



**WATER SERVICES
ASSOCIATION OF AUSTRALIA**



WSAA Submission

**Productivity Commission's
Issues Paper**

National Water Reform



TABLE OF CONTENTS

Executive Summary and Recommendations 3

1.0 Introduction 7

2.0 National reform in urban water 8

 2.1 COAG 1994 8

 2.2 Corporatisation 9

 2.3 Independent regulation 9

 2.4 National Water Initiative 10

 2.5 NWI Pricing Principles 11

 2.6 Recent reviews of reform progress and next steps..... 12

3.0 Unfinished business: continuing reform 13

 3.1 Pricing oversight and economic regulation 14

 3.2 Governance 16

 3.3 Role of Competition 20

 3.4 Water Sensitive Cities 22

 3.5 The Case for Change..... 25

4.0 Contact Details 26

Executive Summary and Recommendations

The Water Services Association of Australia (WSAA) is the peak body that supports the Australian urban water industry. Our members provide water and sewerage services to over 20 million customers in Australia and New Zealand and many of Australia’s largest industrial and commercial enterprises.

WSAA facilitates collaboration, knowledge sharing, networking and cooperation within the urban water industry. The collegiate approach of its members has led to industrywide advances to national water issues.

WSAA welcomes the opportunity to provide a submission to the Productivity Commission on their inquiry into the reform of Australia’s water resources sector.

WSAA has worked with its members over the last three years to define a comprehensive national reform agenda. The agenda builds on messages in three flagship publications:

- Improving economic regulation of urban water
- Doing the important as well as the urgent: reforming the urban water sector
- Next Gen Urban Water: The role of urban water in vibrant and prosperous communities

This submission does not attempt to repeat all the detail in those papers. Instead it sets out why national reform continues to be important and the key reform priorities.

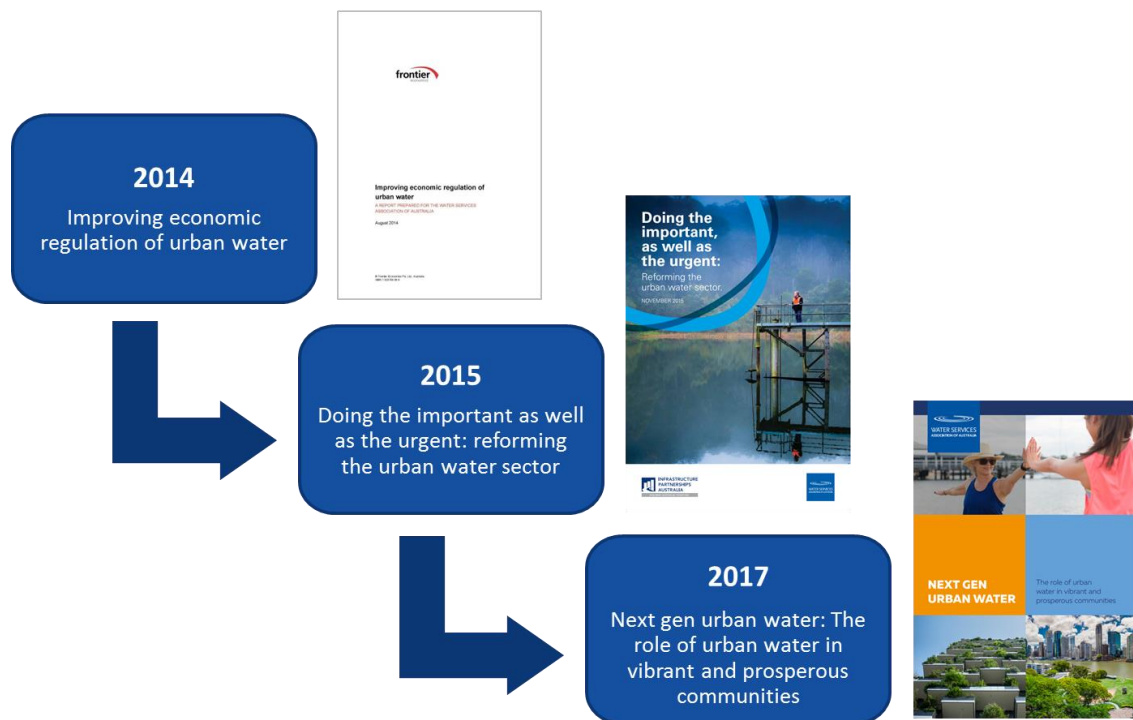


Figure 1 - WSAA's reform agenda

The title of the collaborative paper with the Infrastructure Partnerships Australia on reforming the urban water sector was chosen carefully. It is titled *Doing the important as well as the urgent*. The urban water industry is not in crisis. In terms of quality and reliability it performs well, engages strongly with the private sector, and has a growing focus on delivering customer value. In many ways, it is understandable why it has not attracted the attention of policy makers. The performance of water utilities has allowed governments to ignore the problems in the environment in which utilities operate. As set out in *Doing the important...*, there is a broad consensus across the public and private sectors that the framework the industry operates in must continue to evolve to allow

the water sector to meet existing challenges and take advantage of future opportunities. That report identified reforms in the areas of economic regulation; governance and defining the role of competition as the most critical.

WSAA's work on "Next Gen Urban Water: The role of urban water in vibrant and prosperous communities" (Appendix B) highlights the next big gains for the water industry, likely to come through better integration and involvement in land use planning, looking beyond the narrow scope of water and sewerage provision and collaborating with other sectors (waste, energy, local government). WSAA believes the next era for the industry is one where the value can be leveraged for the benefit of the whole urban water environment and urban communities within which they operate.

Given these drivers for further reform, the Productivity Commission's review is timely.

Implementing reform

Looking at the industry through the lens of national reform reinforces the directions set out in WSAA's reform agenda. The major reforms of the 1990s determined the structure of the industry today. Water businesses are very different to what they were 20 years ago. But the institutional environment has not significantly changed. Indeed, some of the original aspirations of national reform have not been realised. The 2004 National Water Initiative (NWI), while well intentioned, has not been the driving force for reform that is necessary.

The contrast between the success of the first stage of national reform and the mixed results of the second provide lessons for a future reform program. Experience shows that nationally consistent reform is best achieved through incentive payments, such as the National Competition Policy (NCP) payments to states from the mid-1990s to early 2000s. For this reason, WSAA recommends that the Commonwealth and states develop a reform incentive framework with funding for state governments linked to urban water reform milestones. This recognises the national economic benefit flowing from increased productivity and broader performance improvements in the urban water sector.

The 2016 "Intergovernmental Agreement on Competition and Productivity – Enhancing Reforms" between the Commonwealth of Australia and most jurisdictions, provides a significant opportunity to progress urban water reform. **WSAA recommends that the Productivity Commission frames its recommendations for urban water to align with and give impetus to this framework.**

WSAA's reform agenda

Economic Regulation

The urban water sector requires a modern regulatory framework to facilitate better value for customers. Economic regulation has played an important role in the industry's development and it needs to continue to evolve to meet future challenges.

Independent economic regulation in urban water should be supported by national standards. Clear minimum standards are preferable to either regulatory principles or harmonisation. The requirement to meet minimum standards would raise the bar on economic regulation across jurisdictions. However, unlike harmonisation of regulations, minimum standards would not constrain best practice.

