

Productivity Commission Inquiry: Australia's Urban Water Sector

Submission in response to the Commission's Draft Report of April 2011

DRAFT RECOMMENDATION 3.1

The Australian, State and Territory Governments should articulate a common objective for the urban water sector in relevant policy documents along the following lines:

- *The primary objective of the sector is to provide water, wastewater and stormwater services in an economically efficient manner so as to maximise net benefits to the community.*

Economic efficiency should be defined broadly to include environmental, health and other costs and benefits that might not be priced in markets.

Agree that this is an appropriate objective for the sector, but not for utilities or water corporations. As signalled later, there needs to be clear delineation of roles and responsibilities between government, utilities and regulators and there should be minimal overlap between them. Ideally water utilities deliver services commercially, in line with standards set by consumer, health, environmental and economic regulators.

DRAFT FINDING 4.1

It is the role of governments (elected representatives) to:

- *set objectives for policy development for urban water and relevant objectives for each agency*
- *develop policy frameworks and principles in relation to public health, the environment and service delivery that are consistent with these objectives*
- *define property rights for water*
- *put in place institutional and governance arrangements for:*
 - public health, environmental and economic regulation relating to water*
 - service delivery of potable water, non-potable water, wastewater and stormwater services.*

Agree that this is the appropriate role for governments in the sector.

DRAFT RECOMMENDATION 5.1

Urban water sector regulators should rigorously apply the six principles of good regulatory practice spelt out by the Regulation Taskforce in 2006.

Agree.

DRAFT FINDING 5.1

Price regulation is not an appropriate mechanism to deal with affordability concerns or to ensure that urban water utilities fully recover costs.

Agree that price regulation is not the most appropriate mechanism to deal with affordability concerns.

However, it is likely that, without independent (of government) price setting, many water utilities in major cities would have struggled to fully recover costs, particularly in the face of significant investments in desalination. It is also evident that where there is no independent price regulation, or where government has intervened in price setting, the utilities are unlikely to be able to fully recover costs. The decisions to cap water prices in south east Queensland and to limit price increases in Tasmania serve to highlight the difficulty that water utilities have in fully recovering costs.

Nonetheless, while price regulation has most likely enabled full cost recovery, it may not be the most appropriate mechanism.

DRAFT RECOMMENDATION 6.1

State and Territory Governments should adopt policy settings that allow the costs and benefits of all supply augmentation options to be considered using a real options (or adaptive management) approach.

Information on costs, risks and benefits to consumers of all augmentation options should be made publicly available and views of the community sought, especially regarding sensitive options like potable reuse.

Bans on particular augmentation options (those explicitly stated and those that are implied by government decisions) should be removed, including those on:

- *rural–urban trade (to allow water to be allocated to its highest value use)*
- *planned potable reuse (unplanned potable reuse occurs commonly without any apparent ill-effects).*

Agree. These are key reforms that offer significant savings through more cost effective sources of supply and through deferral of significant investments.

DRAFT RECOMMENDATION 6.2

The Australian, State and Territory Governments should not provide subsidies for supply augmentations and other urban water infrastructure, except where:

- *it directs a utility to invest to produce a particular environmental outcome unrelated to its service delivery responsibilities and the subsidy is commensurate with the costs attributable to achieving the outcome*

- *a formal process has identified that a particular community should be exempted from the requirement to fully recover costs through water charges (see draft recommendation 13.3).*

Agree.

DRAFT FINDING 6.1

Integrated water cycle management initiatives are often driven by the assumption that increased water reuse and recycling, and decreased reliance on centralised water supply systems are always in the community's interests. A better approach would be to seek to remove impediments to integration (such as the absence of appropriate property rights for wastewater and stormwater and deficiencies in the analyses, and community awareness, of costs and benefits), thereby allowing efficient recycling and reuse projects to be implemented.

Agree. This situation often creates similar problems to those when all viable sources of supply augmentation are not considered in a transparent way.

DRAFT FINDING 7.1

By more closely reflecting the opportunity cost of supply, flexible (scarcity) pricing of bulk water helps to facilitate a more efficient allocation of water resources and more efficient supply augmentation decisions.

Agree. It is important to distinguish between the influence of scarcity pricing for bulk (wholesale) and retail (domestic) supply.

