



Australian Government
National Water Commission

Wendy Craik
Presiding Commissioner
Public Inquiry – Australia's urban water sector
Productivity Commission

Dear Ms Craik

Inquiry into Australia's urban water sector: submission from the National Water Commission

The National Water Commission (NWC) welcomes the opportunity to make a submission in response to the Productivity Commission (PC) issues paper on Australia's urban water sector. The PC Inquiry comes at an important time for the Australian urban water sector. There is much to learn from recent experiences and, in our view, further reform is required for the urban water sector to perform effectively and efficiently in an increasingly complex and uncertain environment. With the industry now moving out of crisis mode following a decade of drought, there is a window of opportunity to identify and implement reforms that will provide long-term benefits.

The NWC strongly supports the framework and approach outlined in the PC's Issues Paper and looks forward to your draft report. We provide the following views in relation to the future of urban water reform drawing on our experience over the last five years.

Background and objectives of national water reform

While there are undoubtedly challenges to urban water reform in Australia, it is important to recognise that Australia is fortunate to have a robust overarching blueprint for national water reform - the National Water Initiative (NWI). Agreed by all states and territories as well as the Commonwealth, the NWI is an enduring and internationally-recognised framework for consistent and coordinated national reform effort.

Full implementation of the 2004 NWI aims to produce a "***nationally-compatible, market, regulatory and planning based*** system of managing surface and groundwater resources for rural and urban use that ***optimises economic, social and environmental outcomes***". The NWI seeks to deliver improved economic efficiency, environmental sustainability and protection of customer interests. In this way, the NWI embodies and strengthens the key policy principles and objectives established under COAG's 1994 Water Reform Framework.

The NWC believes that the overarching goal and objectives of the NWI remain relevant to urban water. Furthermore, the NWC believes that urban water services should be secure and reliable and meet customers' desired levels of service in an efficient manner, while ensuring that the industry is environmentally sustainable and that public health and safety are protected.

The role of the NWC is to facilitate and advocate full and effective implementation of the NWI, and assess progress made by NWI Parties in this regard.

Progress in implementing the NWI

We refer you to our two previous biennial assessments on progress in implementing the NWI for the NWC's full assessment of urban water reform and related areas such as water pricing¹.

In summary, in 2007 the NWC stated that, despite being largely implemented, the limited set of urban water actions committed to under the NWI were insufficient to address the new challenges for the urban sector. The NWC found that urban water reform had lagged behind reform in other major infrastructure areas such as gas, electricity and transport. The NWC argued that more strategic institutional and structural reforms were required.

Since 2007, urban water supply security has intensified as a critical national issue. Declining water storage levels over much of Australia led to severe and prolonged water restrictions in many of Australia's towns and cities. The NWC has urged further action in urban water to address these challenges. COAG has since agreed to new urban reform actions, national urban water planning principles and new NWI pricing principles. Further and faster implementation of these agreed reforms is now required.

Governments across Australia are also responding in a number of ways, including by investing in new water supplies, improving the management and delivery of urban water services, and allowing for greater innovation and more efficient water use. The NWC acknowledges the significant reforms and investments undertaken by governments and the water industry since 2004.

Despite the many achievements documented in the 2009 biennial assessment, the NWC found that "a lot remains to be done to fully achieve the urban water objectives". While supply side investment is being, or has been, brought on line in most major capital cities to address immediate problems, our 2009 biennial assessment points to serious concerns about whether the most effective institutional frameworks and mix of policy tools are in place to meet our urban water security needs efficiently and sustainably, without compromising public health and safety. We refer you to *Australian Water Reform 2009* for further detail on our assessment.

The future reform agenda

There are a number of challenges that will continue to affect our ability to ensure that urban water and wastewater services are reliable, affordable, safe and environmentally sustainable. These include changing and less predictable rainfall and runoff patterns; uncertainty about the impacts of climate change; rapid population growth; increasing community demands for environmentally sustainable water solutions; and increases in water prices to pay for new water infrastructure.

In our previous biennial assessments, we highlighted concerns associated with:

- the costs of water restrictions—the PC (2008) estimated these costs at over \$1 billion per year.
- potential shifts from under to over-investment—the cost of new investment reaching billions of dollars in each of Australia's five main capital cities.
- the transparency of the decision-making and adequacy of economic tools used for investment appraisal.
- policy and institutional barriers to particular options that could form part of the optimal portfolio of supply and demand side measures (e.g. bans on indirect potable reuse and rural-urban trade).

¹ We also refer you to our annual National Performance Reports for the urban water sector, developed in collaboration with the Water Services Association of Australia.

We have also highlighted areas of incomplete implementation of agreed national reform commitments, including in relation to water pricing, long term supply-demand planning and independent economic regulation. Please refer to our website where, in addition to our biennial assessments, there are a number of NWC and Waterlines reports we believe should be considered in your Inquiry².