WSAA recommends revised national pricing and regulatory standards that:

- enshrine the long-term interests of customers as their overriding objective
- include strong incentives for water utilities to find efficiencies in operating and capital expenditures, and encourage innovation

- **consider the long-term viability of water businesses, when making pricing determinations**
- **promote strong and transparent customer engagement in the regulatory process**
- **have in place merit review and appeal mechanisms for water businesses and other stakeholders**
- **provide greater certainty and predictability, for both existing utilities and potential private investment in the industry**
- **capture the true efficient costs of service provision**

WSAA considers the Victorian Essential Services Commission's (ESC) new model, that requires water businesses to directly own the relationship with the customer through extensive customer engagement including on service levels and investment programs, is an important development. Another avenue for reform is stronger and more flexible links between economic and other regulation that would allow water businesses to work with community agencies to respond to a broader spectrum of community needs and preferences. This flexibility could assist in overcoming the competing interests between these different pieces of regulation, for example increased environmental outcomes that increase bills for customers.

Improved governance

A review of the path of national urban water reform demonstrates there is a need to revisit governance within the water sector.

There needs to be clarity around the roles of utilities, regulators, shareholders, system planners, urban planners, catchment managers and policy makers. This would benefit existing utilities, new private suppliers and ultimately result in improved outcomes for customers.

WSAA recommends all governments:

- **recommit to the corporatised model, providing additional independence, commercial discipline and enhanced accountability to customers**
- **establish a competitively neutral environment between existing and new suppliers**
- **ensure that wider policy outcomes, such as community service obligations or environmental management requirements are explicit, and resolve who is best placed to manage them**
- **ensure that the governance model clearly allocates responsibility for security of supply**
- **ensure that the governance model facilitates integrated water cycle management**
- **ensure government obligations are clearly articulated through instruments such as a Statement of Obligations**

Resolved role of competition

New frameworks are required to enable new entrants into the urban water industry where they offer greater efficiency or innovation. These frameworks should account for and not preclude the growth and adaptation of existing corporatised utilities to deliver greater efficiency and innovation. This should aim to resolve the scope for competition in urban water and guide the development of competition policies at a state and territory level.

Key to this is will be defining the role of competition in urban water markets. This includes a systematic assessment of where, when, and how competition can best be deployed within urban water markets, in the interests of the customer. Ad hoc 'reforms' to introduce competition in individual states to date may impose costs on customers rather than benefits. There are strong question marks over the retail competition push in the water industry in the UK and the electricity industry in Australia. Those lessons should be closely observed for their implications in the context of the Australian water industry.

Competition reform is likely to be best pursued by all states and the Commonwealth collaborating to develop the principles that should underpin state competition frameworks.

WSAA recommends a national review specifically examining where or whether competition could benefit customers in the urban water sector.

Better urban water planning

WSAA will soon release a paper entitled “Next Gen Urban Water: The role of urban water in vibrant and prosperous communities” (Appendix B). This document brings together previous papers exploring the water industry’s contribution to liveability, sustainability and productivity, highlighting that water businesses can play a greater role in creating value for communities. This involves a rethink within the water business, and policy makers in the operating environment, by engaging with customers and the community to determine expectations and to collaborate with other stakeholders.

An underlying shift is required to move away from the current model where a water business is encouraged and regulated just to create value for itself and shareholder, to one of being encouraged to also create community and public or shared value.

WSAA recommendations:

- **systemic change in policy and regulation to encourage collaboration with other agencies and communities to respond to a broader spectrum of customer needs and expectations**
- **integration of the urban water cycle, including stormwater and flood management planning into the urban water governance, institutional and physical structures together with a sustainable funding and pricing framework**
- **integration of water cycle planning with land use planning**
- **recognise the role of water in strategic or early planning of cities and regions and inclusion of water businesses in integrated planning**
- **adapted regulation to allow water businesses the flexibility to respond to their customers’ needs and preferences, particularly in regard to providing ‘value add’ services.**

New national arrangements should reflect the role stormwater management can play in the overall urban water cycle. This can be through harvesting, reuse, creating green spaces in Australian cities, and improving waterway health. Underpinning this should be a robust and transparent framework of rights to the water resource that provides investors with the certainty and security they need for these long-life infrastructure investments. If stormwater is treated separately and not linked to other arrangements (such as the NWI), this could lead to inefficient investment and urban planning, and poor outcomes for water security. Collaboration between all agencies responsible for stormwater management is encouraged. Without a nationally consistent funding and pricing framework, stormwater will remain the ‘poor relation’ in the broader urban water environment.

1.0 Introduction

WSAA is pleased to present a submission to the Productivity Commission. The Australian urban water industry is well regarded across the world. It has made significant gains in efficiency and customer focus. However, it faces significant challenges and the institutional environment in which it operates needs to evolve if it is to meet the challenges of the future. Maintaining the status quo will not be sufficient.

Over the last three years WSAA has set out a comprehensive reform program. This submission reviews the progress of national reform since its inception and sets out the main reforms necessary to meet future challenges. As will become evident, much of the program is completing unfinished business, to realise the original promise of the national reform program.

Chapter 2 reviews the path of national urban water reform, beginning with the Council of Australian Government reforms in the early 1990's.

Chapter 3 assesses the progress made against the original objectives of reform, the remaining gaps and unfinished business, and current and future challenges. It also addresses many of the specific questions posed by the Productivity Commission in the issues paper.

2.0 National reform in urban water

Key messages

- Much has been achieved in urban water reform over the last three decades to, drive efficiency of the sector, improve customer outcomes, and enhance the ability of water utilities to meet challenges such as the millennium drought.
- The 1994 Council of Australian Governments (COAG) water reform framework and National Competition Policy agreements provided a clear case for change and a roadmap with clear milestones for achievement. Competition payments to the states and territories underpinned delivery of the reform program.
- Corporatisation was a central element of the reforms, bringing a commercial focus to the industry as major water utilities moved to operating at arm's length to government in return for clear accountability for outcomes.
- We have seen rising private sector participation in the delivery of functions (i.e. operations and management), and new entrants that service customers in their own right and alternative decentralised wastewater service providers for new developments.
- The 2004 National Water Initiative (NWI) built on the 1994 COAG reforms, placing greater emphasis on promoting efficient water use.

2.1 COAG 1994

The urban water sector has undergone significant change over the last three decades. In the 1980s, population growth, rising customer expectations of service standards, and emerging environmental objectives were placing increased pressure on the cost of supply. In response, the industry began to introduce new models of procurement and to contract out works to private sector that had traditionally been carried out in-house. More widely, a range of direct and indirect pressures were forcing a national focus on reforms to economic infrastructure markets, including urban water, responding to the need to increase national economic competitiveness. Reforms were accompanied by sale of many government owned assets including, banks, airlines, telecommunications, and energy.

Entering this industry landscape, the 1993 review of National Competition Policy (the Hilmer Report) became a catalyst for far reaching reforms. Setting out the principles for effective competition, the Report emphasised removing barriers to competition in monopoly industries. This included the National Third Party Access regime. It provided potential competitors with access to monopoly infrastructure to enable competition in upstream and downstream markets. It also included mechanisms to promote competitive neutrality between the public and private sectors.

In 1994, the Council of Australian Governments (COAG) unanimously endorsed a reform framework for Australia's water industry as part of a wider package of reforms to the government sector. COAG's explicit reform objectives were to increase competition and to improve the efficiency and effectiveness of service delivery. This framework was incorporated into the 2005 National Competition Policy (NCP) agreements that included undertakings to implement a program for reforms to the government sector.