DRAFT FINDING 7.2

There appears to be scope for efficiency gains in ensuring that developer charges better reflect the costs of service provision in new developments. Upfront charges should be used where the incremental costs of development are well established and, in the case of urban infill, benefits do not accrue to incumbents. Where the benefits also accrue to incumbents, costs should be spread across all users through rates, taxes or the fixed part of a two-part tariff for water and wastewater.

Agree that developer charges may provide efficiency gains by sending a clear price signal. However, there are likely to be questions raised about the equity of such an approach. Infill development tends to be targeted at higher income occupants, infrastructure costs are generally lower and benefits often accrue to incumbents. In contrast, fringe developments tend to be targeted at lower income occupants, infrastructure costs are higher per dwelling and the benefits are usually restricted to the new residents.

DRAFT RECOMMENDATION 7.1

Metering technology should be introduced in all new single and multi-unit dwellings. The case for retro-fitting existing single and multi-unit dwellings with separate metering technology should be assessed by utilities.

Agree. While multi-unit dwellings typically have lower per capita water usage, the current arrangements provide no price signal and create perverse incentives on unit occupants.

DRAFT RECOMMENDATION 7.2

Utilities should charge tenants directly for all water charges, both fixed and volumetric, where water is separately metered. Where this does not already occur, State and Territory Governments might need to put in place transitional arrangements to ensure that savings to landlords are passed through to tenants.

Agree.

DRAFT FINDING 7.3

The volumetric component of two-part tariffs is currently distorted by inclining block tariffs. Inclining block tariffs lead to inefficiencies and inequities. There are substantial efficiency gains to be achieved from moving to a flat volumetric retail pricing structure.

Agree.

DRAFT FINDING 7.4

Charging the same price for water over large geographic areas irrespective of the different costs of servicing individual locations within those boundaries leads to inefficiencies and inequities.

There is scope for efficiency gains in moving to more location-specific pricing, particularly where cost differences within 'postage stamp' areas (uniform pricing) are currently large and easy to quantify. In such cases, the benefits are more likely to outweigh the costs.

Agree.

DRAFT RECOMMENDATION 7.3

More consumer choice in urban water tariff offerings should be available. This would:

- *allow consumers to express their preferences on security of supply and price stability*
- *provide an opportunity for water utilities to manage demand better as water availability changes over time.*

Utilities would be required to provide default two-part tariffs with a single volumetric component.

Agree.

DRAFT FINDING 7.5

The National Water Initiative pricing principles are unclear and provide scope to implement pricing policies that are not necessarily in line with the principles of economically efficient pricing.

Agree.

DRAFT FINDING 8.1

Although apparently reasonably well accepted by the community, water restrictions generate costs for households, businesses and the community. They do so by denying consumers the opportunity to choose how to use water in the ways that are most valuable to them. The evidence suggests that the costs of restrictions are significant and can amount to several hundred million dollars per jurisdiction per year where they have been in place.

Agree.

DRAFT RECOMMENDATION 8.1

The use of water restrictions should be limited to times of emergency where a water shortage arises unexpectedly, or in regional urban areas where there are no viable new water sources available to augment supply and restrictions are needed to avoid running out of water. Consumers should instead be able to exercise choice in their water consumption behaviour through an efficient price mechanism.

Agree in principle. It is likely that the circumstances where there are no viable new water sources would be restricted to a relatively few, small regional towns. A loose exception is likely to perpetuate the practice of using restrictions rather than making efficient investment. In addition, it should be recognised that restrictions can provide an effective means of deferring large investments where the prospects of a return to more usual supply are uncertain. As the commission has noted elsewhere, the benefits of deferring large investments that later prove to have been unnecessary can be substantial.

DRAFT FINDING 8.2

The WELS scheme has been successful at providing the public with an objective set of information with which to make informed decisions, and should continue.

Agree.

DRAFT RECOMMENDATION 8.2

Neither governments nor regulators should mandate water use efficiency and conservation activities, unless there is a market failure present and it is clearly established that the social benefits of intervention exceed the social costs.

Government education and information campaigns should be refocused to provide more balanced information on the costs and benefits of water saving activities, as well as the relative merits of using prices, restrictions and water use efficiency and conservation measures to manage demand.

Agree. The mandating of water efficiency and conservation measures without regard for their efficiency creates similar problems to those when all supply options are not considered.

