



LGAQ Commentary on the Productivity Commission's Draft Report titled: *Australia's Urban Water Sector*

The Local Government Association of Queensland (LGAQ) welcomes the opportunity to provide comments on the Productivity Commission's draft report into Australia's Urban Water Sector, which was released in April. As the Commission would be aware, the LGAQ, in conjunction with the Queensland Water Directorate (*qldwater*), originally submitted a comprehensive response to the Commission's September 2010 Issues Paper outlining the strengths, weaknesses, and future challenges confronting Queensland's water industry.

As LGAQ believes many of the comments made in its original submission are still valid, and in light of *qldwater* providing a detailed technical response to the draft report's recommendations, the Association has sought to limit its comments to the themes captured in the recommendations found in chapter 11 - "Institution centred reform", chapter 13 "Reform in regional areas" and chapter 14 "Implementing reform and monitoring progress" as it believes these recommendations are the most significant for its membership.

Additionally, it should be noted that LGAQ's comments have also been informed by its Policy Statement (2010), which defines the policy principles on key subject areas that LGAQ is required to have regard to when advocating on Local Government's behalf - refer to boxes 1.1 and 1.2 below.

Given the above, the Association suggests that this submission be read in conjunction with the submission provided by our industry partners from *qldwater* as well as the original joint submission made to the September Issues Paper, both of which are attached for the Commission's reference.



Box 1.1 - LGAQ Policy Statement

8.5 Water Supply and Sewerage

8.5.1 Institutional Arrangements

8.5.1.1 Local government recognises that water is a resource that should be shared equitably across each region through institutional arrangements that best facilitate efficient service delivery and resource use.

8.5.1.2 The State Government must ensure that no community is substantially disadvantaged in terms of basic access to, and price of a reasonable supply of potable water, as a community service obligation.

8.5.1.3 Local government believes that water demand and supply planning across the State, including the establishment of adequate levels of service provision to the community, should be lead by the State Government, with active involvement of local government as a key stakeholder.

8.5.1.4 Where reform of current institutional arrangements is considered necessary to enhance security, sustainability and efficiency of water services, there should be full consultation with the LGAQ and all local governments likely to be affected by any proposed changes.

8.5.1.5 Local government believes that any change in current water institutional arrangements should seek to build on existing roles, responsibilities and relationships reflecting the existing partnership approach between the State and local governments and amongst local governments.

8.5.1.6 Where regional water supply schemes across a number of councils are necessary, Joint Local Governments or Local Government owned corporations are the preferred approach rather than a separate Statutory Authority.

8.5.1.7 The role of individual councils in water retailing should be maintained in any changes to institutional arrangements.

8.5.1.8 Where any water infrastructure is subsumed into new bulk supply institutional arrangements, there should be a guarantee of full compensation for current owners.



Chapter 11 - Institution - Centred Reform

In general, LGAQ supports the recommendations outlined in this chapter, especially those relating to the use of “charters” (11.2) for urban water utilities and the establishment of a price monitoring rather than price setting regime (11.4).

At present the Queensland State Government has a complicated array of departmental constructs to deliver water objectives for Queensland. These constructs include powers devolved to the Department of Environment and Resource Management (which takes the role of both the regulator of urban water service standards and as the body responsible for policy formation for the water industry outside of South East Queensland), the Queensland Water Commission (which serves as the policy agency for water utilities in South East Queensland), the Department of Local Government and Planning (which has typically been responsible for infrastructure subsidies to councils in Queensland) and other Departments such as Queensland Health who are involved in the direct operational aspects of water quality and reliability of service.

Further complicating these state based structures, is the existence of multiple agencies at a Commonwealth level (the Department of Water, Environment, Heritage and Arts, the Department of Sustainability, Environment, Water, Population and Communities, the Department of Climate Change and Energy Efficiency, the National Water Commission etc), each of whom seem to pursue their own individual objectives.

When viewed from a Local Government perspective there appears to be a lack of coordination and constantly changing policy paradigm between the Commonwealth and State, and further still, between State Government Departments in regard to strategies and outcomes for the water sector. LGAQ considers this to be a fundamental weakness in providing certainty to council owned water service providers and their ability to successfully implement best practice governance arrangements and performance standards.

