

School of Construction, Property and Project Management

PO Box 123
Broadway NSW 2007
Australia

Tel. +61 2 9514 8885
Fax +61 2 9514 8052



University of Technology, Sydney

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Water Study
Productivity Commission
Locked Bag 2
Collins Street East
Melbourne
Vic 8003

Issues Paper: Rural Water Use And The Environment: The Role Of Market Mechanisms

The practical development of a unified the national system of water property has been thwarted in part by the difficulties associated with the expectations all the property right similar to land. It is also questionable whether the free market in water property will realize the goal of optimal economic use of water for Australia we that is defined as the greatest overall net social benefit. This submission seeks to comment on three aspects of the development of independent water property as a strategy for improving the net overall social benefit of water-use efficiency as follows:

- Problems with the definition of the property right.
- Problems with the financial purpose of water property rights.
- Appropriateness of a state leasehold market rather than a freehold market.

These will be dealt with under separate headings as follows:

Definition of permanent water property.

There are currently markets for water entitlement and entitlement across Australia, and these appear to be facilitating a better transference of water resources though it is less apparent if this fulfils the goal of optimal social benefit. What is being traded is still less than a permanent meaningful right, as in all cases permanent water is subject to the vagaries of practical allocation and in many cases potential policy changes regarding the future trajectory of entitlements as a regulatory artefact of state rights to award licenses for various water usages. For water property to be a meaningful property right analogous to land, it must have a permanence and certainty of utility parallel to land. At present this has not been realised to the extent necessary to be robust. Technical issues pertaining to the nature of water and our scientific understanding of its behaviour suggest that definitive creation of permanent water property rights is premature at this point in time.

Financial Purpose of Water Property

One of the main benefits of permanent water property is its suitability as collateral for finance. Land property already has the distinction of being considered by banks as an excellent property form for securing debt. So long as water property is perceived, quite reasonably, as risky due to its permanence and utility, it will continue to be unacceptable as good quality collateral.

A second, and major financial incentive for the development of water property is its potential for capital gain, again analogous to land. As the contribution of water is better understood, its value in the economic process will be upgraded leading to capital gains in its sale price. As such, water property offers speculative potential for investors. Private discussions with rural property valuers suggests that there are currently investors intending to take up water property for this purpose and it reasonable to believe that if problems of definition and utility are resolved, then speculative investment in water property will multiply. This has been seen by other property types including disparate rights from land, to radio bandwidth, to taxi licenses. In all cases, once the property right was formalised, it experienced considerable capital growth that in most cases created contingent economic effects that could hardly be considered socially beneficial.

In the case of taxi licenses, rights that were originally awarded at no price to regulate the industry now trade for hundreds of thousands of dollars. As these prices become the norm in the industry, investors must price the use of the right sufficiently high to earn a reasonable return on the investment. In the case of taxi license, this means that in addition to taxi charges being sufficient to cover physical expenses and drivers' incomes, fares must be inflated to provide a return to third party investors. Considering the unregulated taxi industry could operate on fare levels that did not need to provide the return to property right holders who were not actively engaged in the productive activity, the result of the creation of what is in effect property rights to taxi licenses has not been socially beneficial. There is a strong analogy to water property.

It is very possible that permanent water property rights will facilitate the creation of the need for a separate and substantial premium on water use to provide a return for investment in water property. This will largely come at the expense of existing land values, as is currently widely accepted, but it will be a property type that will not have the same collateral value. This will make it a higher risk property type that may only be affordable by those who do not need debt finance, or at least debt finance secured by water property. The extent to which water will erode land values and the effects on the type and extent of investors and speculative capital gains are all uncertain at this point in time, but potentially may result in massive social costs.

If water does erode land values it will also erode land-based taxes and hence negatively influence state incomes. Water property should consider taxation impacts.

The Appropriateness of a State Leasehold Market for Water.

Many of these problems could be controlled by the use of a state leasehold market for water, rather than a freehold system. Since water entitlements exist as a result of the states' right to regulate water, the benefits of water allocation directly result from that act of the state. If states established a fee for water allocation for all users, it would create an incentive for optimal economic use of water resources consistent with the terms of reference in the study. Holders of water entitlements would be motivated to apply water where it had the most effective use. Since a well-priced leasehold right does not suffer from speculative capital gain, water would not develop a punitive investment value in the way that other property rights have in the past.

This would also make water more affordable by keeping its price down. For users of water this would have several advantages: it would remove the need to borrow to acquire necessary water resources, it would make the long term permanence of any particular water allocation less important as an investment risk and it would keep produce prices down in the long term. For the state it would also consolidate state revenue rather than compromise it.

For all of the reasons above I recommend strongly that the Commission consider a leasehold market strategy for water property rather than a freehold model.

Dr. Garrick Small
Associate Head, Teaching and Learning