DRAFT FINDING 8.3

Although there has been community support for restrictions and water use efficiency and conservation activities, not all consumers share the same preferences for using less water. There is evidence to suggest that many consumers would be willing to pay a higher water bill to avoid being subject to restrictions on their water use.

Agree.

DRAFT FINDING 9.1

Water consumption per capita in Australia is well above generally agreed subsistence requirements. There is no need for an 'essential' volume of water to be determined by governments.

Agree.

DRAFT FINDING 9.2

Expenditure on water and wastewater services generally represents a small proportion of income, including for low income groups. Price increases in water and wastewater services, although contributing to rising costs of living, are likely to have had less detrimental effect on consumers than price increases of other essential goods and services such as energy and housing, on which expenditure represents a greater share of incomes.

Agree.

DRAFT FINDING 9.3

Current state and territory concession arrangements for water and wastewater services are inefficient and inequitable. Efficiency gains can be made by replacing or amending water and wastewater concessions with direct payments to targeted households or rebates on the fixed component of water and wastewater service bills.

Agree.

DRAFT FINDING 9.4

The affordability of water and wastewater services for low income and disadvantaged households, in addition to the affordability of other essential goods and services, is most efficiently achieved through non-concession elements of Australia's tax and transfer payments system.

Agree.

DRAFT RECOMMENDATION 9.1

COAG should commission a review of concessions on utility services across all levels of government. The review should assess:

- the appropriateness of existing arrangements for providing concessions, including eligibility criteria***
- the merit of and scope for abolishing concessions and providing relevant assistance to all low income households via other elements of the tax and transfer payments system.***

Agree.

DRAFT FINDING 9.5

Properly designed hardship policies that outline the obligations of water utilities when dealing with customers facing payment difficulties, including the availability of payment extensions or payment plans, are in the interests of consumers. Other measures to alleviate hardship for low income and disadvantaged consumers in exceptional circumstances, such as utility grant schemes, also have merit.

Agree.

DRAFT RECOMMENDATION 9.2

COAG should develop a set of best practice consumer protection principles for water utilities. These could be included in any new intergovernmental water agreement. At a minimum, the principles should include:

- *access to an independent dispute resolution process, preferably by a specialist utilities industry ombudsman*
- *the establishment of an industry code defining service standards and provisions to assist consumers facing hardship.*

Agree.

DRAFT RECOMMENDATION 9.3

COAG should progress implementation of measures to support consumer advocacy and research consistent with Recommendation 11.3 of the Commission's 2008 Review of Australia's Consumer Policy Framework.

Agree.

DRAFT FINDING 11.1

A key impediment to performance is the lack of clarity about roles and responsibilities for the procurement of new water supplies and services. The most appropriate organisations are the retail–distribution utilities. They:

- *are best placed to understand the preferences of urban water consumers*
- *are in a position to facilitate contestability and competition for new water supplies and services from potential service providers*
- *have the incentives to, and are best placed to, manage the commercial risks of procurement, particularly those associated with long-term supply and service contracts.*

Agree.

DRAFT RECOMMENDATION 11.1

Retail–distribution utilities should be assigned responsibility for meeting security of supply standards and procuring water supply and services.

Agree. For this recommendation to be implemented effectively, a precondition will be acceptance of the principle that governments set clear security of supply criteria and do not interfere unnecessarily in procurement decisions.

It is far from certain that governments will be prepared to take this latter step, or if they do, would resist the temptation to reverse it in the face of criticism of particular supply decisions.

DRAFT RECOMMENDATION 11.2

State and Territory Governments should draw up charters for urban water utilities incorporating best practice governance arrangements and governments' requirements for the performance of utilities.

The charter would set out details about:

- *obligations to serve (security of supply and obligation to procure)*
- *transparent processes and procedures for choosing supply augmentations (public consultation, tenders for supply, public reporting of the decision, and monitoring by an independent body)*
- *principles for pricing and service offerings*
- *transparent processes and procedures for setting prices that involve public consultation, public reporting of decisions and periodic review by an independent body*
- *borrowing and dividend policies*
- *customer service standards/hardship policies*
- *risk allocation (between consumers, government shareholders and private suppliers)*
- *nature and funding of Community Service Obligations.*

There should be public consultation regarding the contents of the charter, and independent economic regulators in each jurisdiction would also be well placed to provide advice to the government.