Whilst the LAGQ supports the concept of setting whole-of-government objectives through the means of a ‘charter’ (or through identified customer service objectives) as recommended in the draft report, the LGAQ would also highlight the need for such charters to take account of local or regional variances. At a minimum, the Association believes that each ‘charter’ should have regard to the objectives and priorities identified in councils’ long term community plans, long term financial plans and long term asset management plans which now form an integrated statutory requirement under the Local Government Act 2009.

Turning to the issue of pricing regulation, guided by LGAQ’s 2010 Policy Statement which states, “Local Government accepts that significant Local Government water retailers should be subject to price oversight by an independent body” the Association supports the draft report’s recommendation for a move away from State and Territory regulatory price setting to a price monitoring regime.



Box 1.2 - LGAQ Policy Statement

8.5 Water Supply and Sewerage

8.5.3 Pricing Regime

8.5.3.1 Local Government accepts that significant local government water retailers should be subject to price oversight by an independent body. However, retail water pricing must remain the responsibility of each water retailer, recognising the varying circumstances that exist.

8.5.3.2 In setting retail prices, local government recognises the need for pricing regimes which encourage efficient use of water resources. This will generally be achieved by use of two-part tariffs including, where appropriate, inclining block tariffs.

8.5.3.3 Where separate institutional arrangements exist for bulk water supply within a region, a common "postage stamp" approach to pricing is generally preferred by local government rather than one based on differential nodal pricing.

As the Commission would be aware, there has been considerable political and media interest though out Queensland (but mostly focused in South East Queensland) about how water entities introduce and regulate pricing mechanisms for the provision of urban water services. Unfortunately, recent actions by the State have resulted in politically motivated interventionist actions to cap retail price increases in South East Queensland to the Consumer Price Index (CPI).

Current arrangements regarding independent retail price review in Queensland are largely limited to the price oversight conducted by the Queensland Competition Authority (QCA) for South East Queensland, where the Minister responsible directs the QCA to undertake an independent assessment of the pricing practices of water retailers. More specifically, the 'monopoly oversight' role of the QCA is triggered by monopoly overpricing not under recovery.

The National Water Initiative (NWI), including the recently endorsed NWI nationally consistent pricing principles, outlines the State Government's policy for urban water pricing outside of South East Queensland. The principles require full recovery of capital costs except in the rural and regional sector where it is demonstrated that it is not practicable to move towards full cost recovery as per the terms in clause 66 (V) of the NWI - that is, there will be some small community services that will never be economically viable but need to be maintained to meet social and public health obligations.

The Local Government Act 2009 allows for full cost recovery pricing by Local Governments, but does not provide any mandatory reporting or enforcement in this regard. Other more specific measures include a statutory obligation to base utility charges for water wholly on water used or apply a two-part tariff. Councils may (but are not required to) apply full cost recovery pricing to water and sewerage charges that recover operating and capital costs and a positive rate of return.

Provider obligations to prepare Strategic Asset Management Plans under the Water Supply (Safety and Reliability Act) 2008 (Water Supply Act) also do not require implementation of best practice pricing.



As LGAQ outlined in its original submission, many rural and remote council owned water service providers face significant costs in meeting regulated water quality standards for drinking water and mandatory water quality monitoring and reporting obligations. In many cases upgrading existing water supply and treatment infrastructure or building new infrastructure will be needed to meet the new standards.

To assist councils manage these problems, the State Government (until recently) provided a range of grants and subsidies for drinking water treatment and supply infrastructure, which some argue has resulted in Local Government not appropriately pricing water due to their reliance on these grants and subsidies.

However, some Queensland councils have been proactive in this area, with a generic water pricing model being developed by the Queensland Treasury Corporation for a consortium led by Townsville Water with five regional Local Government water service providers and *qldwater*. The model takes into account asset management and tiered charging models to create a transparent process for setting prices for any service provider. LGAQ and *qldwater* are supportive of making this model available for use to water service providers state-wide.

In summary, unlike other states, whilst there is no overarching independent authority that provides a pricing oversight for Queensland water providers - namely Local Governments, with the exception of the current investigatory powers of 'monopoly oversight' conducted by the QCA, the LGAQ believes that there is a real and present need for any price regulation to be un-politicised, transparent and independent through the means of an independent monitoring regime, as recommended in the draft report. Interestingly, the Queensland State Government has recently introduced an Energy and Water Ombudsman (which deals with complaints about water in South East Queensland only), with the potential for these powers to be extended beyond South East Queensland.

