the Productivity Commission on the Market Mechanisms for recovering water in the Murray-Darling Basin- Draft Research Report

By

Victorian Farmers Federation

12 February 2010

Foreword

The Victorian Farmers Federation is Australia's largest state farmer organisation, and the only recognised, consistent voice on issues affecting rural Victoria.

The VFF consists of an elected Board of Directors, a member representative Policy Council to set policy and eight commodity groups representing dairy, grains, livestock, horticulture, chicken meat, pigs, flowers and egg industries.

Farmers are elected by their peers to direct each of the commodity groups and are supported by Melbourne-based staff.

Each VFF member is represented locally by one of the 230 VFF branches across the state and through their commodity representatives at local, district, state and national levels. The VFF also represents farmers' views on hundreds of industry and government forums.

Andrew Broad

President

I. Introduction

The Victorian Farmers Federation (VFF) welcomes the opportunity to comment on the Productivity Commission's Draft Research Report on the Market Mechanisms for recovering water in the Murray-Darling Basin (MDB).

The VFF understands outcomes and recommendations developed from this draft report will be utilized to report to the Australian Government into alternative market-based mechanisms that could be used to diversify the Commonwealth's water purchase program and secure access to the suite of entitlements necessary for the Commonwealth's Restoring the Balance program[1]. The VFF recognises the importance of a wide discussion on current and potential practices as to alter the allocation of water within the MDB that reflects the significance of this precious resource, and the industries and communities of which it supports.

The VFF concede with the Productivity Commission's view that greater gains can be achieved by clarifying objectives of the different means by which water is being recovered and the links between them. VFF has always maintained that Governments should firstly explore investment opportunities in irrigation infrastructure and on-farm efficiency programs. If, as a last resort, Governments need to enter the market on behalf of the environment, then the process of Government buyback requires a thoroughly planned approach. A "targeted-buyback" plan, based on a strategic view of the irrigation systems across the basin must be developed and is essential to the success of the reforms. Such an integrated approach will ensure an alliance of infrastructure upgrade and buyback.

The VFF believe the primary goal of the Murray Darling Basin Authority (MDBA) Basin plan is to balance water for consumptive use and water to the environment. Unfortunately, the Sustainable Diversion Limits (SDLs) issues paper released last December by the MDBA takes an extreme environment first approach that does not properly value the social, environmental and economic benefits in setting the SDLs. The VFF has long opposed governments taking such an unbalanced approach to provide water to the environment, which not only fails to provide sensible tradeoffs between water for consumptive use and the environment, but also delivers a biased value of the environment in the decision analysis process.

VFF also agree with Commission's view that it is difficult to look at market mechanisms for obtaining water, without looking at how much water will be required, when and where it will be required, and with what reliability and frequency. VFF has always argued that as a pre-requisite to developing the Basin Plan including the SDLs, the MDBA must first must specify how water for the environment will be utilised, how the additional flows will be accounted for, the river health benefits that can be expected and how these benefits will be measured, and the engineering works' potential to optimise such benefits. In its recent submission to the MDBA's SDL issues paper, VFF recommended an immediate release of a draft list of

[1] Productivity Commission's Issues Paper on the Market Mechanisms for recovering water in the Murray-Darling Basin, Pg III

environmental assets and their watering requirements as a pre-requisite to develop the SDL and Basin Plan. The Commonwealth buyback program should be then based on the set SDLs. The VFF believe that using the Basin Plan and the SDLs to guide the buyback program through targeting overallocated sytems, based on transparent and community approved environmental plan, would also reduce the Commonwealth's potential financial implications resulting from the new SDLs and Basin Plan.

As a principle, VFF does not support Government entering the water market to secure additional water for the environment. Dealing with movements in the water market due to inflow and demand variability is a difficult issue for farmers to plan for. The VFF believe water market will lead to structural adjustments such as contraction in the demand for complementary agricultural services and output from districts. This may result in significant and rapid changes to the demographics population and sustainability of communities.