Independent economic regulators, or some other appropriate government agency in each jurisdiction, could oversee reporting against the charter.

Agree.

DRAFT FINDING 11.2

Government-owned water utilities are typically given a number of conflicting objectives by governments. Some objectives are inefficient (for example, utilities being required to reduce per capita consumption) and some are more appropriately assigned to other agencies. Often, little guidance about the relative importance of objectives is provided.

Agree. Ideally water utilities should be tasked with optimising the efficient delivery of water services in line with standards set by consumer, health, environmental and economic

regulators. Such a position should remove the common conflict within water utilities when faced with conflicting objectives.

DRAFT RECOMMENDATION 11.3

Governments should further improve governance arrangements for publicly-owned urban water utilities. Areas for improvement include:

- ***governments setting overall water security and reliability objectives, and requirements for wastewater, stormwater and flood mitigation***
- ***further separation between Ministerial and board governance***
- ***greater definition and alignment of objectives and assignment to appropriate agencies***
- ***implementing procedures to ensure independence of boards***
- ***regular reviews of Community Service Obligation payments***
- ***regular reviews of board performance***
- ***greater flexibility regarding dividend payments to ensure they are consistent with investment intentions. Initial recommendations on payments should be made by boards.***

Agree. These reforms are critical to effective implementation of associated reforms called for by the Commission, particularly in giving power to water utilities to set prices and decide preferred supply augmentation options. Given their criticality, it must be recognised that there is no indication to date that governments would be prepared to implement these reforms. Indeed, there is much evidence to suggest they see a central role for government in day-to-day decision-making, not just in direction setting.

DRAFT FINDING 11.3

Establishing good governance procedures would render much of the current price regulation of government-owned water utilities unnecessary, and would be likely to provide greater net public benefits when compared to price regulation.

Agree in principle. However, achieving acceptance and implementation of the proposed governance reforms is likely to be difficult.

DRAFT RECOMMENDATION 11.4

State and Territory Governments should move away from regulatory price setting to a price monitoring regime (where some form of prices oversight is considered necessary). Within five years of moving to a price monitoring regime, all State and Territory Governments should initiate independent reviews (not by regulatory agencies) to determine:

- ***whether water utilities are abusing their market power and, if they are, what action should be taken to deal with this***

- *whether ongoing price monitoring would likely produce net benefits to the community and, therefore, whether it would still be required. If such benefits cannot be demonstrated, all price regulation should be abolished and replaced by a self-reporting regime to be overseen by an appropriate government agency in the relevant jurisdiction.*

Rather than proceeding to implement a price setting regime, Queensland should continue with its interim price monitoring arrangements until it undertakes a review of whether price regulation produces net benefits to the community.

The National Water Initiative pricing principles should be amended to remove any reference to independent regulatory price setting, except where it can be demonstrated that a more light handed approach as described above would be unlikely to prevent an abuse of market power.

Agree in principle. However, in the absence of the governance reforms being accepted or in the face of compromised implementation, removal of price setting is likely to result in under-recovery of full costs. This is likely, in turn, to lead to a reversion to the situation where utilities cut back on maintenance and investment, resulting in worker safety, water quality and water security being compromised. In addition, economic regulators have, in setting prices, not only ensured that market power is not misused, but also that costs are efficient. Without this discipline, there would be a risk that utilities would not have sufficient incentive to ensure efficient operations.

DRAFT FINDING 11.4

In urban water, there is no competitive market-based mechanism to reveal the preferences of individual consumers regarding potential service offerings, such as the willingness of individual consumers to pay for different levels of reliability and security of supply. One possible way to facilitate the revelation of such consumer preferences is through the use of representative consumer groups.

There is room for regulatory protection of consumers' rights, but this would appear to be adequately covered by existing arrangements at the state, territory and Commonwealth levels. However, there is little evidence to suggest that an advocacy group would provide consumers with an effective voice on potential service offerings, and, as the Commission notes, this would be difficult and susceptible to unrepresentative influence.

Where retail competition is introduced, such as under the Commission's Option 4, there is no need for consumer groups to advocate for potential service offerings.