Competition payments under the NCP agreements were a critical stimulus to gaining the commitment of state and territory governments to implement the reforms within the Federal Government's seven-year timeframe.

The water reform package was important for urban water markets because it agreed on a national approach to reform water tariffs, based on full direct cost recovery and consumption-based pricing. The policy also sought to reduce the degree of cross-subsidisation and to make remaining subsidies explicit. The structural separation recognised the inherent conflict where a single public authority was concurrently the operator, regulator, and shareholder and also set prices.

A key element of the COAG agreement was that urban water utilities should have a commercial focus. This was expected to be achieved through corporatisation, contracting out or privatised services as determined by each State. However, the NCP made a direct recommendation that government business enterprises be corporatised to meet the competitive neutrality principles.

2.2 Corporatisation

Perhaps not surprisingly, corporatisation was the most commonly adopted approach by the major urban water utilities and no state or territory pursued a privatisation model. This was perhaps the most impactful reform of the 1990s. Corporatised water utilities moved from being government-run departments, to operating at arm's length from government under an independent board structure. A key outcome was that utilities became responsible for their financial and operational performance.

A necessary debate in any review of reform of the water industry is how well the corporatisation model has been implemented and how well it has served the reform objectives. The NCP referenced the work of the inter-governmental committee responsible for Government Trading Enterprise (GTE) national performance monitoring as an appropriate model for corporatisation from 1991. This set out seven characteristics of a fully corporatised GTE to achieve effective reform. These are summarised in Box 1. These characteristics may remain the most effective approach for government business to operate under the principles of competitive neutrality. However, reviews of the corporatisation model in the water industry indicate that elements of the model have not been implemented in full.

2.3 Independent regulation

The NCP acknowledged that price oversight is primarily the responsibility of states and territories. A key principle was that government-owned businesses should have '*independent sources of price oversight advice*' (*Competition Principles Agreement, 1995*). The prime objectives of regulation were listed as being to achieve efficient resource allocation, allow public submissions to the process, and provide transparency on price setting.

However, the COAG water framework did not prescribe a model for independent regulation. The states and territories interpreted this requirement differently and developed pricing and economic regulatory regimes that were unique to their jurisdiction. Some regulatory models were more independent from government decision-making than others. Twenty years on independent economic regulation is not a feature in all jurisdictions.

Box 1: Characteristics of a Fully Corporatised GTE

- i) **Clear and Non-Conflicting Objectives**
 - a clear understanding of the government shareholder objectives
 - guidance given where there are conflicts between commercial, social and regulatory objectives
 - contractual arrangements covering community service obligations (CSOs) between the entity and government provider and that ideally, the provision of such services should be open to competitive tender to minimise the costs
 - ministerial responsibility for the commercial success of an enterprise should be separated from the responsibility for associated regulatory functions.
- ii) **Managerial Responsibility, Authority and Autonomy**
 - government as owner should operate at arm's length from the Board and management of the enterprise so that managers can be held fully accountable for their performance.
- iii) **Effective Performance Monitoring by the Owner-Government**
 - established independent and objective performance monitoring arrangements, such as a central monitoring unit
 - such a unit would review the GTE's business plans and provide advice to the shareholding Ministers, including on the entity's proposed core activities, rate of return, dividends and capital structure.
- iv) **Effective Rewards and Sanctions Related to Performance**
 - incentive systems and penalties should exist against agreed performance targets and should act to motivate the Board and management to maximise the performance of the enterprise.
- v) **Attaining Competitive Neutrality in Input Markets**
 - GTEs should not enjoy any special competitive advantages or disadvantages over their private sector counterparts because of their government ownership
 - a level playing field is needed on a range of issues, including cost of debt, return on equity, tax arrangements.
- vi) **Attaining Competitive Neutrality in Output Markets**
 - removal of protective barriers that reduce competition faced by government enterprises
 - GTEs should be subject to the same legislative regulations as private sector enterprises.
- vii) **Effective Natural Monopoly Regulation**
 - where GTEs enjoy a natural monopoly, a public policy framework should be established to ensure that natural monopoly powers are not abused

NSW Treasury, Characteristics of a Fully Corporatised Government Trading Enterprise, August 1991

2.4 National Water Initiative

The 2004 National Water Initiative (NWI) was presented as the national blueprint for water reform. It sought to foster inter-jurisdictional cooperation on the management of ground and surface water through nationally compatible planning and regulation systems. By comparison to the more principle-based 1994 COAG agreement, the NWI identified specific actions, including the establishment of a National Water Commission to oversee delivery of the reforms.

Where the COAG 1994 reforms were focused on driving supplier efficiency by creating commercial frameworks and competitive pressures, the NWI placed greater emphasis on promoting efficient water use. It encouraged further reform and added to the 1994 framework rather than being a holistic revision of urban water reforms. It included some pricing principles where inconsistencies had been identified in jurisdictional approaches to setting urban water tariffs and also outlined the pricing principles for recycled water and stormwater reuse. The NWI also formalised the requirement for the industry to develop demand management policies and to benchmark utility performance.

The NWI was not binding on the states and territories in the same way as the 1994 COAG reforms, nor was urban water the prime focus of the NWI. The NWI was also a broader mix of incremental water reform initiatives and principles when compared to reforms under the NCP agreements that had a clear case for change and were equally relevant to all states and territories. Timing was also

a key difference in the implementation of the two reforms. In 2004, the states and territories were grappling with drought. This meant issues around water security and the need for supply augmentation were dominant and pressing, lessening focus on NWI reforms.

2.5 NWI Pricing Principles

The NWI provided general guidance on best practice water pricing to achieve target outcomes, these included efficient delivery of services, the sustainable use of water resources, pricing transparency and full cost recovery for services provided. In 2006, a steering group comprising representatives from Commonwealth, state and territory governments and pricing regulators was established to review inconsistencies in pricing approaches and to identify whether these were impeding the achievement of the NWI outcomes.

Box 2: National Performance Reporting

Under the 2004 National Water Initiative (NWI), governments agreed that an independent report on urban water utilities would be published annually to benchmark pricing and service quality. At the time, WSAA's publication, *WSAAfacts*, was already reporting on a range of key performance indicators including water resources, health, customer service, asset management, environment, finance and pricing.

In 2006, by agreement between the National Water Commission, WSSA and representative NWI parties, *WSAAfacts* was replaced by the National Performance Report (NPR). Since 2012 the NPR has been produced by the Bureau of Meteorology in conjunction with state and territory governments and WSAA.

The 2015-16 NPR compares the performance of 86 water utilities providing urban water services to over 20 million people across Australia. The Report covers 182 performance indicators that are based on nationally consistent definitions.

Water utilities are required to meet audit requirements, for example carrying out audits on nominated indicators at a minimum of three-year intervals by suitably qualified and independent auditors.

WSAA will continue to support the NPR and maintain its valued role on the Report's Steering Committee. WSAA will proactively work with its members to continuously improve the quality and usefulness of the Report. The independent and public nature of the Report helps consumers and government determine whether the water sector is operating in an efficient and cost effective manner.

The steering group identified the need for a best practice road map on a number of areas relating to water pricing methodologies and went on to develop four sets of principles. These became known as the NWI pricing principles and addressed:

- recovering capital expenditure
- setting urban water tariffs
- recovering the costs of water planning and management
- recycled water and stormwater reuse

These principles were agreed by Australian governments in 2007 as the basis for setting water prices in their jurisdictions. There was also agreement that where these principles were not followed in particular circumstances, the reasons justifying an alternate approach would be tabled in parliament.