Research commissioned by the VFF has found that irrigated agriculture employs one person for every 95 ML of water used. To put this into the context of the Basin plan, draining 100,000 ML out of irrigation will result in 1063 job losses in rural Victoria. This research also indicated that the community would need to receive benefits of up to $31,000 today for every megalitre of water removed to offset the loss they would likely suffer over the next 20 years. This is an equivalent of $3 billion for each 100,000 ML of water taken from irrigators.

Therefore, it is imperative for the Commonwealth to put in place a policy that maintains the integrity of the water market, provides the level of certainty needed, and prevent any distortion in the market, including those that may arise from Governments entering the market to secure additional water for the environment in the form of permanent entitlement or seasonal allocations and/or funding an over-allocation buy-back. The total value of Commonwealth's allocated budget for the buyback program in the next three years is around $2 billion, this is far above the water market turnover in Victoria.

It is important to note that while water markets enhance water use efficiency and provide a mechanism for water users to manage their businesses and survive extreme conditions, it is equally important to take into account social and economic impacts of water transfers. Water is vital to the ongoing viability of agriculture and regional communities. The VFF supports mechanisms like the 4% limit on permanent trade out of an irrigation district not only to ensure that rural adjustment resulting from movements of water occurs at a manageable pace, but to also guarantee that farmers not selling their water and wanting to continue farming are not faced with stranded assets and increased costs. Aligning the Commonwealth's environmental water purchase program with the infrastructure upgrade would also facilitate a manageable adjustment. That's why VFF acknowledged the Commonwealth – Victorian agreement which will retain the 4 per cent cap on water trading until at least 2011. Under the agreement, and subject to a review of progress on the modernisation project, Victoria will begin to phase out the four per cent cap on permanent water trades from irrigation districts from July 2011, with a view to removing the cap entirely by 2014. There is no doubt that the Commonwealth-Victorian agreement on the exemptions was originally aimed at aligning the Commonwealth's environmental water purchase program with the Goulbourn Murray Irrigation District (GMID)'s modernisation

programs. However, the VFF is concerned with hardship and equity issues across irrigation districts and has lobbied the Victorian Government to provide a limited exemption criteria to the cap in order to address these concerns.

One of the most important issues around the new Basin Plan is the Sustainable Diversion Limit (SDL). VFF has been working on this issue and lobbying Governments on related issues to SDL, namely the risk assignment. This is a water priority issue for our members and may involve compensation for any reduction in the current diversion levels. Of most important to note in regards to SDL is that the Australian Government water purchase program may have the effect of reducing the gap between current diversions and the SDL, and help water users with the transition to sustainable water use. Another major component to consider in this argument is that the Australian Government, working with the Basin states and industry, is also investing significant funding to improve the water-use efficiency of irrigation infrastructure in the Basin. A portion of the water savings generated by this work will also be used to reduce any gap between current diversions and the SDLs. However, NO one can state, with confidence, that selling water now will lessen the impact of a future adjustment in the SDL, either in principle or for any particular irrigation district. Lifting the trading cap will not align Commonwealth water purchases with the yet to be determined reductions in SDLs for individual catchments. The lack of a strategic approach to the government's water purchases is a key reason the VFF have continued to support a trading cap.

VFF is continuously consulting with its members, and is carefully considering the critical needs of irrigators to be able to make business decisions. The Commonwealth-Victorian agreement on the 4%, the Commonwealth's approach to the new sustainable diversion limits, including risk assignment, and our long held views on the 4 percent cap will continue to inform the VFF's position moving forward.

VFF supports the Commission's recommendation on the urgent need to clarify how the risk assignment provisions apply under the Basin Plan. VFF believe that the Basin Plan and the SDLs are a Commonwealth government policy decision primarily addressing the issue of overallocation in the Murray Darling Basin, through providing more water to the environment under a climate variability resulting in lower inflows into the system. This means that the Commonwealth bears the full risks of any reduction in entitlements (both in terms of volumes and /or reliability) resulting from the implementation of the Basin Plan SDLs. Given the new Basin Plan and SDLs is "newly-introduced Commonwealth policy decision", any potential erosion of water entitlement holders' property rights (whether in the form of volumes and/or reliability) resulting from these SDLs should trigger Commonwealth just compensation to those entitlement holders for the loss of property rights and for any structural adjustment assistance for irrigators and the communities that rely on them.