DRAFT RECOMMENDATION 11.5

The Australian Government should proceed with the scheduled independent review of the National Access Regime. This review should commence no later than 31 December 2012. The terms of reference should include an examination of all state-based access regimes, including those for the urban water sector.

Agree.

DRAFT RECOMMENDATION 11.6

Environmental and health regulators should be more transparent and accountable in their decision making. Except in matters where urgent public or environmental safety issues are involved regulators should also publish draft decisions and seek public comment on these. They should publish the reasons for their decisions in a similar manner to economic regulators and governments should consider the development of appropriate decision review mechanisms.

Agree.

DRAFT RECOMMENDATION 11.7

All remaining impediments to rural–urban trade, particularly volumetric restrictions and excessive termination fees, should be removed as soon as possible.

Agree. This is a critical issue for many major cities if all viable sources of supply are to be considered.

DRAFT RECOMMENDATION 11.8

Any bans (legislated or otherwise) preventing trade between regional water utilities should be independently reviewed and, if it cannot be shown the bans provide net public benefits, they should be removed.

Agree.

DRAFT FINDING 12.1

Available evidence on economies of scale in the water and wastewater industry suggests:

- *water supply and wastewater utilities are characterised by constant or increasing returns to scale (economies of scale) for a wide range of output levels*
- *horizontally aggregating small utilities is expected to generate gains from economies of scale. This is particularly likely if utilities are located in relatively close proximity to each other, and there is scope to increase scale without a significant increase in network costs*
- *horizontally disaggregating very large utilities is unlikely to lead to economies of scale losses, that is, produce utilities that thereafter operate below minimum efficient scale. However, scale impacts are location (and context) specific, and should be assessed on a case-by-case basis. Some utilities may be approaching diseconomies of scale, such that there are efficiency gains from horizontal disaggregation, all else equal.*

Agree.

DRAFT FINDING 12.2

There is a range of structural options for urban water supply in Australia's large urban cities, including:

- *Option 1: a vertically-integrated utility*
- *Option 2: vertical separation of the bulk water supply function from other elements of the supply chain, and horizontal separation of the bulk water supply function*
- *Option 3: vertical and horizontal separation of the wastewater treatment function (in addition to option 2)*
- *Option 4: horizontal separation of the retail–distribution function (in addition to option 3)*
- *Option 5: a fully competitive, decentralised urban water market.*

There are potentially significant risks and costs associated with establishing a fully competitive, decentralised market for urban water services at this time (option 5), and it is unlikely that the benefits justify the costs. This should be reviewed on a periodic basis.

The potential benefits of options 2, 3 and 4 are much more compelling. State and Territory Governments should undertake a detailed assessment of the full costs and benefits of undertaking structural reform in large urban cities.

Agree that there is potential for efficiencies from structural reform and that further detailed assessment is required to inform this on a case-by-case basis.

DRAFT FINDING 13.1

In many areas of regional Australia, water utilities recover their costs and are financially sound.

However, a significant number of regional water utilities are earning negative or very low real rates of return. It is not clear that these utilities are achieving genuine cost recovery (that is, recovering all costs — including asset maintenance and renewal costs — over the capital cycle). This could have serious implications for water system infrastructure over the longer term, particularly if negative or low returns are sustained over a number of years.

Agree. The Commission's draft report highlights the potential for misleading information when inappropriate indicators are used to measure performance. Implementation of the Commission's suggestion and the Office of the Tasmanian Economic Regulator's view that a positive economic rate of return is an appropriate measure of cost recovery would significantly improve transparency in the regional water sector.

DRAFT RECOMMENDATION 13.1

There is a strong case for undertaking aggregation of small water and wastewater utilities in regional areas of New South Wales and Queensland. The precise approach — including identification of affected councils and the preferred grouping of councils — should be assessed and determined by relevant State Governments, in consultation with Local Governments and affected communities.

This process should consider the relative merits of alternative organisational structures, including:

- ***county council***
- ***regional water corporation***
- ***regional alliance (or regional organisation of councils).***

Agree. There is a very strong case for the aggregation of small water and wastewater utilities in regional areas of New South Wales and Queensland. As the draft report demonstrates, concerns raised by local government over the costs that would be incurred do not outweigh the benefits that will flow.

