



27 October 2017

Peter Harris AO
Chairman
Productivity Commission
GPO Box 1428
CANBERRA CITY ACT 2601

Dear Mr Harris,



RE: SUBMISSION ON THE NATIONAL WATER REFORM DRAFT REPORT

Further to our discussion last week, Infrastructure Partnerships Australia (IPA) is pleased to make this brief submission on your above referenced Draft Report released on 15 September; and to annexe a copy of our joint paper with WSAA, titled *Doing the important, as well as the urgent: Reforming the urban water sector*, which develops the high level themes discussed herein.

In summary, we respectfully submit that the current Draft Report gives insubstantial regard to urban water and wastewater services markets – which have seen the glacial pace of economic reform stall – and now, beginning to reverse in some places.

We therefore submit that the Final Report would be substantially strengthened through a much more ambitious and forensic focus on the structure, efficiency and resilience of Australia's urban water utilities.

Specific items that should be recommended in your work:

The Final Report should be enhanced by considering and making firm recommendations dealing with the following four factors, being:

- 1. Urban water needs a 'reform champion':** The Final Report should consider whether a body or regular reporting mechanism (for example, by the PC) could increase the transparency, efficiency and accountability for good urban water markets.
- 2. Good water services are borne of good economic regulation:** The Final Report should interrogate and resolve a national best practice framework for the economic regulation of urban water and wastewater utilities – including a merit review mechanism.
- 3. Constraints on competition would be a logical focus:** The Draft Report does not provide detailed analysis of the degree to which competition has emerged in water services – and would be much stronger again if it provided further guidance about competition





frameworks, legal, regulatory and other changes needed to foster embryonic competition in urban water markets.

- 4. Good governance begets good practice:** Beyond the major cities, the governance and structure of the (entirely public) water utilities becomes a challenge. In the absence of the regulation of the form discussed in 2 (above), there can be insubstantial insulation between (say) local elected leaders and a council's water price setting policy - which could see under or over-pricing.

The legal structure of utilities is also highly varied, with many operating simply as a division of a local government – which denies the governance benefit and financial and operational transparency under the *Corporations Act* 2001. Again, the Final Report would be substantially strengthened by addressing and recommending appropriate governance arrangements – beyond high level principles on a separation of the roles and responsibilities of regulators, governments and utilities – which should be rectified in the Final Report.

Our understanding of the urban water sector and high level comments

1. Urban water needs a reform champion

Australia's urban water sector has seen little clear minded, consistent or meaningful structural reform since the NCP-led changes in the 1990s. Current arrangements see the capital city water utility 'majors' enjoy independent regulation, are well-operated and largely effective utilities; whereas regional water utilities are often unregulated, unincorporated and both financially and practically, deeply under resourced to deliver.

While they largely operate well, the major urban utilities are also struggling under balance sheets that have enlarged substantially, through borrowings for the massive and 'urgent' network and supply side investments made during the drought; and many of the good structural traits, for example the determination of the RAB, are undeveloped in many jurisdictions and would benefit from modernisation and improvement.

Even the relatively rudimentary structural reforms brought into place in the 1990s are increasingly pressured and being frayed by political interventions. For example, South Australia has recently announced its intention to decorporatise SA Water – and used its 2014-15 budget to transfer general government sector debt onto SA Water's balance sheet.

Similarly, Tasmania has announced that it will remove independent price regulation and return to the less optimal process where the Treasurer – an elected politician – will determine water prices. Moreover, Tasmania will remove the requirement for Tax Equivalent Payments – removing the 'level playing field' that was a fundamental underpinning of the Hilmer reforms.





This shows that far from advancing, the 1990s urban water policy consensus is increasingly frayed and worn – with the basic beachheads established under the National Competition Policy, like independent price regulation and corporatisation, now retreating.

Observed reality shows us that urban water only becomes a public and political priority, once failures in supply or services become obvious (for example, Sydney's cryptosporidium in the late 1990s, the Millennium Drought et al).

This leads to potentially very inefficient 'urgent' responses – with costs that ultimately accrue to the national economy.

The closure of the National Water Commission in 2014 means that water no longer enjoys a regular 'reform champion' – beyond the three yearly PC review.

We respectfully submit that the Final Report should consider the utility of either:

- Re-establishing a dedicated national urban water body, similar to the National Water Commission, or expanding the remit of an existing agency, for example, IA; or
- An enhanced, regular process that reports on the state of Australian urban water markets, effectively an improved and systemised version of this subject report.

2. Good water services are borne of good economic regulation

Good economic regulation has a fundamental, causal relationship with efficient water and wastewater services. Economic regulation establishes the rules, the behaviours and market dynamics which ultimately dictate the quality, monetary cost and economic value of water services.

As noted in our joint report with WSAA and in section one above, the quality, scope and efficacy of water market regulation varies wildly, across the country and within each state.

Many regional utilities do not enjoy independent price regulation, with elected political leaders determining the price based on drivers other than efficient prices, which would recover long run marginal costs.

We welcome the Commission's recommendation to enhance the role of regulators in Queensland, NT and WA (Draft Recommendation 6.1).

We note that the Draft Report provides a set of common principles to guide regulatory arrangements in all jurisdictions and that these are broadly in line with the recommendations in the IPA and WSAA report.





However we submit that the Final Report would be materially strengthened, if it outlined a 'model' best practice economic regulatory framework for adoption by the states, which includes appropriate incentives and checks and balances, in the long-term interest of the consumer.

This will need to consider the benefit of a single national regulator, versus existing state regulation – and issue that does not yet enjoy a consensus view in any part of the water sector.

3. Constraints on competition must be a focus

The Draft Report acknowledges the potential for competition to be more widely introduced into the water life-cycle – but does not clearly assess the competition frameworks already introduced, nor the degree to which competition has emerged in that time; nor does it identify clear reforms needed to better deploy the disciplines of competition into the future.

To some degree, the discussion about water industry competition is being resolved by state regulators, without the focus or inputs of the PC.

The recent review of wholesale water pricing in NSW is a contemporary illustration that the discussions and decisions about how, where and why competition will be deployed in urban water services is occurring without the PC in the room.

4. Good governance begets good practice

While the Draft Report correctly discusses the importance of institutional arrangements around, and legal form of, urban water utilities – it does not appear to form a firm recommendation.

As noted in the introduction, this is all the more important noting the pending reversal of SA Water's corporatised model – and the various changes to regulation and legal structure to come into effect in the near future for water services in Tasmania.

Corporatisation was undertaken in the 1990s, to introduce the disciplines and transparency created by the requirement to publish audited financial accounts and the duties created under corporations law.

We also agree with the traits of good governance in the report around the utility of a clear separation of the responsibilities between economic regulators, utilities and government and the important role of corporatised public utilities.

We submit that the Final Report should develop firm recommendations on these issues.

Conclusion and next steps

Peter, as discussed we are very supportive of the PC's work in water policy but feel that the current Draft Report would be substantially enhanced, where it focus on the four areas identified herein.





Urban water reform remains significantly underdone in terms of sound economic regulation, good governance and has yet to properly resolve how, where and when to deploy the disciplines of competition in the interest of the customer.

And it remains underserved in part, because it lacks a regular reform champion to shape and drive the discussion.

Water is too important to be left idle, awaiting an urgent crisis in supply or service quality.

That is why we submit that the Commission's work is important in its content – and equally important in a context of reform that has slowed, stalled and now reversed.

In the meantime, should you require any further information please contact the undersigned or our Senior Policy Adviser, Mr Gavin Chan

Yours sincerely,

BRENDAN LYON
Chief Executive Officer

