Natural Resources, Mines & Water (Qld)
Submission to the Productivity Commission

July 2006

Rural Water Use and the Environment: The Role of Market Mechanisms

The Department of Natural Resources, Mines & Water (NRMW) welcomes the opportunity to provide comments on the Discussion Draft *Rural Water Use and the Environment: The Role of Market Mechanisms*.

Many of the issues raised in this submission have previously been discussed with the Productivity Commission.

General Comments

NRMW is concerned that the report has been developed based on issues particularly relevant in the Southern Murray Darling Basin where many water resources are over-allocated. Although the report notes that not all of the recommendations are appropriate in all areas, the discussion and recommendations give the impression that they should be considered universally. It is suggested that many of the recommendations are only appropriate where resources are over-allocated.

The discussion about a "net entitlement approach" may be appropriate in a context of needing to ensure that environmental flows are not diminished by reduction in return flows or base flow. In Queensland, return flow (or water efficiency) is a matter that is considered in the water planning stage, along with "sleeper" and "dozer" issues. This culminates in initialization of the modern water access entitlement in a way that ensures that environmental flow objectives are attained. The resulting entitlement is clearly specified as a volume that can be taken at the pump, irrespective of any return flow. Clear specification of the entitlement is an important market element. Water users are provided with a clear and unambiguous signal that they will be the sole beneficiaries of any efficiency savings they achieve. If the report is proposing other applications of a "net entitlement approach" then it would be useful to provide more detail as to how the entitlement would be specified and managed.

The report suggests that the holding of water access entitlements or derivative products is an alternative to a rules based provision for the environment. It promotes the holding of water access entitlements for the environment as having advantages and raises concerns about regulation crowding out market processes. It is considered that the report does not adequately recognise the basic nature of a rules based provision for the environment as set out below.

In practice all jurisdictions provide for the environment to some extent in the way water access entitlements are specified, dams are operated and water access entitlements are traded. These sets of arrangements are often referred to as "rules based" environmental flow provisions. The objective is for these arrangements to result in the retention of the essential shape of the natural hydrograph. Proposed arrangements for entitlement specification, dam operating rules, trading rules etc are

tested for impact on the natural hydrograph by long term simulation using models. If environmental objectives are achieved in this way there is no need to actively manage water access entitlements from time to time for the environment. The rules based approach is fully adequate in Queensland because modern planning has been introduced before resources have been over-allocated. However, in over-allocated systems such as the Southern Murray Darling the holding and active management of water access entitlements for environmental outcomes may be needed to supplement the rules based approach. Water access entitlement based provisions for the environment should be recognised as a possible supplementation of the rules based provisions, rather than an alternative.

The report suggests that over-reliance on water resource planning can crowd out opportunities for market based instruments. It should be recognized that sound water planning is the cornerstone of effective water management and is therefore a key element of the NWI. It is suggested that the report could recommend that a comprehensive planning process should leave adequate scope for development of market based instruments.

The report promotes the unbundling of the delivery right. In Queensland old entitlements for supplemented supply are unbundled into water access entitlements and water supply contracts with the delivery system operator. These supply contracts are flexible enough to allow development of derivate delivery products that meet the needs of water users. Any premature standardization of "delivery rights" could crowd out opportunities for the development of market based delivery products.

It is suggested that the discussion about exit fees (and access fees), should recognise that these fees are only relevant as 'transitional tools' to manage the results of separation of water from land. In Queensland, exit fees are matters explicitly dealt with in the supply contract between SunWater and its channel customers. We note that work is currently underway by the ACCC to develop national principles for the calculation and application of exit fees.

It is also suggested that the report include information on the market based releases of unallocated water in Queensland. Detailed information is included in the Queensland Government submission to the Productivity Commission in February.

Furthermore, it is suggested that the report include more in depth analysis of environmental externalities including water quality issues. Pricing issues, particularly in relation to inter-sectoral trading, could also be explored further. It is noted that prices should be based on the reliability of the products and not on the use of the water. Where prices are based on the use of the water, there is likely to be a need for subsidies. Subsidies generally have distortionary effects on trade.

