SUBMISSION TO THE PRODUCTIVITY COMMISSION ON

DRAFT REPORT ON "MARKET MECHANISMS FOR RECOVERING WATER",

December 2009

BY MURRUMBIDGEE IRRIGATION (February 2010)

INTRODUCTION

Murrumbidgee Irrigation Ltd (MI) is an unlisted public company providing water supply, drainage and environmental services to approximately 3200 landholdings or 1800 customer/shareholders in the MIA. The Company employs 170 staff and manages $500 million of infrastructure assets servicing over $2.5 billion in water entitlements.

The Murrumbidgee Irrigation Area (MIA) is one of the most diverse and productive regions in Australia contributing over $5 billion annually to the national economy. The MIA was first established in 1912 following the commissioning of Burrinjuck Dam. Further expansion occurred in the 1970's with the completion of the Snowy Mountains Scheme and construction of Blowering Dam. The region has played a significant role in fostering cultural diversity with over 50 different nationalities now resident in the region. The region also played a significant role during and after WW1 and WW2 in terms of national security and repatriation.

In making this submission to the Productivity Commission (PC), MI recognises its regional and national responsibilities to assist in meeting water reform objectives for water supply services, while maintaining regional production and welfare of shareholders and other stakeholders.

OVERVIEW

MI draws on both the contents of the December 2009 Draft Report on Market Mechanisms as well as the discussions on the draft report with stakeholders held at Griffith on 2 February 2010 in making this submission. Generally we find this report an important contribution to water reform. Our major comments request the PC to consider:

- Making minor revisions to some of its findings and recommendations to ensure context and/or clarity.
- Introducing a recommendation about how to identify environmental objectives, and strategies that are consistent with achieving lowest cost recovery of environmental water (in light of alternative inputs such as land use management and investment in environmental infrastructure such as pumps to improve delivery efficiency).
- More analysis of the risks associated with the current management of the reform agenda using the experience with risk assignment provisions to show how related uncertainties can impact negatively on regional investment but also significantly drive up the costs of reform.
- The risks associated with inadequate institutional arrangements associated with management of rural water supply relative to the COAG agenda of 1994 for achieving environmental benefits from water purchasing, as well as other reforms.

DETAILED COMMENTS: based on the findings and recommendations of the draft report

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.***

Although acknowledging the importance of incorporating the prospect of climatic change in allocating water between the environment and consumptive use, MI remains concerned at the lack of context in this finding. In the context of current environmental programs that focus on water recovery without clear objectives, strategies, and quantifiable demands for and the value of proposed environmental water use across the range of expected climatic conditions, it seems dangerous to imply to Governments that "you might consider trying to get more water for the environment in drier conditions".

Also, the PC finding carries the unfortunate implication that current arrangements do not enable adaptive adjustment and risks inviting unwarranted Federal intervention. But that is not always the case. For example, the Water Sharing Plan for the Murrumbidgee (WSP) tried to ascertain appropriate distribution between the environment and consumptive users across all expected climatic scenarios and relative values for water use as at 2004. This was based on best available modeling and inputs from representatives of environmental and consumptive users. The climate has since been much drier than anticipated (certainly by the modeling then available). However, provision was made for review in 2014 (and continual review) along with what Murrumbidgee irrigators had thought were clear risk assignment provisions for subsequent re-distribution of water. Also, it is worth noting that the WSP was suspended due to the unexpectedly dry conditions and the Government made allocative decisions based on guiding principles for such events. This process is surely sufficient to enable orderly and sensible adaptation to the risk of structural (or even long term cyclical) climate change.

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.***

Agreed. However, the finding could beneficially be qualified by noting that the difficulty of market based recovery in markets that are less developed can be addressed through – admittedly higher cost – methods such as direct tender (which is what Governments are doing everywhere).

Draft finding 3.2 ***Market intermediaries, including brokers and exchanges, have developed alongside the market to facilitate increased trade, with lower transaction costs.***

Agreed. However MI recommends the introduction of a licensing regime for all water brokers (including trust account facilities and full accountability for all trades and transactions) or at the very least the provision of operating guidelines/standards for market participants in order to reduce the risk exposure of trading parties.