Many jurisdictions have achieved the obligations set out in the NWI. However, there is little evidence that the NWI has exerted a strong influence on urban water pricing policies and state regulation. The pricing principles released in 2007 were a reflection of prevailing practice rather than a driver of change.

2.6 Recent reviews of reform progress and next steps

There have been a number of subsequent reviews of the progress of reform in the water sector and more generally on NCP reforms by the National Competition Council and others. The major reviews are summarised below.

- In 2011, Productivity Commission Inquiry – Australia’s Urban Water Sector investigated opportunities for efficiency gains in the Australian urban water and wastewater sectors and proposed a plan to implement a number of reform options for regional and urban water systems.
- In 2013, the Standing Council on Environment and Water (SCEW) reported to COAG on the next stage of water reform in response to key reviews including the National Water Commission’s (NWC) review of the National Water Initiative (NWI) and the Council of Australian Governments (COAG) review of the NWC. SCEW identified some gaps in the NWI framework and opportunities for improvement and recommended a work plan including reviewing the NWI Pricing Principles and the National Urban Water Planning Principles by end 2014.
- In 2014, the NWC released Australia’s water blueprint: national reform assessment. This was a comprehensive assessment of the progress made in implementing the NWI and set out the NWC’s view of future water reform priorities. The NWC recommendation directly relating to urban water was that the reform program should be accelerated to drive greater efficiency and innovation.
- In 2015, the Competition Policy Review (Harper Review) found that reform of water has been slower than reform in other sectors and saw that a more national approach to water reform may re-establish its momentum. The Review recommended progressing implementation of the NWI principles and focusing on strengthening pricing and economic regulation in urban water.

There is a high level of consistency in the findings of these reviews – key being that the reform journey needs to continue. However, none have provided the momentum to achieve the changes envisaged under the core recommendations.

COAG Intergovernmental Agreement

At its meeting of 9 December 2016, Council of Australian Governments (COAG) leaders agreed the importance of reforms to raise Australia’s economic growth potential. The Commonwealth, New South Wales, Western Australia, Tasmania, the Australian Capital Territory and Northern Territory signed the Intergovernmental Agreement on Competition and Productivity-Enhancing Reforms to build future productivity, growth and jobs.

Importantly the Agreement includes references to urban water under areas for competition and productivity-enhancing reforms. Specifically:

- Consistent with the NWI signed at COAG in 2004, the Parties agree that water reforms should be developed and considered, with a focus on more efficiently and sustainably securing urban water services.
- The Parties agree that opportunities to promote improved governance, better economic regulation and a better understanding of where competition can be deployed to deliver benefits in each jurisdiction should be examined.

The Agreement also states that “*The Commonwealth will provide payments to the States for the delivery of reforms that drive Australia’s economic performance and living standards*”.

The agreement is consistent with WSAA’s advocacy in the report “Doing the important as well as the urgent”.

3.0 Unfinished business: continuing reform

Key messages

- There is broad agreement across the water industry that further urban water reform would improve outcomes for customers and the community.
- Independent regulation was a key requirement under the NCP to deliver price and service improvements for customers. Not all states and territories have independent economic regulation.
 - There are a number of promising developments. For example, WSAA supports the ESC's proposal to enshrine the utility-customer relationship at the heart of the regulatory framework.
- Governments are yet to achieve the agreed separation of policy, regulation and service delivery functions as outlined in the 1994 COAG water reform framework.
- Governance in the industry is generally sound, but could be strengthened to be more resilient when the industry comes under pressure. Over time elements of the original governance model have not been fully realised or have been weakened.
- The journey to develop a framework for competition in the provision of urban water services has hardly begun.
 - It is most advanced in NSW, but it is yet to create an environment conducive to new market entrants while protecting the needs of existing customers.
- WSSA considers that the next big gains for the water industry are likely to come through integration. Government frameworks and processes that support collaboration between sectors will lead to co-investment, lower costs and better value outcomes for businesses and the community. There needs to be a national catalyst to advance greater integration of the urban water cycle.

As the previous chapter showed, the 1994 reforms were fundamental to the current structure and direction of the water industry. Structural, institutional, and pricing reforms embarked on since the 1990s have helped the Australian water sector improve productivity, efficiency and private sector participation.

Competitive outsourcing now delivers benefits to customers and shareholders, and the cost of capital investments are increasingly recovered partially or in full. Customer perceptions of the value of water are generally high, and complaints are very low compared to other essential services. The industry has a proven record of delivering outcomes in a dynamic and often challenging environment, most notably in response to the millennium drought. However, not all of the objectives of the water reforms have been achieved. There remains a strong case for a nationally coordinated reform program as previously conducted under the COAG framework.

The Harper Review and the NWC's characterisation of urban water reform as unfinished business is accurate.

Overcoming the challenges in the urban water sector will require much more than business as usual. It requires action to, meet customer and environmental needs, achieve more efficient regulation that facilitates competition and innovation, better understand liveability and customer value, and improve adaptive planning, skills, culture, and risk management. Without change, these drivers will translate into higher than necessary water bills for customers, an erosion of taxpayer value in public utilities, and missed opportunities for innovation and efficiency.

The rest of this chapter assesses where the industry measures up against the original objectives. These objectives broadly fall into:

- Pricing oversight and economic regulation
- Governance
- Competition
- Water sensitive cities

3.1 Pricing oversight and economic regulation

Independent economic regulation of utilities was one of the key aspects of the competition policy frameworks and reforms. Its aim is to ensure a degree of independent oversight and helps ameliorate the inherent conflict where government is at once the shareholder, rule setter, operator and retailer. The intention was for regulation to reproduce the disciplines otherwise provided by competition, to ensure that monopoly businesses do not earn monopoly profits or provide sub-standard services, while still enabling them to cover the efficient cost of operating and maintaining the network assets. A best practice regulatory framework for the water industry would typically entail:

- determination or oversight of the prices and service levels provided by monopoly suppliers
- licensing of suppliers as a means of monitoring and enforcing compliance with these services/prices
- overseeing competition in contestable elements of these industries (e.g. via regulation of third party access to essential facilities)

The Commission has asked if there a need for greater consistency in price setting approaches across different jurisdictions.

Economic regulation and independent price oversight has played an important role in the water industry's development and it needs to continue to evolve to meet future challenges. Overall, there is strong evidence of significant benefits from the pricing and institutional reforms undertaken, including the introduction of consumption-based charging in most metropolitan and regional urban areas. This has consistently resulted in reductions in residential water consumption (per property). The NWI recommitted Australia's governments to ensuring independent regulation to set or review price determinations for the urban water sector, however, it has not maintained its reform momentum. While all Australian states have a form of economic regulation, in execution this has occurred with varying degrees of clarity and effectiveness.

In 2014, WSAA commissioned Frontier Economics to review the economic regulation of the urban water industry in Australia and identify improvements that would be in the long-term interests of customers and stakeholders. The findings highlight that no one jurisdiction has it completely right. Some jurisdictions meet most elements of a best practice model, but no jurisdiction meets them all. Challenges cited by the Report included a continuing absence of independent economic regulation in some jurisdictions, unclear or conflicting remits given to regulators, and inadequate rights of review of regulatory decisions.

The Commission is seeking feedback as to whether current pricing practices promote investor confidence.

The Productivity Commission should seek the views of potential private investors with regards to their confidence in the current arrangements. For its part WSAA considers that a principal of good economic regulation is that it is neutral with regards to ownership. We do not consider that there should be different regulation for government owned utilities and privately owned utilities. The competitive neutrality requirements in the COAG agreement would tend to support this view.