It is integral that water market provide sensible mechanisms and tools, on a level playing field, to allow individuals to be responsible for decisions about their water supplies, manage climate variation and change and provide farmers with the essential level of certainty.

II. Findings and Recommendations

Water use in the Murray-Darling Basin

DRAFT FINDING 2.1

Current planning arrangements tend to assign a more than proportional cut to environmental water during dry periods. With climate change expected to increase the prevalence of dry conditions (particularly in the southern Basin), the environmental consequences of this could become increasingly significant. Accordingly, the prospect of climate change adds to the imperative to reconsider the balance between environmental and consumptive uses of water.

The VFF has always been supportive of an effective, collaborative, efficient and whole-of-basin water management approach for the MDB's water and other natural resources, which will enable the social, environmental and economic values of the MDB to be protected into the future. However, VFF concerns have always been focussed on ensuring the nation's food security and that issues surrounding reliability of water and the property rights of farmers were protected. Demand for food is not negotiable. The MDB is Australia's most important agricultural region. The Basin contains more than two thirds of Australia's total area of irrigated crops and pastures; producing over one-third of Australia's food supply, and is home to more than 2 million residents.

The VFF believe the primary goal of the Basin plan is to balance water for consumptive use and water to the environment. Unfortunately, the SDL issues paper took an extreme environment first approach. The VFF has long opposed governments taking such an approach to provide water to the environment. Our opposition has always been based on ensuring food security, social stability and the dependence of rural communities on the economic activity and food production that is generated by irrigation. Such an unbalanced approach does not provide sensible tradeoffs between water for consumptive use and the environment.

The VFF view that as a pre-requisite to developing the SDLs, the MDBA must first must specify how water for the environment will be utilised, how the additional flows will be accounted for, the river health benefits that can be expected and how these benefits will be measured, and the engineering works' potential to optimise such benefits. Therefore, VFF recommended an immediate release of a draft list of environmental assets and their watering requirements as a pre-requisite to develop the SDL and Basin Plan

The Commonwealth Water Act 2007 aims at promoting the use and management of the Basin water resources in a way that optimises economic, social and environmental outcomes. However, the VFF believes an environment first approach totally ignores the socio-economic and financial impacts on rural communities and the public policy importance of maintaining the farm produce base in the Basin. The SDLs and the Basin Plan should clearly recognize the traditional property rights of rural communities to utilize water.

Development of water markets

DRAFT FINDING 3.1

Water markets are well developed and active in the southern-connected Basin, but not in parts of the northern Basin. This has implications for the buyback — market-based water recovery is more difficult where markets are not well developed.

VFF believe that it is integral to develop water markets that provide sensible mechanisms and tools, on a level playing field, to allow individuals to be responsible for decisions about their water supplies, manage climate variation and change and provide farmers with the essential level of certainty. It is also imperative that the development of these water markets, in situations where there is likely to be a change in current state arrangements/ trade practices, are mindful of adverse impacts on existing users and water holders.

DRAFT FINDING 3.2

Market intermediaries, including brokers and exchanges, have developed alongside the market to facilitate increased trade, with lower transaction costs.

The VFF believe that there is no regulation of water broker activities. The transactions that are facilitated by the brokers often involve substantial sums of money and there is potential for disputes to arise between the broker and the users of their services; whether a buyer or seller of temporary or permanent water entitlement.

There is potential for serious disputes to arise and the possibility of unethical or questionable dealings, the VFF strongly supports establishing a suitable framework to ensure dealings between brokers and water users are fair and equitable. It may also be advisable to explore a process for resolving disputes that will inevitably arise.