<u>Draft finding 4.1</u> 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.

At a very broad level there is no problem with this finding, but – as currently written - there are considerable dangers in using it to inform specific actions. Many of the Northern rivers are connected to the Murray via the Darling. Those rivers do have more hydrological constraints and therefore higher losses and other costs in delivering water for environmental use in the Murray. However, the same could be said for recovery of water in the upper parts of the southern basin catchments relative to lower parts. Moreover, environmental priorities within each catchment in the highly connected south should not be sacrificed in the name of 'connectivity'. For example, water delivered from the Murrumbidgee to the Murray could theoretically be transferred between upstream dams rather than as end-of-system flows from the Murrumbidgee. But, Murrumbidgee environmental objectives must inform such decisions. On this basis it seems worth qualifying the finding with observations such as:

- costs associated with delivery of water to environmental assets increase with distance upstream from the point of delivery to the environmental asset,
- every catchment in the highly connected Southern basin has "local" environmental priorities, but
- all connected catchments can yield water that contributes to basin outcomes.

<u>Draft finding 4.2</u> 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.

Agreed. There is a case for strengthening this observation by pointing to the relative strengths that Australia has at its disposal as inputs into the process of altering allocation distributions from time to time. There is little doubt that Australia generally has very strong institutions, sound governance structures, high levels of customer knowledge and skills, and clear processes of accountability in the governance and management of our public resources. On the other hand the science required to underpin highly informed allocation of basin water resources is still being developed. This is explicitly recognised in the risk assignment provision that recognises the potential for new knowledge becoming available. Yet most of the typical institutional, management structures, and accountability processes for management of public resources are not as evident in rural water supply as for other public resources. Rather, we seem to be rushing headlong into 'black box decisions' based on best available science (largely modeling) with little community input to test relative values or provide ongoing accountability.

To achieve more effective engagement governments should consider a move from policy development based on Ministers and departments delivering information-based consultation to a more participatory approach. One model that could be used is the OECD Framework for public involvement in government policy. The NSW Irrigators' Council also released a guide to consultation that may prove useful.

Governments have a tremendous opportunity for true engagement with Basin communities on the MDBA's preparation of the Basin Plan and Sustainable Diversion Limits (SDLs).

Given we are now only 5 months away from a Draft Plan, with very little effective engagement so far, the options appear limited. However MI would make the following observations:

- 'Black box' scientific studies of environment demands, hydrology, and socio-economics while useful cannot hope to provide the Authority with the full information required to set SDLs or assess community impacts. Also, they are unlikely to harness community support (including environmentalists and consumptive users), and do not enable the dialogue among community groups that would promote a more consensual approach.
- Impact analysis from afar will not provide the contextual picture focus groups or other face-to-face methods will provide – these methods should be utilised to give texture to broader studies.
- If the MDBA does not intend to involve communities in decisions leading to a Basin Plan then they should be up front that this is the case; and
- If they do then it needs to be clear as to what extent they will have involvement and/or impact and at what level (for instance peak groups or kitchen tables).

***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.*

Agreed. MI would further qualify this finding with the observation that the institutions, capacity, and processes for identifying the missing information and the structures, processes, and capacity for ensuring accountability of resource use and subsequent review are all available. These could be accessed readily through a participatory approach and effective community engagement.

***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.*

Agreed. In our view this finding should extend to the whole of the governance of water reform rather than just a component part such as the risk assignment provisions (although they may be the 'flavour of the moment'). The problem is that the water reform agenda becomes a movable feast. The associated uncertainty has strong negative impacts on irrigator's ability to plan for the future, and associated investment, employment, incomes and social welfare in regional Australia. It also significantly increases the direct administrative costs of reform. An example is the history of water redistribution in the Murrumbidgee Valley and the relationship with risk assignment provisions.

The introduction of the basin cap in the mid 1990s was the first major limitation on the extraction of water resources in the basin. The cap was defined as the volume of water that would have been diverted at 1993-94 levels of development.