In this context, improving economic regulation would promote better outcomes for the customers of government owned utilities and would promote investor confidence if there were to be greater direct private investment in the urban water sector.

Improving the consistency and predictability of economic regulation is good for the sector regardless of whether it is publicly or privately owned. WSAA has pointed to the need to ensure that the sector is financially sustainable in the long term. This is necessary to renew and maintain long lived assets, but is also a requirement for private investment in the utilities sector. Looking at average credit rating metrics, Australian water businesses are well below those in the UK, with some water businesses in Australia having little financial room to move if they are to maintain an investment grade credit rating.

In a similar vein, merits review procedures are critical in providing investors with confidence and allowing them to access low cost sources of capital. In turn, this reduces costs to consumers.

The Commission seeks comments on the merits of increasing customer involvement in regulatory decision making, as is commencing in Victoria, and the best way to do this.

Water utilities locally and internationally are increasing their focus on providing value to their customers and better engaging with them on products and services. The customer value proposition is a relatively simple one – providing the best possible product and service (experience) at the least possible price – while maintaining a trusted brand and reputation. In this context WSAA has supported the Essential Services Commission’s (ESC) proposal to enshrine the utility–customer relationship at the heart of the regulatory framework and to hold utilities accountable for the outcomes they provide to customers. Effective regulation is the keystone to aligning the interests of the customer, the water business itself and the wider community and ensuring long-term planning to meet long term needs.

While well intentioned, some regulator-led customer reference groups and other customer review mechanisms have the potential to blur the essential relationship between the customer and the utility rather than enhance it. Regulators will never have as much information about customers as utilities. When they attempt to capture the same amount of information – this is necessary, for example, to set individual prices for all services – it creates a significant regulatory burden for utilities and sub optimal outcomes for customers.

In the ESC’s model the role of the regulator becomes to assess how well the utility has engaged with customers and how well they have taken their views into account when developing business plans. The utilities own the customer relationship and are accountable to customers and regulators for delivering outcomes. The key elements to implement the new ESC model are a set of customer engagement principles (see Box 3), and a new incentive framework where the utility’s financial return is linked to the ESC’s assessment of the quality of customer engagement and how well customer values had been incorporated into their pricing submission.

Box 3: ESC’s Customer Engagement Principles

1. The form of customer engagement undertaken by a water business should be tailored to suit the content of consultation, and to the circumstances facing the water business and its customers.
2. A water business must provide customers with appropriate instruction and information, given the purpose, form and the content of the customer consultation.
3. A water business’s customer engagement should give priority to matters that have a significant influence on the services provided and prices charged by the business.
4. A water business should start customer engagement early in its planning. The engagement should be ongoing, to keep testing proposals with customers.
5. A water business should demonstrate in its price submission how it has taken into account the views of its customers.

Customers are the ultimate beneficiary of reforms to economic regulation. Better economic regulation means, prices are kept as low as possible, services and investments are targeted at areas of highest customer value, and there are greater opportunities for customer engagement and more transparent decision making. This requires that all aspects of the broader regulatory framework including economic regulation, environmental regulation and drinking water quality regulation are focused on achieving outcomes at lowest cost in an integrated manner.

WSAA recommends revised national pricing and regulatory standards that:

- enshrine the long-term interests of customers as their overriding objective
- include strong incentives for water utilities to find efficiencies in operating and capital expenditures, and encourage innovation
- consider the long-term viability of water businesses, when making pricing determinations
- promote strong and transparent customer engagement in the regulatory process
- have in place merit review and appeal mechanisms for water businesses and other stakeholders
- provide greater certainty and predictability, for both existing utilities and potential private investment in the industry
- capture the true efficient costs of service provision

3.2 Governance

As set out in section 2, a key element of the original COAG reforms was separating the policy making functions of government, from regulation and service delivery. The corporatisation model was developed to provide government owned businesses with similar incentives for efficiency as private counterparts. Corporatisation improves the disciplines facing water utilities, because designation as a government trading entity requires qualifications including:

- clear and non-conflicting corporate objectives
- managerial responsibility, authority and autonomy from executive government
- effective performance monitoring by the owner government
- effective rewards and sanctions related to performance

However, a number of previous studies have claimed that governance is one area of unfinished business in urban water reform. Over time, elements of the original governance model have not been fully realised or have been weakened.

The Productivity Commission (2011) found that “*Conflicting objectives and unclear roles and responsibilities of governments, water utilities and regulators have led to inefficient allocation of water resources, misdirected investment, undue reliance on water restrictions and costly water conservation programs.*”

Box 4: Office of Living Victoria review of economic regulation, governance and efficiency in the Victorian Water Sector

WSAA has previously stated that Victorian Economic Regulation has many aspects of a modern regulatory approach.

In 2014, as part of the Fairer Water Bills Initiative the Office of Living Victoria released a Review of economic regulation, governance and efficiency in the Victorian Water Sector.

The review proposed an ‘active shareholder’ model where prices would be set by an independent reviewer appointed by the Government, seemingly downgrading the role of independent regulation performed by the ESC. It also proposed to abandon a building blocks approach to setting prices, for an unspecified ‘price path’ approach.

WSAA, as well as consumer groups, made submissions to the reviewer questioning how the new approach would work. WSAA questioned whether the approach would provide consistency or predictability necessary for long term planning. Indeed, the new approach appeared to have more in common with Pre-Hilmer approaches to price setting rather than modern economic regulation.

The abolition of the OLV meant that the new policy was not implemented.

The NWC in its final assessment of urban water reform identified the critical policy priorities that would enable the sector to meet customer and community expectations in the future. It found that:

- governments are yet to fully achieve the agreed separation of policy, regulation and service delivery functions as outlined in the 1994 COAG Water Reform Framework
- major metropolitan utilities' capacity to manage operation and investment decisions is being undermined by a shifting policy environment and political interventions
- a lack of institutional alignment across the urban water cycle is creating a barrier to integrated water management

It further commented that:

“Today, major metropolitan utilities operate under a corporatised governance structure that is intended to provide flexibility and accountability for operational and investment decisions. This is underpinned through accountability mechanisms, including varying degrees of independent regulation and, in many cases, scrutiny of utility boards under the Corporations Act 2001 (Commonwealth). Governments, however, continue to intervene in regulatory and operational decisions, often under the guise of their role as equity shareholders, to the extent that the operating mandate of utilities is unclear.”

WSAA's view is that for the most part there is a good level of accountability and responsibility between governments and utilities. However, it recognises that arrangements are not always resilient. When put under pressure through challenges such as water security or concerns about affordability, the roles of government, utilities, regulators and shareholders can become blurred.

Two recent examples, addressed in Box 4 and 5 are the current challenges facing TasWater and the issues around a new regulatory framework proposed by the Office of Living Victoria.

Box 5: TasWater

In August 2016 TasWater, owned by Tasmanian councils, revealed a 10-year plan to upgrade infrastructure across the state. Included in the plan was a promise to remove boil water alerts in 24 Tasmanian towns within two years.

In March, the Tasmanian State Government announced their intention to assume ownership of TasWater from July next year. They have promised to speed up water and sewerage upgrades to towns with unsuitable drinking water. The Government's plan is to accelerate the program, completing the remainder of TasWater's capital investment program within five years.