Specific comments:

Page xxix – "Under current arrangements, some utilities (for example in Queensland and Victoria), face restrictions in selling water they 'save' as a result of infrastructure or other investments". This statement is incorrect for Queensland. In fact, SunWater can sell its 'loss' allocations and it has done so. The process

involves a change to the ‘purpose’ of the water access entitlement from ‘loss’ to ‘any’. Water access entitlements with a purpose of ‘any’ can be used for any activity and the entitlement is not limited in its use. To be able to change the purpose of the water entitlement, SunWater must be able to demonstrate that the claimed efficiency has been achieved.

Page xxxii - “A portfolio of water products will be required to deliver increases in environmental flows in a timely and cost-effective manner”. It would be more appropriate to write “Where it is necessary to hold water access entitlements or derivate products for environmental purposes, a portfolio of water products is required to deliver increases in environmental flows in a timely and cost-effective manner”.

Page xxxiii - “Many river flow objectives require sourcing additional water for environmental purposes. There are often more flexible and cost-effective ways to achieve these objectives than purchasing entitlements or investing in infrastructure”. It would be more appropriate to write “In the Southern Murray Darling Basin, river flow objectives require sourcing from additional water ....” or “Where river flow objectives require sourcing additional water for environmental purposes, there are often more flexible and cost-effective ways ...”.

Page 15 - “Unbundling water entitlements from water use approvals should be completed by all states as a matter of priority. There may be further opportunities to simplify the specification, and reduce the number of types, of water entitlements”. This is a Southern Murray Darling Basin issue and an interstate trading issue. The issue disappears under a tagged trading regime. In the absence of such issues, the number and design of products is a matter for water users to decide in a water planning context.

Page 24 - Water Resource Plans in Queensland, however, assume no return flows in determining water plans. This is a highly conservative approach for managing issues of return flows. This is an inappropriate description of the Queensland system. The statement would be more correct if it read “This is a *secure* approach which is entirely consistent with the requirements under the NWI”.

Page 27 - “Offset arrangements have been incorporated into legislation in Victoria - a farm dam cannot be constructed unless water is purchased that is equal to that which the development will intercept, and this cannot be traded until the dam is no longer used”. Similar arrangements can be established under water resource plans in Queensland.

Page 42 - “Where mortgages are held over the entitlement, the process is significantly more laborious and requires removing a mortgage off the title, splitting the entitlement share, selling the share then re-mortgaging the other part”. This is not the case in Queensland. When subdividing a mortgaged water access entitlement, the mortgage will automatically be registered as an encumbrance on the new entitlements. Subdivision of a water access entitlement requires approval from the resource manager and mortgagee consent (where applicable). Resource manager consent is required because some of the attributes of unsupplemented water

allocations cannot be subdivided, including threshold flows at which pumping can commence. To take effect, the subdivision must be registered on the water allocations register. If ownership of a newly created part is subsequently transferred, the vendor must arrange the release of the mortgage.

Page 43 - "It is also important to have registration and titling processes across the states and territories that recognise each other ...". This is only relevant under an exchange rate regime. The problem does not exist under a tagged trading regime.

Page 52 - Registers could also provide information on historic trade data, trading rules, administrative and regulatory requirements ...". It can be strongly argued that the requirements for a water entitlement register are different from the requirements for databases which store other information relevant to the management of water such as water trading rules. Such information is more appropriately placed in water planning instruments. A strong water planning framework is a fundamental element of the NWI.

Page 58 - Queensland and South Australia's water resource plans often prohibit trade between defined management zones. Concerns have been raised regarding the arbitrary nature and large number of these zones in both states". It is not appropriate to only include one view on this issue. NRMW's view is that there are only as many zones as are necessary to be able to administer trading rules that are designed to protect environmental flows and the security of water entitlements. In Queensland, the design and number of the zones is based on scientific modeling and is not arbitrary.

Page 65 – Table 3.2 Time for regulatory approvals for trade in seasonal allocations

The reference for Queensland should be changed to "1 day".

It appears the report has inaccurately quoted the Allen Consulting Group report (Table 3.3, Page 17). The references for Queensland and New South Wales have been mixed up.

Page 66 – Assessment of fees and approval times for trade in seasonal allocations
The report would benefit from the inclusion of additional information on how transaction costs (as a percentage of the value traded) were calculated. E.g. 2.5 per cent for Queensland. Note from Table 3.3 that there is no charge for SunWater customers for trades in seasonal allocations.

Page 74 – Table 3.4 Government fees and charges for trade in entitlements

The Queensland reference in this table quotes fees and processes for different types of entitlements without highlighting the differences.