Expected long term average cap diversions for the Murrumbidgee Valley were first quantified in cap audits in 1999-2000 at 2,521 GL[1]. That was subsequently refined, presumably due to modeling improvements, down to 2,358 GL in 2001-02 which has remained the expected long term average diversion under the cap for the Murrumbidgee in 2008-09.[2] In the early years following introduction of the cap the Reviews of Cap Implementation tended to report overuse relative to the cap for the Murrumbidgee. However this was corrected with successive changes in water management and allocation rules and the introduction of environmental water rules culminating in the introduction of the final Murrumbidgee Valley Water Sharing Plan (WSP) in 2004. The main purposes of WSPs are shown at http://www.water.nsw.gov.au/Water-Management/Water-sharing/default.aspx as:

1. to protect the fundamental environmental health of the water source
2. to ensure that the water source is sustainable in the long-term
3. to provide water users with a clear picture of when and how water will be available for extraction.

Although guidelines for preparing WSPs in NSW state that compliance with the MDB Cap is a minimum standard, it is clear that the Murrumbidgee WSP has exceeded that limit in terms of making average expected water available to the environment. As correctly noted by the PC (Box 2.2) the Murrumbidgee WSP established an expected long term extraction limit of 44 per cent of expected average inflows or 1,925 GL. However, far from being 'consistent with the Cap', 1,925 GL is well below the long term average diversion of 2,358 under the MDB Cap for the Murrumbidgee.[3] Diversions for consumptive use to the Lowbidgee need to be added to this but on average these diversions would be much lower than 433 GL. It is now impossible for Murrumbidgee Valley water use to reach the Basin Cap let alone breach it. This is supported by the observation in the 2008-09 Review of Cap Implementation published by the MDBA that "The cumulative credit of 1,427 GL implies that the Murrumbidgee Valley has been 6.2% below Cap since July 1997" [even though early returns tended to deliver Cap debits].

It is also worth noting that the WSP used best available scientific knowledge and extensive consultation with representatives of consumptive users and the environment to establish relative values and water allocations across all expected climatic conditions, along with progress reports and formal review after 10 years. Also, none of this water recovery involved any compensation to consumptive users for reductions in water use.

As noted by the PC, the risk assignment provisions were to apply "after States had addressed known over allocation and/or over use through their water planning processes". In addition, States were expected to enable these arrangements through appropriate changes to legislation and/or regulations. Again, as noted by PC NSW and the Commonwealth have adopted the specific NWI risk assignment provisions.

The expectation was that Murrumbidgee and other compliant NSW catchments would have the future certainty provided by the risk assignment framework. But, we are now being told that there is a definitional problem about whether States have addressed over allocation and/or overuse in their water plans. The implication is that States and catchment stakeholders are unable to address over allocation and/or overuse without specification from the Commonwealth.

[1] See successive reports on "Review of Cap Implementation in the Murray Darling basin" by the Independent Audit Group from 1996-97 to 2006-07 published by the MDBC and subsequently by the MDBA.
[2] Op cit.
[3] These modeled results are based on the same scenario for future climatic conditions.

Aside from being a highly contestable proposition on its own, it is particularly onerous – and downright offensive - to ask States and catchments to go through the very difficult and high cost reallocation processes before raising the issue in retrospect. The Commonwealth must recognize that the risk assignment provisions as cited in the Water Act 2007 must apply in NSW from the commencement of the Basin Plan in 2014.

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.***

Agreed.

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.***

In some cases yes but in other cases no. Water savings projects, when taking into account broader implications of asset redundancy and loss of economic activity can be more cost effective depending upon the nature and cost of the projects. Also, purchasing water may reduce efficiency and increase costs of operating irrigation delivery systems because of 'Swiss cheese' effects, and more often than not these costs will not be fully offset by specific purpose instruments such as termination fees.

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.***

Care should be taken not to ignore the possibility of very sound investments in water savings and other environmentally and economically beneficial projects that may reduce the quantity of water required to achieve environmental objectives. We agree that infrastructure upgrades should not be a welfare mechanism as they can easily add to the costs of sustaining irrigation services. However this could be addressed by placing the burden of proof on applicants to show that infrastructure upgrades will reduce costs for customers and regional stakeholders before approval.