The VFF view a regulatory and/or licensing approach would provide a means to enforce compliance with expected or stipulated broker practices, but will add costs to the broker operations. A Code of Practice while possibly imposing a lesser cost does not have the compliance strength of regulatory approach. VFF supports a national exchange model similar to the stock exchange model. All brokers are then brokers to the national exchange.

Allocating environmental water

DRAFT FINDING 4.1

Water recovered in the northern Basin will usually result in limited environmental benefit for the southern parts of the Basin, given hydrological constraints. Water recovery within the northern catchments that are effectively disconnected should be driven primarily by environmental priorities within those catchments. Conversely, the southern Basin — including the Murrumbidgee, the Murray and the Goulburn rivers — is highly interconnected, allowing considerable flexibility in sourcing and delivering water for environmental purposes.

VFF maintains that a pre-requisite to buyback and the SDLs would be to specify how water for the environment will be utilised, how the additional flows will be accounted for, the river health benefits that can be expected and how these benefits will be measured, and the engineering works' potential to optimise such benefits.

DRAFT FINDING 4.2

Decisions on allocating water between competing uses in the Basin should be based on good science. But this is not a sufficient basis for achieving the best outcome for the community.

Community preferences should be considered where tradeoffs are required between different environmental outcomes, and between environmental and consumptive outcomes.
The VFF have always been concerned about the decision analysis process to allocate water among various users including the environment. It seems like the yet to be determined environmental objectives need to be achieved regardless of the socio-economic impacts and the damage it might cause to the Basin's economy and communities. VFF believes that the final set of SDLs should be determined following a Multi Criteria Decision Analysis (MCDA) approach that is more comprehensive, efficient and effective and considers social, economical and environmental criteria in the decision analysis process.

Multi criteria decision analysis (MCDA) will enable considering different weights for the evaluation criteria by different water users including the environment. The VFF also believes that this analysis should be flexible enough to address any future changing conditions including: food security, engineering and construction works to reduce to the need for environmental water recovery, water buyback program, water savings as a result of modernisation; predictions of future water availability may be improved as a result of improved climate knowledge; and updated modelling assumptions.

Integrated catchment management framework links physical, social and economical sciences into planning, policy and decision making. Specifically, prioritizing and evaluating different management alternatives through a multi-criteria decision analysis model is essential to achieve a long–term agricultural and natural resources sustainability in agriculture-dominated catchments.

A more comprehensive, multi-criteria approach to decision-making in allocating water among various users is required. This approach should use comprehensive criteria to inform decisions, rather than environment first approach.

Recovering water through non-market means

DRAFT FINDING 6.1

Under the Water Act 2007 (Cwlth), the Murray-Darling Basin Authority is required to determine environmental watering needs based on scientific information and to consider least cost ways of meeting these needs in setting sustainable diversion limits. This way of allocating water between environmental and consumptive uses does not take into account community preferences, the opportunity cost of water or the role of other inputs such as land management. As the sustainable diversion limits will be used to guide future water purchasing under Restoring the Balance, the effectiveness and efficiency of this program are likely to be compromised.

VFF also agree with Commission's view that it is difficult to look at market mechanisms for obtaining water, without looking at how much water will be required, when and where it will be required, and with what reliability and frequency. VFF has always argued that as a pre-requisite to developing the Basin Plan including the Sustainable Diversion Limits (SDLs), the Murray Darling Basin Authority (MDBA) must first must specify how water for the environment will be utilised, how the additional flows will be accounted for, the river health benefits that can be expected and how these benefits will be measured, and the engineering

works' potential to optimise such benefits. In its recent submission to the MDBA's SDL issues paper, VFF recommended an immediate release of a draft list of environmental assets and their watering requirements as a pre-requisite to develop the SDL and Basin Plan. The Commonwealth buyback program should be then based on the set SDLs.

DRAFT FINDING 6.2

Considerable uncertainty exists about the application of the risk assignment provisions set out in the National Water Initiative, as amended by the Water Act 2007 (Cwlth), in respect of compensation that might be payable to irrigators upon the implementation of the Basin Plan. This is impeding the ability of irrigators to plan for the future and is affecting the efficient conduct of the buyback.