TasWater has stated that 99 per cent of its customers receive drinking water that fully complies with Australian standards and the remaining 1 per cent will be receiving similar quality water within 18 months. In a statement, TasWater Chairman Miles Hampton said the State Government's initial plans to upgrade water and sewerage infrastructure would result in significantly higher debt than TasWater's 10 year plan.

TasWater's prices are currently determined by the Tasmanian Economic Regulator. Part of the Government's plan is to resume within government the final power to set prices.

Ownership and structure of water businesses are matters for the relevant state government.

However, WSAA has consistently argued that prices should be determined by an independent regulator. Appropriate regulation allows the right balance between the needs of customers and the financial sustainability of a water utility. Indeed, independent price regulation has been an element of urban water reform since the 1990s.

Consistent with the original intent of the corporatisation model there is a need to improve the foundations of the relationship between governments and utilities to provide greater resiliency. As new players enter the urban water market it will be important to ensure that there is good governance so as not to advantage or disadvantage any participants. The original success of the COAG reforms suggests that this demands a national recommitment to the elements of the

corporatisation model for water utilities.

Another aspect of governance exists at the planning level. The PC and NWC have both referred to the limitations that policy bans place on the water industry innovation.

PC 2011 “...the largest gains to the community are likely to arise from achieving water security at a lower expected cost. This can be achieved by governments removing ‘policy bans’ on supply augmentation from certain sources, such as rural-urban trade and indirect potable reuse.” (pg. XXXII)

Removal of these impediments would allow water planners to properly explore all their options on their merits, considering the economic, public health, environmental, and customer value. For example, a number of jurisdictions are yet to discuss options for direct and indirect potable reuse.

Box 6: Nutrient offsets to improve the Logan River

The provision of a voluntary offset mechanism under the Queensland Environmental Protection Act 1994 has allowed Queensland Urban Utilities (QUU) to find an innovative solution to nutrient discharge limits at Beaudesert Sewage Treatment Plant. Instead of a plant upgrade, they completed riverbank restoration works at Logan River to reduce sediment and nutrient loads. The 500 metre, re-engineered back of the Logan River prevents more than 11,000 tonnes of sediment, 5 tonnes total nitrogen and 8 tonnes of total phosphorous from entering the waterway every year due to natural channel erosion. The \$800,000 water quality project was more cost effective than the \$8 million alternative to upgrade the Beaudesert Sewerage Treatment Plant. This approach has led to significant benefits such as lower greenhouse gas emissions, improved biodiversity, stream cooling and reduced erosion for landholders.

The Commission has asked whether the processes for determining public health, safety and environmental regulations applying to urban water providers promote cost-effective and targeted regulations. In addition, they seek feedback on whether there is separation between the various policy-making and regulatory bodies’ roles and responsibilities.

The regulatory frameworks across Australia vary from state to state. Like all regulatory systems improvements could be made, however, it is not the key impediment to the industry’s development. The Australian Drinking Water Guidelines serve as a model for national consistency. WSAA sees possibilities to improve environmental and social outcomes through a more outcomes focused approach to regulation.

Regulation, particularly environmental regulation, can force a water business to only consider managing their particular activities, rather than looking at a whole of urban water cycle approach. For example, when upgrading a sewage treatment plant, should success be measured as achieving license compliance, or as achieving environmental outcomes such as a healthy waterway? While an outcomes-based approach may be more difficult to measure and attribute, it can lead to significant innovation in the industry. It can also deliver solutions that are both more cost effective and beneficial to the environment, such as using nutrient offsets to improve the biodiversity and health of a waterway (see Box 6, 7 and 8). A more integrated approach to planning and environmental regulation would mean water and wastewater infrastructure would be planned alongside other major services, maximising benefits and reducing unwanted impacts, leading to overall better outcomes for customers and the community.

WSAA does not recommend any particular governance structure but advocates that any changes need to be in the long term interests of the customers and regulatory and policy frameworks should adequately support any changes in industry structure or ownership.

Box 7: Treatment wetlands to improve Obi Obi Creek

Unitywater was able to find an alternative lower cost solution to managing growth and discharge limits at the Maleny Sewage Treatment Plant. The existing treatment plant was discharging into the sensitive Obi Obi Creek, a waterway which is used for swimming and ultimately enters a regional water supply dam. Continuing this discharge approach was not a viable option. Unitywater used a combination of a modular upgrade to the Sewage Treatment Plant and final effluent treatment through an irrigated forest and constructed wetlands that covers close to 20 hectares.

This approach removes an average of 97% of total nitrogen (average of 416 kg/year) and 97% of total phosphorus (average of 77 kg/year) from the effluent. The irrigated forest and wetland are located in the Maleny Community Precinct and are restoring former grazing land into an ecological parkland and wetland for the community.

The \$15million project was more cost effective than an option whereby raw sewage would be transferred for treatment at the Landsborough Sewage Treatment Plant and ultimately ocean outfall disposal at a cost of \$30million.

This alternative treatment approach will lead to other significant benefits such as lower greenhouse gas emissions, improved biodiversity and community recreational opportunities.

Box 8: Nutrient offsets to improve Maroochy River

Unitywater has been able to find a lower cost, total water cycle solution to managing growth and nutrient discharge limits at the Coolum Sewage Treatment Plant through the provisions of a voluntary nutrient management mechanism under the Queensland Environmental Protection Act 1994.

Unitywater purchased 191 hectares of former agriculture land to reinstate tidal flows from Yandina Creek, a tributary of the Maroochy River. The tidal inundation of the land will regenerate a wetland environment in the years ahead preventing more than 5 tonnes of total nitrogen from entering the waterway every year. The site also provides opportunity for non-regulated revenue from environmental offsets as enabled by Queensland Environmental Offsets Act 2014.

The \$3.2million project was a more cost effective option than \$8million alternative to upgrading the Coolum Sewage Treatment Plant to treat the equivalent level of total nitrogen. This approach will lead to other significant benefits such as lower greenhouse gas emissions, improved biodiversity and community recreational opportunities.

WSAA recommends all governments:

- **recommit to the corporatised model, providing additional independence, commercial discipline and enhanced accountability to customers**
- **establish a competitively neutral environment between existing and new suppliers**
- **ensure that wider policy outcomes, such as community service obligations or environmental management requirements are explicit, and resolve who is best placed to manage them**
- **ensure that the governance model clearly allocates responsibility for security of supply**
- **ensure that the governance model facilitates integrated water cycle management**
- **ensure government obligations are clearly articulate through instruments such as a Statement of Obligations**

3.3 Role of Competition

Reviewing the path of urban water reform, it is hardly an exaggeration to note that we are no closer to resolving the role competition than we were when the original Hilmer Competition Review was released.

The urban water sector has been very effective in using traditional forms of private sector involvement, such as outsourcing and other contracting models, but evolving private participation to the next level will require careful consideration of pro-competition models to signal for it. With the right structures, private investment into public infrastructure like urban water can be an effective way of driving price and design competition, in turn driving down costs for consumers.

The NWC described the traits of a good market structure in water—saying: *“To give service providers the incentive and freedom to innovate, government and regulators need to reconsider how they go about their business and how the sector is governed, including being more open to moving away from the government-owned monopoly water business model.”*

While the benefits of competition are well understood, there is much work to be done to consider and resolve how to apply the disciplines of competition within the urban water sector. Current regulatory, competition and governance frameworks are a barrier to both the public and private sectors maximising productivity gains for customers. New players want to enter the industry but the frameworks are not in place which will allow them to do so while also ensuring positive outcomes for customers.