With the above conclusion noted, the LGAQ's Policy Statement (2010) supports that "retail water pricing must remain the responsibility of each water retailer, recognising the varying circumstances that exist".

Information Request for Draft Finding 11.2

The Commission has requested further information be provided on draft finding 11.2 which states:

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.

The Commission is seeking information on whether there are similar issues with instructions from councillors in those cases where utilities are council owned. The LGAQ offers the following comments in response:

- Whilst there will no doubt be examples where conflicting objectives occur within councils, LGAQ would argue that on the whole, Local Government councillors and staff have unambiguous objectives relating to their water management responsibilities, which in most part is driven by the separation of powers provided for in the Local Government Act 2009 and further still, the requirement for an individual councillor's rights and responsibilities to be subservient to the majority view of Council.



- Council objectives relating to urban water provision would be clearly described in councils' mandated strategic, corporate, asset management, financial, as well as plethora of specific water legislation that Local Governments must adhere to daily, and regularly report against.
- Additionally, strategic directions, including those relating to water, are invariably undertaken by a team of individuals, usually involving technical, planning and finance professions, the Chief Executive Officer and ultimately the Mayor and Councillors through the formal council decision making process.

Reform in Regional Areas (Chapter 13)

Chapter 13 proposes significant changes to the structure of Queensland's urban water sector and consequently, the Association will focus its comments on recommendations 13.1 and 13.2 which state, respectively, that:

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 councils
- regional water corporations
- regional alliance (or regional organisation of councils).

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).

In its original submission, the LGAQ outlined the significant challenges confronting Queensland's rural and regional Local Government water industry, which can be summarised as insufficient revenue, ageing infrastructure and an inadequate skills base. Recognising these challenges, and in light of structural reforms occurring in other states and territories as well as in South East Queensland, both LGAQ and *qldwater* have, for a number of years been communicating with councils about the need to improve their performance and consider alternative business models or structural arrangements, as is evidenced in the principals identified by the joint LGAQ and *qldwater* industry taskforce which was established to guide the reform of the Queensland Water Industry.

As such, it is important that the Commission understand that LGAQ is not opposed to structural reform of Queensland's water industry, on the proviso that:

1. A thorough evaluation of the possible institutional models is undertaken to ensure informed decision making;
2. Financial support and / or other resources are secured to ensure a comprehensive and timely evaluation of different institutional models;
3. Current state based regulatory frameworks are also reviewed to ensure their capacity to support and / or align with the outcomes of any new institutional arrangements;
4. The State Government's policy position on institutional reform is clearly articulated to Local Government;
5. The LGAQ and all Local Governments likely to be affected by any proposed changes are fully engaged, or better still, given the opportunity to lead the proposed changes;



6. Fit for purpose solutions are identified which take account of the diversity of Queensland communities;
7. Where possible, changes in current water institutional arrangements should seek to build on existing roles, responsibilities and relationships reflecting the existing partnership approach between the State and Local Governments and amongst Local Governments; and
8. The role of individual councils in water retailing should be maintained in any changes to institutional arrangements.

As also referenced in LGAQ's original submission, in order to progress a number of water policy issues within Queensland, in June 2010, the LGAQ, *qldwater* and the Department of Environment and Resource Management (DERM) signed an "Urban Water Services Memorandum of Agreement (UWSMOA)" to facilitate and support the delivery of improved management of water and wastewater services to regional Queensland. Among others, a key focus of the MOA centres around "providing opportunities for the Local Government water sector to consider innovative service delivery models while continuing to own and manage these assets and provide acceptable levels of service to all local communities".

Driven by the recommendations contained in the Productivity Commission's draft report as well as recent reports from Infrastructure Australia and the National Water Commission, the LGAQ has suggested the priorities of the UWSMOA be reviewed to focus on the establishment of a Local Government Urban Water Service Provision Institutional Review Program (or similar) to support regional groupings of councils evaluate various structural reform models for their region.