One must take a broad view of benefits and costs when comparing infrastructure projects with purchases. Much can be achieved to reduce potential regional costs and economic losses by working with infrastructure service providers to better integrate the purchasing program and system rationalisation and re-development under the Sustainable Rural Water Use and Infrastructure Program.

<u>Draft recommendation 6.2</u> 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.

We agree that rigorous approval processes should be applied to all projects under this program however we do not agree that the cost per megalitre should in all instances be similar to the market price.
As stated in responses above, there are some factors that need to be considered when assessing the relative merits of savings versus purchases. These include:-

- Water savings avoid the "lost economy" that takes place when purchasing removes entitlement from production This includes lost primary production as well as the flow on secondary and tertiary effects.
- When compared on a cap equivalent basis instead of market price, water savings are often more reliable than most high security entitlements and hence of higher value.
- Water savings avoid the costs of "swiss cheese" effects that are associated with purchase of entitlements. This should increase the economic value of water savings relative to the market price of entitlements.

Also, there have been precedents that are at significant odds with this recommendation. How does the Commonwealth deal with new applicants in light of these prior approvals, without compromising the principle of equal treatment of stakeholders? If benefits not specifically related to water savings such as stimulus to regional economies, improved technologies, and skills enhancement through capital works have been acceptable in other jurisdictions then they should remain consistent throughout implementation of the Sustainable Rural Water Use and Infrastructure Program. Moreover, the willingness to finance such alternative benefits should be communicated to all prospective applicants.

<u>Draft finding 7.1</u> 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.

Agreed.

<u>Draft recommendation 7.1</u> 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.

Agreed.

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.***

Agreed.

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.***

Agreed.

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.***

Agreed.

Draft finding 8.4 ***The efficiency of the conveyancing process could be improved by:***

- ***exchanging the contracts of sale before the due diligence process commences***
- ***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.***

Agreed.

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.***

MI is worried by this recommendation because it implies that the only instrument available to meet a distributional goal is through water reallocation by administrative decree (as PC eliminates both water buying and infrastructure investment as legitimate means to meet such a goal). Such centralised decision making is currently not supported by sufficient modeling, information, or typical institutional structures and engagement processes to ensure appropriate accountabilities – nor is it supported by a history of success when used elsewhere.

On this basis, we believe that Government should meet the costs of any distributional goals by paying over the odds for water and/or for infrastructure investment – as opposed to asking irrigators to pay for such waste and experimentation by use of administrative decree. The achievement of distributional goals through "administrative reallocation" would obviously be inefficient (as it would using other mechanisms) because it would need to follow up with constraints to trade if the initial redistribution is to be maintained.

MI would also be surprised if issues such as salinity impacts did not influence costs and therefore the market price of water in affected regions. The value of water could be expected to be lower in saline areas (as the cost of production increases). This would likely mean that a value for money purchasing program would be consistent with moving water out of saline areas.

<u>Draft finding 9.1</u> 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.

Agreed.

<u>Draft finding 9.2</u> 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.

Agreed.

<u>Draft finding 9.3</u> 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.

Agreed. However, we believe that other inputs such as capital works, improved management practices, and improved institutional arrangements are necessary conditions for improved environmental outcomes.

<u>REQUEST FOR INFORMATION</u>: 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?

MI has very strong concerns about the institutional arrangements that look like being put in place to deal with water reform generally. Those arrangements have implications for the efficiency and effectiveness of the water purchasing program as well as for all other aspects of water reform.