A national approach is also necessary to resolve the appropriate role for competition. State action to date has been piecemeal. The Water Industry Competition Act in NSW is most advanced, but still lacks a vision for the market structure. From an efficiency perspective, it makes sense to pool resources and expertise to progress these complex issues.

The PC examined the role of competition in urban water in its 2011 Report, concentrating on the bulk water sector. WSAA considers that the PC reached a balanced view. The PC saw a case to ‘introduce greater competition and promote innovation where cost effective’ and considered the gains could be substantial, particularly for bulk water supply.

However, it noted:

“The potential gains in urban water are likely to be more modest [than other utility industries] because:

- *limited forms of competition have already been introduced through contracting out and build, own and operate arrangements*
- *compared with other utility sectors, a greater proportion of costs are in natural monopoly elements of the supply chain (for which competition in the market would be inefficient) (p.245)”*

The PC reached the conclusion that competition is unlikely to ‘naturally’ develop in urban water. It also questioned whether the benefits of established competition via administered markets outweighed the costs at this time.

“If well-functioning markets already exist, competition in the market can develop ‘naturally’. Alternatively, competition in the market can be administratively established (that is, markets can be created).

Naturally occurring competition depends on a number of preconditions being met, for example:

- *many producers offering a relatively similar/homogenous product*
- *many consumers that can choose between competing providers*
- *low or no transaction costs*
- *low or no barriers to market entry or exit (over the long term), and so on.*

Where these conditions do not hold, and competition in the market does not occur naturally, there might be a case for establishing competition. The National Electricity Market provides an example of this approach. Administering competitive markets is a complex and costly task, and has relatively onerous preconditions. The Commission is not convinced that there is a compelling case for creating this type of competition in the urban water sector at this time – a view strongly supported by inquiry respondents. The absence of any international precedent of urban water markets compounds the risk and uncertainty associated with establishing competition of this kind in the Australian urban water sector at this time.” (p.334)

Box 9: Competition in water and sewage services in NSW

In NSW, the path to introducing competition in water and sewerage services began more than 10 years ago. Key enabling legislation and facilitating frameworks to enable market entrants to provide water and sewerage services are summarised below.

Third Party Access under Part IIIA of the Trade Practices Act 1974

In 2005, the Australian Competition Tribunal (ACT) declared the transportation and interconnection services for three of Sydney Water Corporation Limited’s sewerage reticulation networks under Part IIIA of the Trade Practices Act 1974. This was in response to an application by Services Sydney Pty Limited. The ACT decision gave third parties the right to negotiate access arrangements with Sydney Water. Services Sydney subsequently sought arbitration by the Australian Competition and Consumer Commission (ACCC) on the pricing to apply to its third party access arrangements with Sydney Water. In June 2007, the ACCC issued its final determination, being the first application of access pricing to water and sewerage in Australia. The ACCC’s determination set out the access pricing and asset valuation methodology.

NSW Legislation

The Water Industry Competition Act 2006 (WICA Act) was introduced by the NSW Government to promote private sector investment and innovation in the water and wastewater industries. It established a licensing regime for parties to operate as providers of retail and supply services. It also provided for third party access arrangements to certain water infrastructure services in New South Wales.

The WICA Act was reviewed by the Metropolitan Water Directorate in 2014. As a result, extensive changes were recommended and passed by the parliament in October 2014. Some barriers to competition were removed and key reforms introduced, including:

- refocusing the Act to regulate utility like services and high risk schemes
- enabling an entity to provide retail or operational services (as permitted on their license) under a single license anywhere in NSW
- strengthening customer protection through last resort arrangements

Before the provisions in this Amending Act can commence, the Water Industry Competition (General) Regulation 2008 will be reviewed to support the new regulatory framework. IPART oversees implementation of the WICA Act. To-date, IPART has issued 30 Retail and Network Operator licenses to private sector operators. To-date, no third party access arrangements have been established in NSW.

IPART review of wholesale pricing

IPART is current reviewing the wholesale prices for water and sewerage services for Sydney Water and Hunter Water Corporation. IPART’s stated objective for this review is to establish an approach for regulating wholesale prices that allows new entry to the market for end-use water and sewerage services to occur where this is efficient, to promote competition for the benefit of consumers.

In this context, the Commission's request for information on **how the level of competition in the provision of urban water services be increased**, seems overly simplistic. As the Commission itself recognised in 2011, it must be considered whether there *are* models of competition for the water industry that would promote the best interest of our customers. These issues are examined in more detail in Appendix A.

A significant proportion of the services in the water industry are subject to competitive tendering, and the industry has shown a preparedness to work with new players. However, competition in the market in its traditional form is more difficult to introduce in the water industry than in most industry sectors, and is challenging even by infrastructure sector standards.

The UK is currently introducing retail competition with 1.2 million businesses, charities and public sector organisations in England no longer restricted to buying water services from their regional monopoly. Instead, they can shop around, renegotiate, and find the right deal for them. In Australia, the retail segment is a very small proportion of the total cost chain, comprising of less than 5 per cent of the total water bill. This means that significant bill reductions are unlikely in a retail-only competition model.

In March this year the Turnbull Government directed the Australian Competition and Consumer Commission (ACCC) to review retail electricity prices, examining retailer behaviour and contracts offered to customers to ensure consumers benefit from competition. The Government's media release stated that *"Competition in retail electricity markets should mean lower prices for residential and business customers. However, retail electricity markets don't appear to be operating as effectively as they could."*

The question is not just whether competition in the market can be introduced, but whether the potential benefits of creating such a market justify the costs. Careful consideration needs to be given to a systemised approach to engage the private sector in a way that is sustainable, and delivers consumer benefits. Important in any new framework will be protection of existing water customers in the event of failure by new entrants. Supplier of last resort arrangements are necessary to define who will provide services in the event of withdrawal or financial failure by new entrants. Such arrangements to protect end customers need to be clearly defined upfront including how they will be funded.

WSAA recommends a national review specifically examining where or whether competition could benefit customers in the urban water sector.

3.4 Water Sensitive Cities

WSAA is about to release the paper "Next Gen Urban Water: The role of urban water in vibrant and prosperous communities" (Appendix B). This paper brings together previous papers exploring the water industry's contribution to liveability, productivity and sustainability, highlighting that water businesses can play a greater role in creating value for communities. This involves a rethink within the water business, by engaging with their customers and the community to determine expectations and to collaborate with other stakeholders to create shared value.

The Commission asks what is the importance of integrated water cycle management and if the roles and responsibilities in relation to this are clear.

Water and wastewater services are fundamental to the broader amenity, liveability, and productivity of Australia's cities and towns. The Australian water industry has been largely successful in the provision of drinking water and sewerage services. There is an opportunity to transition to a water sensitive city by building off these strong foundations and optimising the whole urban water cycle (e.g. stormwater, groundwater) through integrated water cycle management. Greater integration of water, wastewater and stormwater planning within built environment

planning is required at an early stage to reduce costs, and create and capture the value of urban water services. There are, however, impediments to transitioning to a water sensitive city:

- the industry is siloed and responsibilities for various parts of the urban water cycle vary across the country resulting in the piecemeal and fragmented management of water
- inflexible regulation frameworks mean that the water businesses are not required and in most cases discouraged from considering benefits beyond their regulated responsibility of water and sewerage when making investment decisions.
- there is still a limited understanding of the needs and preferences of the water business customers and the communities in which they operate

Water businesses are proactively exploring how they can deliver greater community value through initiatives focussed on water sensitive cities. However, there is strong evidence to suggest that these initiatives are more often than not opportunistic. Less than favourable view of this activity by an economic regulator, policy unit or shareholder will see the utilities having to retreat back to the provision of traditional water supply and sewerage products.