It is clear that weak governance structures are behind many of the water-related problems faced by regional communities in NSW and Queensland. Examples of poor governance include the failure to recover full costs (as demonstrated in the draft report), using water and wastewater revenue to offset capped general council rates and widespread failure to address situations that pose a high risk to drinking water quality.

Local government-owned regional water corporations have the best potential to meet aggregated water utilities' objectives because of the strong governance structures they bring. There is also much to recommend the county council model as applied in NSW.

The existence of county councils that have already achieved aggregation of water utilities and many of the benefits proposed in the draft report provides a template for broader application of such reform in NSW.

Regional alliances, binding or voluntary, do not provide the same potential for improvement because of their weaker governance structures.

While much good work was done in NSW by the Armstrong and Gellatly inquiry, the next stage of considering the optimal models for aggregated water utilities would be better served if less proscriptive terms of reference were to be used.

The terms of reference for the Armstrong and Gellatly inquiry required that in identifying the most effective arrangements for water and sewerage services, the model proposed must, among other things, protect or enhance councils' revenue stream and maintain or enhance job opportunities. Such restrictive directions effectively limit the range of options that can be considered and are akin to the policy bans on supply options criticised earlier in the draft report.

Regional communities should have the opportunity to understand the risks posed by inadequate water services, and the costs and benefits of each of the models in addressing those risks. Even where communities are exposed to this information, state governments have a role in prescribing minimum standards for the protection of consumers.

DRAFT RECOMMENDATION 13.2

The New South Wales Government should provide a formal response to the recommendations of the Armstrong and Gellatly inquiry as a matter of priority.

The Queensland Government should commence a similar process, in consultation with Local Governments and communities, to consider the costs and benefits of different structural reform options for the urban water sector in regional Queensland (outside of south-east Queensland).

Agree. The next stage for NSW should be to commence the detailed assessment of all potential models against the objectives the Commission has recommended for the water sector. This next stage should consider the full range of options without formal or informal policy proscriptions.

While Queensland could take a lead from the process applied in the Armstrong and Gellatly inquiry, a lesson from that inquiry would be to ensure the terms of reference do not explicitly or implicitly exclude the full consideration of options.

DRAFT RECOMMENDATION 13.3

Jurisdictions should identify those regional utilities that are unable to provide safe and secure water and wastewater services for economic reasons. In doing so, the relative merits of alternative supply options (including moving to a system of self-supply) should be considered.

State and Territory Governments should subsidise the provision of water supply and wastewater services in regional areas where it is uneconomic for the utility to provide these services safely and efficiently. This funding should be granted via an explicit Community Service Obligation, and subject to periodic review.

The case for providing subsidy funding for capital works, financial incentives for reform and assistance for affected local councils should be determined by State and Territory Governments.

Agree.

DRAFT RECOMMENDATION 13.4

State and Territory Governments should undertake regular, public reviews of water and wastewater outcomes in Indigenous communities. Water and wastewater services should be assessed against the same metrics that are used to measure service quality in non-Indigenous communities.

Agree.

DRAFT RECOMMENDATION 13.5

Compliance with the health critical elements of the Australian Drinking Water Guidelines should be mandatory, and implemented via legislation.

Utility performance against all elements of the Australian Drinking Water Guidelines should be publicly reviewed and reported on annually by State and Territory Governments. Sanctions should apply if water utilities do not comply with the mandatory elements of the guidelines, and directors or other accountable persons such as councillors should be personally liable for the risks associated with non-compliance.

Utilities that do not comply with the non-health critical elements of the guidelines must develop and implement a risk management plan (approved by the relevant health department) that will move the utility toward full compliance with all elements of the guidelines.

Agree. The objective in calling for mandating compliance with Australian Drinking Water Guidelines is that risks to human health will be rigorously assessed and robust systems put in place to manage any significant risks.

Submissions to Infrastructure Australia from a number of jurisdictions' health agencies propose that mandating compliance with the health-related parameters of the Australian Drinking Water Guidelines is a sub-optimal approach. They argue that the ADWG requirements for risk-based management systems with assurance mechanisms are a more appropriate means of addressing the problems. Testing and reporting of the extent to which samples meet particular parameters is an important part of quality assurance, but, if used in isolation, is likely to drive a reactionary approach to managing water quality.

Victoria, Tasmania and Queensland currently have legislation in place that mandate the risk management approaches of the ADWG. NSW and South Australia are moving toward mandating this approach.