The NWC is supportive of the need to further examine the case for more fundamental institutional and market-oriented reform. In our 2009 biennial assessment, the NWC recommended that “institutional arrangements in the water sector be subject to a national review to identify opportunities for competition and public sector participation and innovation” and we are pleased that the Australian Government issued the PC with its terms of reference for the current Inquiry as a result.

The role of more market-oriented approaches and greater competition is an area which we believe will require careful consideration. Many stakeholders and governments remain unconvinced that such reforms are necessary. To be convincing, the case for reform needs to be based on clear evidence of inadequacies in existing arrangements in dealing with future challenges, and a strong argument that specific market-oriented reforms represent the most effective means of addressing these problems. Market-oriented options must be seen as a means to an end (i.e. improved economic efficiency and security), not an end in themselves.

The case for fundamental institutional and market-oriented reform has not yet been made sufficiently, nor have the specific reform requirements and implementation plans been clearly defined and agreed. Combined with arguments from some elements of the industry that there are no fundamental problems, gaining traction for market-oriented reform remains a challenge.

Making the case for reform in a compelling manner will be a critical determinant of the success of the PC's Inquiry.

Implementation of priority reforms

A number of recent reports³, including the PC's (2008) own research paper *Towards Urban Water Reform*, have outlined the general case for market-oriented reforms in urban water sector. Two studies commissioned by the Joint Steering Committee on Water Sensitive Cities established under the NWI, and managed by the NWC, have also explored the overarching feasibility of market-oriented approaches and reforms to water entitlements in the urban sector⁴. The NWC has also published studies on urban water pricing⁵, which examined the case for administered scarcity pricing, among other options.

This work makes it clear that the optimal mix of reforms to best achieve our agreed objectives will vary from place to place, as the underlying costs and benefits vary. For the PC to add most value to the debate, and to build on existing knowledge, we believe the Inquiry should identify reform options tailored to the current status and needs of particular urban areas and jurisdictions. The PC should pay particular attention to the full range of urban water systems in metropolitan, regional, and remote areas, including in indigenous communities.

2 <http://www.nwc.gov.au/www/html/397-introduction---urban-water-publications.asp?intSiteID=1>

3 For example, Business Council of Australia (2006), Marsden Jacob Associates (2006), Allen Consulting Group (2007) for Infrastructure Partnerships Australia, the Productivity Commission (2008), Global Access Partners and Allen Consulting Group (2010), and various state-based reviews, such as the Western Australian Economic Regulation Authority (2007) and the Victorian Competition and Efficiency Commission (2008). Full references provided in the 2009 Biennial Assessment.

4 Frontier Economics (2008) *Urban water markets*. A report for the NWI Joint Steering Committee on Water Sensitive Cities. http://www.nwc.gov.au/resources/documents/Urban_water_markets.pdf

Frontier Economics (2008) *Review of urban water entitlements in Australia*. A report for the NWI Joint Steering Committee on Water Sensitive Cities. http://www.nwc.gov.au/resources/documents/Review_of_urban_water_entitlements.pdf

5 Frontier Economics (2008) *Approaches to urban water pricing*. A waterlines report for the National Water Commission. http://www.nwc.gov.au/resources/documents/UrbanWaterPricing_Waterlines-Body-0708.pdf

NWC forward work program in urban water reform

The NWC is now focused on preparing our third biennial assessment in 2011, where, in addition to an update on progress since 2009, we have a legislative requirement to undertake a comprehensive review of the NWI. The review of the NWI will reflect on the effectiveness and impact of the Agreement and inform the next generation of water reform. To support our review, we have a number of research and consultation tasks underway, including a number of projects on urban water reform.

Current initiatives of particular relevance to your Inquiry include:

- *Developing future directions in the Australian urban water sector:* A review of the urban water sector to identify reforms that will meet the challenges of maintaining safe, secure, efficient and sustainable urban water supply across Australia in the face of population growth and climate change.
- *Exploring opportunities for further competition in the Australian urban water sector—making the case for economic reform:* A project which aims to inform the debate about the need for institutional and policy reform in the urban water sector by producing a body of evidence on the case for reform.
- *Review of water pricing reform under the NWI:* A review of the implementation, effectiveness and impact of water-pricing reforms under the NWI, including the achievement of agreed NWI pricing outcomes; covering the NWI element of 'Best practice water pricing and institutional arrangements' as per paragraphs 64-77 of the NWI.
- *National review of water quality regulation:* A review of current water quality regulatory approvals processes and current implementation practices across Australia; focussing on institutional and governance frameworks and the extent to which they provide for efficient and effective regulation of urban water quality.

Through these initiatives, the NWC will be well placed to advise COAG on emerging directions for national urban water reform, and water reform more generally. Given the potential synergies through collaboration with the PC, we reiterate our commitment to cooperating with you over the course of your Inquiry.

Yours sincerely,



James Cameron
Acting CEO

25 November 2010