WSAA's view is that to address this, a holistic and collaborative approach is required. A different, integrated approach that focuses on optimising outcomes across the whole of the urban water cycle will benefit communities and water businesses in the long term. Facilitating integrated planning and encouraging organisations to think outside their silos to address issues and realise opportunities. This view aligns with recommendations in the Australian Infrastructure Plan (2016) and the recent "COAG Intergovernmental Agreement on competition and productivity - enhancing reforms". The Agreement states that '*water reforms should be developed and considered, with a focus on more efficiently and sustainably securing urban water services*'.

The next big gains for the water industry are likely to come through integration, looking beyond the narrow scope of water and sewerage provision, and collaborating with other sectors and the community. Government frameworks and processes that support collaboration between sectors will lead to co-investment, lower costs and better value outcomes for businesses and the community.

Box 10: Making the Parramatta River swimmable again

The Parramatta River Catchment Group (PRCG) is comprised of councils, Sydney Water, EPA, Department of Planning and Environment, other State government agencies, and community groups, who are all key stakeholders or have various responsibilities for the river catchment. Through regional collaboration, the PRCG seeks to ensure coordination of effort, optimal use of resources and greater impact on governmental policies and decisions affecting the catchment than could be achieved through each member working separately.

In 2014, the group launched the Our Living River initiative, with the mission to make the Parramatta River swimmable again by 2025. To achieve this mission, the PRCG are developing a Masterplan to map the necessary steps and milestones required to meet our objectives. The PRCG are taking a strong outcomes based approach to this complex task, driven by community needs. The Masterplan therefore encompasses the many dimensions of making the river swimmable, including water quality, ecological health, swimming site activation and waterway governance. These elements cut across the entire urban water cycle so this collaborate approach is vital for the success of the initiative.

National water reform should reflect the role stormwater management can play in the overall urban water cycle. This can be through harvesting, reuse, creating green spaces in Australian cities and improving waterway health. If stormwater is treated separately and not linked to other arrangements such as the NWI, this would lead to inefficient investment and urban planning and poor outcomes for water security and waterway health. Collaboration between all agencies responsible for stormwater management (e.g. Parramatta River catchment or Melbourne Greening the West model) is encouraged. Without a nationally consistent funding and pricing framework,

stormwater will remain the 'poor relation' in broader urban water environment. There is an opportunity to review the value of stormwater services, and recover the costs for services delivered to the community. This could drive efficiencies and innovations through more integrated planning and decision making, through the full use of the water cycle.

The Commission asks how the interests and needs of Indigenous people can be better accommodated and represented in water planning processes. WSAA recognises that as an industry we need to do more to ensure that the interests and needs of Indigenous people be better represented in water planning. Prior to the NWI, there was an absence of culturally appropriate mechanisms for Indigenous people to actively participate in water planning and management processes. Through the Initiative, it was agreed that consistent water planning frameworks would address Indigenous access to and management of water through, representation in water planning processes, water planning arrangements which included Indigenous social, spiritual and customary objectives, and strategies to achieve these. The 2014 NWC assessment has indicated that while some jurisdictions have improved consultation with indigenous communities, participation in water management decisions remains patchy. It is important that there is continued and renewed support for Indigenous representation in water planning and management decisions so that Indigenous voices can continue to be heard in the national water debate.

The NWC recommended that all jurisdictions develop and publish processes for effective engagement of Indigenous people in water planning. These parties should ensure that all new water plans (including statutory reviews of existing water plans) provide for Indigenous access to water resources by at least incorporating Indigenous social, spiritual and customary objectives and strategies for achieving those objectives.

The Commission has asked if water and wastewater services delivered to regional and remote communities, including Indigenous communities, comply with relevant public health, safety and environmental regulations, and if not, what policy remedies might improve performance.

WSAA recognises these are important and challenging issues, we would like to work further with our members to properly respond to this request. However, it is a fact that remote areas outside metropolitan cities experience a different level of service and quality in water and wastewater services. Any policy solution has to provide a cross-council/boundary solution that combines the short term needs of infrastructure improvement and training with the long term support to ensure that these improvements are established within the communities themselves. Building the capacity of regional communities is an important long term solution. This would build on work that is already being done in other initiatives like the Queensland Regional Water Alliance Program (QWRAP) an industry-led initiative to investigate regional collaboration on water and sewerage services in regional Queensland.

WSAA recommendations:

- **systemic change in policy and regulation to encourage collaboration with other agencies and communities to respond to a broader spectrum of customer needs and expectations**
- **integration of the urban water cycle, including stormwater and flood management planning into the urban water governance, institutional and physical structures together with a sustainable funding and pricing framework**
- **integration of water cycle planning with land use planning**
- **recognise the role of water in strategic or early planning of cities and regions and inclusion of water businesses in integrated planning**
- **adapted regulation to allow water businesses the flexibility to respond to their customers' needs and preferences, particularly in regard to providing 'value add' services.**

3.5 The Case for Change

The urban water industry has always been able to provide safe, reliable water and wastewater services. Despite its importance, Australia's urban water sector faces significant unresolved challenges to its operation and long-term financial viability. While some progress has been made, the original intent of reform has not been completed consistently with backsliding on some of the previous reform efforts. Sector performance is being impacted by:

- fragmented economic regulation which fails to effectively incentivise innovation or promote the primacy of the customer-utility relationship
- pricing approaches that preclude signalling for actual servicing costs, distorting competition and impeding efficient investment
- poorly identified and inconsistent linkages between economic and environmental regulation, impeding a sufficient focus on customer needs and preferences
- utility and broader state balance sheet constraints, impacting public utilities' capacity to maintain and renew assets in time to meet population growth
- unclear and embryonic frameworks governing competition and third party access, creating barriers to private investment and long-run financial uncertainty for public utilities
- insufficient consideration—and coordination—in respect to the potential value of stormwater as part of the total urban water cycle
- ongoing exposure to pressures from climate variability and extreme events

Together, these factors leave Australia's urban water sector under resourced to effectively meet the community's growing needs and expectations for water services.

Given the scale of the future challenges facing the urban water sector, such as climate change and extreme events, urban growth, aging assets and liveability of our cities and regions, WSAA considers that national government leadership will be the key to unlocking water utility reform. The NWI needs to include a focus on urban water and recognise these future challenges across the urban water cycle. Urban water is a state responsibility; but it is also a national economic and social challenge. Australia's economic history suggests that national policy leadership, backed by financial incentives for reforming states, is a proven way to drive national good practice and better regulation, across utility markets which are owned, operated and regulated by states.

WSAA considers that the 2016 COAG agreement provides the right framework to progress the national agenda and the PC should consider framing its recommendations to feed into this process.

WSAA recommends that the Productivity Commission frames its recommendations for urban water to align with and give impetus to this framework.

Good national reform could provide each individual utility and their customers with the right framework and adequate financial resources to accommodate the task ahead. These reforms should be developed and considered, with a focus on more efficiently and sustainably securing urban water services and outcomes-based regulation, moving away from highly engineered, to more integrated and potentially catchment-based solutions that deliver broader outcomes.

4.0 Contact Details

WSAA welcomes the opportunity to discuss this submission further.

If there are any details you wish to follow up on please contact:

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