DRAFT RECOMMENDATION 13.6

The Governments of Western Australia, South Australia and the Northern Territory should consider the costs and benefits of replacing the single, jurisdiction-wide public corporation model with a regional water corporation approach (horizontal disaggregation).

In undertaking this analysis, relevant State and Territory Governments should consider factors other than scale, including opportunities for yardstick competition, the proximity of utilities to the customers they serve, opportunities for more location-specific pricing arrangements and the effectiveness of water resource management and water system planning.

Agree.

DRAFT FINDING 13.3

There may be scale and scope benefits for water supply and wastewater services to be provided by a single utility in regional areas. This should be considered by jurisdictions as part of the reform process.

Agree.

DRAFT RECOMMENDATION 14.1

Governments should implement the universally applicable reforms to policy, governance and institutions identified by the Commission. These should be the highest priority for reform of the urban water sector as they present the greatest scope for efficiency gains, and are an essential precursor to pursuing structural reform. These universally applicable reforms centre on:

- setting an overarching objective for government policy in the sector for the provision of water, wastewater and stormwater services in an economically efficient manner to maximise the net benefits to the community***
- developing appropriate policies and principles that align with this objective***
- putting in place best practice institutional, regulatory and governance arrangements.***

Agree.

DRAFT FINDING 14.1

An intergovernmental agreement could be formulated by the end of 2012 through the COAG process that commits each jurisdiction to implementing the universally applicable reforms identified by the Commission, and to implementing structural reform, with agreed deadlines for progress.

The universally applicable reforms could be in place by the end of 2013. Where a case in favour of structural reform is identified, the reform process could begin by the end of 2014.

Agree.

DRAFT RECOMMENDATION 14.2

Agreement across all jurisdictions is not necessary for the State and Territory Governments to pursue the recommendations made by the Commission as most relate to implementation of best practice. The State and Territory Governments should immediately commence enacting reforms unilaterally.

Agree. Unfortunately the evidence to date suggests that progress in implementing reforms that deliver significant benefits but which have organised, politically-focused opposition is patchy at best.

In addition, some of the reform streams recommended by the Commission will result in elected representatives ceding significant discretion and authority to water utilities. Again, history indicates that this authority is relinquished slowly and is quickly reasserted in the face of politically sensitive circumstances. An example of this was the change in Sydney Water's status as a State-owned corporation in response to the cryptosporidium and giardia incident in 1998. This change gave the Minister greater authority to direct the corporation in its day to day activities.

Even though progress with implementation of the National Water Initiative is mixed, it would seem to have a degree of moral force that extends beyond governments' contemporary policy positions. Gaining agreement to implementation of the priority, universally-applicable reforms and institutionalising this agreement within the National Water Initiative provides the opportunity for widening this moral force.

DRAFT FINDING 14.2

The social security and taxation systems, together with generally available adjustment measures, are likely to be the most appropriate ways of providing transitional assistance to those significantly disadvantaged by urban water reform. However, in some cases there might be a need for additional specific transitional assistance from State and Territory Governments. General principles for the provision of such assistance should be spelt out at the beginning of the reform process.

Agree.

DRAFT FINDING 14.3

State, Territory and Local Governments will be the major beneficiaries of the Commission's proposed reforms to the urban water sector. While some costs will be incurred, these are expected to be outweighed by the benefits from more widespread cost recovery and increased dividend payments. Therefore, there is no case for Australian Government funding to promote urban water reforms.

Agree in principle. It is likely that the bulk of the benefits from the Commission's priority reforms will flow to residents and their state or local government authority.

However, particularly in the case of aggregation of water utilities in regional NSW and Queensland, there are also likely to be national interests being served to some extent. These would include support for regional communities that service agricultural and resource production and supporting regional communities in their adjustment to new economic structures.

Precedents exist for the Australian Government providing incentives for implementation of contentious reform and for supporting structural adjustment. It is, therefore, not clear that there is no case for the Australian Government supporting reform in regional Australia.

DRAFT RECOMMENDATION 14.3

Progress against COAG agreed water reforms should be subject to monitoring. The National Water Commission would be the most logical body to undertake such monitoring.

Agree.

DRAFT RECOMMENDATION 14.4

An independent public review of the reform package should take place after five years.

Agree.