DRAFT RECOMMENDATION 6.1

All Basin jurisdictions should clarify how the risk assignment provisions set out in the National Water Initiative, as amended in the Water Act 2007 (Cwlth), will apply to the reductions in water availability that are likely under the Basin Plan. This should occur as soon as possible.

VFF supports the Commission's recommendation on the urgent need to clarify how the risk assignment provisions apply under the Basin Plan. VFF believe that the Basin Plan and the SDLs are a Commonwealth government policy decision primarily addressing the issue of overallocation in the Murray Darling Basin, through providing more water to the environment under a climate variability resulting in lower inflows into the system. This means that the Commonwealth bears the full risks of any reduction in entitlements (both in terms of volumes and /or reliability) resulting from the implementation of the Basin Plan SDLs.

DRAFT FINDING 6.3

Purchasing water products from willing sellers is generally the most effective and efficient means of acquiring water, where governments are liable for the cost of recovering water for the environment.

DRAFT FINDING 6.4

Funding infrastructure upgrades is generally not a cost-effective way for governments to recover water for the environment. It is also unlikely to be an effective or efficient means of sustaining irrigation communities.

DRAFT RECOMMENDATION 6.2

Rigorous approval processes should be applied to all projects under the Sustainable Rural Water Use and Infrastructure program. In particular, projects should generally only be approved where the cost per megalitre for water entitlements recovered is similar to the market price. Premiums above this price should only be paid in exceptional circumstances.

The VFF totally disagree with the Commission. The VFF does not support Government entering the water market to secure additional water for the environment. The VFF maintains that Governments should firstly explore investment opportunities in irrigation infrastructure and on-farm efficiency programs. When Governments invest in infrastructure,

the community maintains the economic benefits and the environment receives the water savings without damaging the important economic contribution of agriculture. If, as a last resort, Governments need to enter the market on behalf of the environment, then the process of Government buyback requires a thoroughly planned approach. A "targeted-buyback" plan, based on a strategic view of the irrigation systems across the basin must be developed and is essential to the success of the reforms.

Designing a portfolio of water products

DRAFT FINDING 7.1

Purchasing unregulated water entitlements can provide environmental managers with different environmental watering possibilities to holding storage-backed entitlements. Although less reliable, holding unregulated entitlements can help managers to restore natural flows in river systems. However, their effectiveness and efficiency can be compromised by complexities involved in shepherding environmental water downstream. These third-party effects may need to be addressed through negotiating with groups of irrigators, or through administrative changes to environmental flow rules.

DRAFT RECOMMENDATION 7.1

The Australian Government should adopt a portfolio approach to purchasing water products, and not focus solely on water entitlements. Other products, such as seasonal allocations, leases on entitlements, options contracts and contracts for environmental services, have advantages in specific contexts and should be considered.

Generally in Victoria, trade within unregulated systems is restricted to downstream trade, must be 'back trade' and all trades require a 20% reduction in Volume for environmental purposes. However, trading rules can vary depending on local circumstances and risks to specific unregulated systems. The VFF supports a further clarified model of trade within unregulated systems. The VFF believe that rules for trade within unregulated systems should not be so rigid and not to be applied in such a blanket manner. The trade rules for unregulated systems should demonstrate some flexibility in application, as characteristics of each system vary quite greatly. For example, some unregulated systems have a much greater capacity to deliver water upstream, and other do not. There should be trade upstream where possible. Under all scenarios, rules should have no third impacts including reliability of water entitlements.

As a principle, VFF does not support Government entering the water market to secure additional water for the environment in the form of permanent entitlement or seasonal allocations. Other mechanism like leases on entitlements, options contracts and contracts for environmental services, should be individually reviewed on their merits subject to no third impacts including reliability of water entitlements.

Mechanics of the buyback

DRAFT FINDING 8.1

Where active markets for water entitlements exist, acquiring water entitlements directly from those markets is likely to be more efficient than utilising alternative purchase mechanisms.