The COAG agenda identified the following key areas for water reform:

- Water pricing based on full cost recovery and the amount of water used
- The establishment of clearly specified water entitlements and the arrangements to enable trade in those entitlements
- The allocation of water to the environment
- The establishment of regulatory and water service institutions that have clear roles and responsibilities

Further it stated that "in relation to institutional reform:-

a. that where they have not already done so, governments would develop administrative arrangements and decision-making processes to ensure an integrated approach to natural resource management;
b. to the adoption, where this is not already practised, of an integrated catchment management approach to water resource management and set in place arrangements to consult with the representatives of local government and the wider community in individual catchments;
c. to the principle that, as far as possible, the roles of water resource management, standard setting and regulatory enforcement and service provision be separated institutionally;
d. that this occur where appropriate, as soon as practicable, but certainly no later than 1998; and….

g. to the principle that constituents be given a greater degree of responsibility in the management of irrigation areas, for example, through operational responsibility being devolved to local bodies, subject to appropriate regulatory frameworks being established."[4]

What we have actually seen is a centralization of water resource management, standard setting, regulatory enforcement, and service provision on the one hand through the establishment of the MDBA which is clearly contrary to point c above. Rather than formulating administrative arrangements and decision-making processes to ensure an integrated approach to NRM we have created a super-agency with a virtual monopoly on NRM and service delivery in significant parts of the basin. Not surprisingly, little has been achieved by way of point (b) because by establishing a centralized super-agency with significant vertical monopoly the incentives for integrated catchment management and community consultation are reduced dramatically. The super-agency approach is also fundamentally at odds with point g. Yet – despite the clear super-agency model – clients and other stakeholders are forced to deal with a large range of Government agencies that seem to have over-lapping responsibilities in relation to sorting out various aspects of the reform program (also at odds with a and b above).

MI recommends an immediate return to the more culturally consistent institutional framework represented by the COAG recommendations with institutional separation of and clear roles and responsibilities for institutions to Govern and regulate NRM, river operations (involving delivery to environmental water managers and consumptive users), environmental water managers, and consumptive users (including off-river irrigation infrastructure operators). The roles of specific purpose advisory bodies should be specified in relation to the agencies made responsible for delivery of these services. The responsibilities of each of these bodies should be set out in order to clarify accountabilities to owners, clients and customers, and other stakeholders. Duplication should be eliminated.

[4] COAG communiqué August 1994

If this is achieved MI would suggest that the over-arching environmental water manager should include the environmental water buyer role and the environmental water holder role. The environmental manager could also benefit from resources to enable purchase of water, infrastructure and environmental services from other environmental management agencies as well as exchange water for the delivery of specified environmental outcomes. It should be able to devolve service provision to catchment based environmental service providers if devolution to specific catchments is appropriate – which seems very likely. The environmental water manager should be owned by the Government, but it should operate at arm's-length from Government regulators and other Government owned agencies (as should river operators and off-river infrastructure service providers). It should also operate on a more commercial basis than existing Government departments including full asset registration and reporting. This suggests that a Government corporation may be the appropriate structure. That said, a specific purpose Government agency would be acceptable – and a big improvement on current arrangements – if it can deliver the critical elements of separation, accountability to owners (for acquisition and use of resources) and to customers and other stakeholders, and capacity to conduct commercial operations (including buying and selling water and other environmental services).

<u>Draft finding 10.1</u>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.***

The NSW embargo on sales to the Commonwealth was directly related to Victoria's effective 'hold out' on out of area trade due to its machination of the 4 per cent rule.

<u>Draft Recommendation 10.1</u> 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 4 per cent limit was intended to enable service providers to manage the costs of adjustment and is still supported by MI in that context. A more urgent need here is to ensure that there is a level playing field throughout the basin. That clearly has not been the case in the past nor is it likely to be in the future. For example, Victoria is not required to prepare formal water plans compliant with the basin plan until 2019. This creates a continued need for 'game playing' because it is too much to expect any of the States within the basin to accept distortions that may work to their significant disadvantage.

As noted earlier, unfortunately the implementation of the water reform agenda, going back to COAG in 1994, has seen early compliers facing high costs without reward while the 'hold outs' mitigate costs and negotiate high relative benefits to participate. In such a climate, would PC advise its stakeholders, shareholders, or customers to jump in early?

<u>Draft finding 10.2</u> 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.

This is true in principle, but the benefits are likely to be quite small relative to the costs involved with changing pricing systems and related definition of delivery rights. MI has already gone through such changes and is still wrestling with consequences and costs. The benefits would need to be very clear and very large before we would entertain such changes again.

<u>Draft Recommendation 10.2</u> 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.

Agreed.