At a minimum, LGAQ believes such as program would:

- Respond to and position any outcomes within the context of the Australian Government's drivers for reform of urban water provision in regional Queensland;
- Build on the partnership and networks already developed under the UWSMOA;
- Be predicated on the LGAQ securing the "voluntary" agreement of regional groupings of councils to participate in the program. This has already occurred in central west Queensland through the Remote Area Planning and Development Board (RAPAD) group of councils; and
- Financial assistance being made available to engage specific resources and augment the financial and in kind assistance proposed to be contributed by the Local Government sector.

Whilst it is acknowledged that not all councils within regional Queensland would willingly volunteer to investigate reform measures, it is expected that any identified benefits during the investigation process would be a useful tool to promote this program to other regions within Queensland. This is particularly relevant if LGAQ can secure funding from the State to assist the investigation process, thus providing a financial incentive for regions to also investigate alternative institutional models for their own particular setting. LGAQ, *qldwater* and DERM are currently discussing the details of this proposal.

In summary, LGAQ supports the investigative nature of the draft report's recommendations which appear to avoid rushing to a specific structural model without first understanding or exploring the reasons why there may be water service providers in Queensland underperforming in aspects of their water responsibilities (as indeed there will invariably be in each of the States and Territories regardless of the number and type of water service providers operating in those jurisdictions). LGAQ would further argue that this is especially



relevant in rural and regional Queensland where amalgamation of some water service providers is unlikely to capture the economic benefits of scale due to the scattered nature of some communities over a wide land mass. Also, experience has demonstrated in Queensland that the reality of so called “larger”, but still, in the regional Queensland context, a small and remote organisation attracting appropriately qualified staff is difficult to overcome. Indeed, these are some of the reasons cited by the Queensland Local Government Reform Commission for not proceeding with the amalgamation of councils in far western Queensland.

As previously commented upon with respect to recommendation 11.2, the LGAQ would argue that until the Australian and State Governments, and further still, Queensland State Government Departments successfully provide whole of government certainty around the strategy and outcomes for water, which is reflected in legislation and other statutory planning and policy processes, then it is premature to judge what institutional arrangements need to be put in place to provide best practice governance arrangements for urban water provision. LGAQ notes that this sentiment is captured in recommendation 14.1 of the Commission's draft report, dealing with “implementing reform and monitoring progress”.

Again, LGAQ broadly agrees with the recommendations (with the exception of 14.3) in this chapter and would reiterate its support for a full and comprehensive evaluation of various structural models and their associated strengths and weaknesses prior to any decision being made to move to implementation.

In LGAQ's opinion, such investigations should be led by the industry itself, especially within the context of the common themes emanating from reports recently released by various national institutions (as previously identified, including the Productivity Commission). Recognising however, that the water service providers located in rural and regional Queensland are the least able to fund such investigations, the LGAQ also believes that financial support from the State Government and possibly the Australian Government should be made available for this purpose.

The draft report also recommends that it is not necessary for the State and Territory Governments to reach an agreement before implementing the recommendations highlighted in the report. The Association strongly supports this measure given the difficulty of aligning the priorities of different jurisdictions, especially where different urban water models exist.

More specifically, recommendation 14.2 indicates that the State and Territory Governments should immediately commence enacting reforms unilaterally. In line with this recommendation, and as previously mentioned, the LGAQ in conjunction with its industry partner, *qldwater*, is currently discussing with DERM the details of a Local Government Urban Water Service Provision Institutional Review Program based on voluntary regional groupings of councils investigating different institutional models.

Finally, experience with structural reform of council boundaries in Queensland throughout 2005 to 2007 suggests that the investigation phase, whilst required to be comprehensive, should not be prolonged. The timing of elections, both at a local and state level is also critical to the duration of the investigation phase and subsequent implementation process.



The LGAQ appreciates the opportunity to provide a submission to the Productivity Commission and trusts that the issues raised will assist in further policy development.

Upon the release of the Commission's draft report, the Association and *qldwater* were pleased that the Commission reviewed our submission and referenced elements of it in its draft report. Although it is understood that the arguments articulated by LGAQ and *qldwater* will never fully align with that of a nation wide inquiry, it is promising that the Commission has undertaken a significant consultation process in developing the draft report, particularly in light of similar reports that have been released by other agencies in the past six months on this very issue. As such, the Association commends the Commission in gauging the views of key stakeholders in the urban water industry across Australia in the development of this draft report.