Within the context of the table, the following fees should be quoted for Queensland:

- Column 2 – Application fee for a change to a water allocation (e.g. location), subdivision or amalgamation $83.90[1]
- Column 3 – Registration fee for a transfer of ownership, change, subdivision or amalgamation $108.30[2]

In the last column, the Queensland reference should read "Land and Water Management Plan approval fee $173 *if not already held*"[3].

For details, refer to **Appendix A**.

Page 76 – Table 3.5 Typical times for regulatory approvals for entitlements trades

The reference Queensland should be changed to "1 week for pre-tested trades".

It appears the report has inaccurately quoted the Allen Consulting Group report (Table 3.3, Page 17). The references for Queensland and New South Wales have been mixed up.

For details refer to Appendix B.

Page 76 – Brokerage Fees
The report states that "SunWater does not charge to transfer water entitlements between SunWater customers". It should be noted that transfers of ownership of water entitlements must be registered on the water allocations register before they can take effect. Registration of a transfer of ownership involves a fee of $108.30[4]. SunWater's involvement is limited to entering into a new supply contract with the buyer of the entitlement. SunWater does not transfer ownership of water allocations. That is the role of the registrar of water allocations.

Page 87 – see comment for page xxix.

Page 184 – Table A.2 List of visits and meetings
The 2-part meeting on 24 January involved Natural Resources Mines & Water in session one, and NRMW, The Treasury (Qld), Department of Primary Industries & Fisheries (Qld) and the Environmental Protection Agency (Qld) in session two.

[1] As at 1 July 2006, the fee is $86.20.
[2] As at 1 July 2006, the fee is $111.30.
[3] As at 1 July 2006, the fee is $177.80. The fee for approving a previously approved plan is $57.70 ($59.30 for 2006-07). The fee for approving a previously approved plan, if the plan to be approved applies to additional land or provides for a different or additional irrigation method is $115.40 ($118.60 for 2006-07).
[4] As at 1 July 2006, the fee is $111.30.

Appendix A

The Queensland reference in this table quotes fees and processes for different types of entitlements without highlighting the differences. In particular, the fee quoted for transfer of ownership ($246.10) refers to *interim water allocations*, while the fee quoted for a change in location ($83.90) refers to *water allocations*.

An *interim water allocation* is an authority to take water managed under an interim resource operations licence that represents a volumetric share of water. Interim water allocations can be traded separate to land in areas approved under the *Water Regulation 2002*. Trading of interim water allocations is possible in specified areas despite the fact that the water resource planning process has not been completed.

Water allocations are created on completion of the water resource planning process. A water allocation is an authority to take supplemented or unsupplemented water. Water allocations can be traded separate from land and may be held by non-landholders. Water allocations are registered on the water allocations register.

It should be noted, that in Queensland

1. There is no application or approval process (involving the resource manager) for a transfer of ownership of *water allocations* (entitlement). The transfer needs to be registered on the water allocation register. The registration fee for such dealings is $108.30 ($111.30 for 2006-07).
2. To change to location of a water allocation, an application needs to be made to NRMW and an application fee of $83.90 ($86.20 for 2006-07) applies. Upon approval, the change must be registered on the water allocations register and a registration fee of $108.30 ($111.30 for 2006-07) applies.
3. The application for transfer of *interim water allocations* is $246.10 ($252.90 for 2006-07). These transfers are not registered on the water allocations register.

Trade in interim water allocations is being phased out as interim water allocations are progressively converted to water allocations through the planning process. It is suggested that for the purpose of the table it is more appropriate to only include cost information about trading water allocations.

Appendix B

Queensland resource operations plans include water allocation change rules. These rules identify ‘permitted’ and ‘prohibited’ changes. If an application for change can be approved under the rules, the change is approved immediately (normally around 7 days) and a water allocation dealing certificate is issued. To take effect, the change must be registered on the water allocations register.

Changes that are not mentioned in the resource operations plan involve a more comprehensive assessment based on detailed modeling. The timeframe for such changes is variable as it largely depends on how quickly the applicant can provide necessary information to NRWM. To date there have not been any such changes recorded on the water allocations register for the Nogoa Mackenzie Water Supply Scheme in Emerald.

It appears the report has inaccurately quoted the Allen Consulting Group report (Table 3.3, Page 17). The references for Queensland and New South Wales have been mixed up.