DRAFT FINDING 8.2

Allowing irrigators to bid several combinations of entitlements and prices as part of a single bid could improve the efficiency of the tender.

DRAFT FINDING 8.3

The effectiveness and efficiency of the tender process would be improved by making the offers to sell binding on potential sellers.

DRAFT FINDING 8.4

The efficiency of the conveyancing process could be improved by:

- *exchanging the contracts of sale before the due diligence process commence*
- *assessing the current due diligence process for potential duplication with current state approval processes and removing the sources of duplication*
- *introducing a formal requirement on the Department of the Environment, Water, Heritage and the Arts to notify tender participants of any delays in the process and the reasons for the delays.*

VFF supports a national exchange model similar to the stock exchange model. This represents a transparent system where temp and perm trades are listed in the daily paper similar to the stock exchange. e.g water system are listed, high-low prices, average for the year, no of ML traded for the day and daily price, etc. All brokers are then brokers to the national exchange. A proposed framework could include:

- Funds held in trust until transaction complete
- Audit of trust accounts
- Time frames for transfers
- Standard form contracts
- Dispute procedure established
- Interest on the trust accounts transferred to an exchange compensation fund similar to the solicitors guaranteed funds.

DRAFT FINDING 8.5

Using the buyback to address indirect objectives, such as achieving distributional goals, system rationalisation, and reducing the salinity impacts of water use is likely to compromise

its effectiveness and efficiency. Other more direct instruments would generally achieve those objectives at lower cost.

This might not be necessarily the case. VFF believe that way forward on that is to first specify how water for the environment will be utilised, how the additional flows will be accounted for, the river health benefits that can be expected and how these benefits will be measured, and the engineering works' potential to optimise such benefits.

Governance and institutional issues

DRAFT FINDING 9.1

Transparency in environmental water recovery by the Commonwealth would be improved by providing clear and public information summarising the existing and planned holdings of environmental water across the Basin, and explicitly explaining how Commonwealth water recovery is being coordinated between the two Commonwealth water recovery programs (Restoring the Balance and Sustainable Rural Water Use and Infrastructure), and with other environmental water holdings.

VFF strongly supports transparency in environmental water recovery by the Commonwealth including clear and public reporting on the purchased water. VFF has always supported an integrated approach that will ensure an alliance of infrastructure upgrade and buyback.

DRAFT FINDING 9.2

Current governance arrangements for the management of environmental water in the Basin are fragmented between various state and local environmental water managers and the Commonwealth Environmental Water Holder. Governance arrangements for coordinating environmental watering activities are unclear.

This is fully supported by the VFF. The VFF supports an integrated and coordinated approach towards the use of environmental water among all holders of environmental water entitlements to achieve defined environmental objectives in such a way that:

- Makes the most efficient and effective use
- Addresses the social and economic impacts
- Engages the irrigators in the Basin through full consultation processes.

The VFF believe the primary goal of the water reform plans, namely the Commonwealth Water for the Future plan, is to balance water for consumptive use and water to the environment. The Governments must specify how water for the environment will be utilised, how the additional flows will be accounted for, the river health benefits that can be expected and how these benefits will be measured. An assessment must be made of the current environmental status of rivers to provide base data and a procedure put in place to monitor and publicly report environmental benefits arising from additional flows.

DRAFT FINDING 9.3

Recovering water is necessary in most cases, but is not always sufficient to achieve desired environmental outcomes in the Basin. Other inputs, such as capital works to manage and direct environmental flows, and changes to land management practices, may also be

required. Yet the focus of the Basin Plan, and the Australian Government's buyback and infrastructure programs is solely on recovering water, without regard for the role of these other inputs. Better systems are needed to coordinate the mix of water purchases with other actions and inputs to achieve the desired environmental results.

This is strongly supported by the VFF. The construction of environmental asset works should be a tool implemented to increase the efficacy of environmental water delivery. Investing in infrastructure to deliver environmental water, just as in the case of water for other uses, minimises losses thereby reducing the volume of water needed to achieve any particular outcome. This could involve upgrading channels and piping water to supply wet lands.

A very good example of that is the Lindsay Island. To water the Lindsay Island floodplain requires 1,000 billion litres of environmental water, but with $43 million worth of structural works, this could be done with only 92 billion litres, a reduction of more than 90%[2].

REQUEST FOR INFORMATION

Based on good governance principles, what do you think are the appropriate institutional structures for:

- *conducting the purchase of entitlements under the Restoring the Balance program*
- *purchasing the suite of water products that the Commonwealth Environmental Water Holder will need, to meet varying environmental demands in the interim before the Basin Plan takes effect*
- *purchasing environmental outcomes through new programs aimed separately at private providers and public environmental managers?*

What do you think the role of the Commonwealth Environmental Water Holder should be in holding and trading in water products once the Basin Plan has been fully implemented?

An independent entity managed and guided by a board that comprises key stakeholders including governments, irrigators, and environmentalists. Such a body will develop rules around Commonwealth buying water for the environment in such a way that facilitates:

- Transparency
- Alliance of infrastructure upgrade and buyback
- Targeted purchase in accordance with reconfiguration and modernization processes
- Accountability
- Mature market – a level playing field on both state and national levels.

The VFF supported the Federal Government's consultative committee to guide the $3billion purchase of water for the environment through establishing formal transparency rules around how those purchases will be managed. Appropriate guiding principles would need to be applied and formally documented if, as a last resort, Governments need to enter the market on behalf of the environment.

[2] Northern Region Sustainable Water Strategy, DSE, 2009

Overcoming impediments

DRAFT FINDING 10.1

Restrictions on water trade in Victoria and New South Wales have the potential to impair the effectiveness and efficiency of the buyback

- *Victoria's agreement to allow some exemptions to a 4 per cent limit on out-of-area trade of water entitlements is an improvement but because the extra purchases can only occur from specified areas, the constraints are still distortionary and decrease the cost effectiveness of the buyback*
- *New South Wales' agreement to lift a blanket embargo on sales to the Commonwealth and replace this with annual volumetric caps is less distortionary than the Victorian restrictions, but it does limit options for conducting a faster buyback should this be deemed necessary.*

DRAFT RECOMMENDATION 10.1

The 4 per cent limit on out-of-area trade of water entitlements should be eliminated as soon as possible, rather than phased out by 2014 as currently scheduled. Limits on the amount of entitlements that can be sold to the Commonwealth through the buyback should also be eliminated.

The VFF supports mechanisms like the 4% limit on permanent trade out of an irrigation district and termination fees, not only to ensure that rural adjustment resulting from movements of water occurs at a manageable pace, but to also guarantee that farmers not selling their water and wanting to continue farming are not faced with stranded assets and increased costs. Aligning the Commonwealth's environmental water purchase program with the infrastructure upgrade would also facilitate a manageable adjustment. To put things in context, our calculations shows that in terms of volumes of water accessible by the Commonwealth under the buyback program, the volume of Victorian high reliability water accessible by the Commonwealth this year is ten times the annual NSW volumetric limit on general security water (or equivalent).

DRAFT FINDING 10.2

Moving to cost-reflective pricing for water delivery is likely to improve the efficiency of water trading. Irrigation infrastructure operators that implement this reform will reduce the risk that geographically dispersed sales into the buyback could harm the competitiveness of their irrigation area.

DRAFT RECOMMENDATION 10.2

The Murray-Darling Basin Authority should commission an independent study into ways of expanding the ability of water users to carry over water, while adequately managing third-party impacts. This study should consider options that treat environmental entitlements and consumptive use entitlements the same and options that treat them differently.

The VFF notes that this issue has been addressed through the Australian Competition and Consumer Commission (ACCC) trading rules advice and the current state pricing mechanisms through the Essential Services Committee (ESC). VFF is happy to make available a copy of its submissions to ACCC in that regards.