

Water rights and water trading

Background

- 4.1 During the course of its Inquiry, the Committee received voluminous evidence on the importance of water rights and water trading to the future of rural Australia. Indeed, it is the Committee's view that defining water rights, or 'water access entitlements',¹ is the critical issue underpinning provision of water for both agriculture and the environment. Likewise, the market mechanisms used to establish water trading will have a profound influence on the future of irrigated agriculture.
- 4.2 The key principles of the new National Water Initiative announced by COAG on 29 August 2003 included references to water rights and water trading. The NWI announcement reiterated the need to improve 'the security of water access entitlements, including by clear assignment of risks of reductions in future water availability, and by returning over-allocated systems to sustainable allocation levels', and ensure 'water is put to the best use by encouraging the expansion of water markets, involving clear rules for trading, robust water accounting and pricing based on full cost recovery'.²

1 Council of Australian Governments Communique, 29 August 2003.

2 Council of Australian Governments Communique, 29 August 2003.

- 4.3 It is the Committee's belief that these aspects of the National Water Initiative should be pursued as a matter of urgency, to create a clearly defined and robust system of water access entitlements, and a free, fair and transparent market for water trading.

Water Rights

- 4.4 While the various State and Territory water rights all conform to the broad principles of the COAG water reform framework, their differences reflect the historical circumstances under which they have developed over the last century or more. This becomes a particular issue in the Murray-Darling Basin where the members of the Basin are all part of one very large system, yet have different water access rights.
- 4.5 Some have argued that the implementation of the COAG water reforms has been less than satisfactory. In evidence before the Committee, Professor Peter Cullen noted that the question of water rights was the most important issue in the water reform process, yet the one where COAG had failed to deliver. He argued that the clarification of 'access rights' was vital. Without clear entitlements, trading would be difficult, and the question of returning water to the environment would be encumbered by conflict over loss of rights and issues of compensation. Clearly defined entitlements would allow everyone to know where they stood, what degree of access they were entitled to, and what level of remuneration or compensation they were entitled to for the sale or loss of that entitlement.³
- 4.6 In its submission, Murray Irrigation stressed the importance of water rights, and the need to establish an effective system of rights before engaging in water trading:

Establishment of property rights to water is fundamental to most of the policy issues facing government. Property Rights issues must be satisfactorily resolved through the COAG agreements before governments pursue a more liberal trade in water entitlements and any further decisions are made about environmental flows for the Murray River. Any decision by governments, Commonwealth or State to interfere with water policy will have impacts and should only occur after rigorous analyses. Any attenuation of irrigators' water rights should at least

3 Transcript of evidence, pp. 1-3, 19.

be based on just terms compensation. In the case [of the] Murray Darling Basin the starting point should be the 1995 Cap on diversions.⁴

- 4.7 The Committee is concerned that the COAG Water Reform Framework has reduced the security of irrigators' water entitlements, while leaving them with little or no control over the planning processes to which they are now subject. It is also concerned at the lack of clarity and compatibility in the current system of rights.

Security of tenure

- 4.8 The Inquiry received considerable evidence that security of entitlement is a key issue for farmers. In its submission, the National Farmers' Federation (NFF) urged that water licences be issued to 'all water users in perpetuity'.⁵ Other peak farming bodies have also stressed the need for security of access.⁶ Mr Clay Manners, General Manager, Policy, for the Victorian Farmers Federation (VFF), told the Committee that:

We—along with, I think, farmers across Australia—believe that secure access rights to water are very important in managing the business so that if farmers purchase water they understand what they are purchasing and know they are purchasing it for the long term and if they make investments on their farm they know they are making them for the long term and can invest with confidence.

- 4.9 Mr Manners emphasised that a system of periodic review of entitlements would not be welcomed in Victoria, stating:

A system with a review of water rights every 10 years would not be seen very well in Victoria. We view water rights as a permanent allocation to farm land and we would be very nervous about any system which implements an automatic 10-year or 15-year review of water rights in this state. That is not the way we have managed water rights for a long period. We would not like to see such a system introduced in Victoria.⁷

4 Submission no. 161, executive summary.

5 Submission no. 168, p. 2.

6 Transcript of evidence, pp. 569–70.

7 Transcript of evidence, pp. 247–8.

4.10 Similar sentiments were expressed in the submission from the Queensland Farmers' Federation (QFF).⁸ In his evidence to the Committee, Mr Ian Johnson, Water Advisor to the QFF, indicated that the QFF wanted certainty and transparency to be built into any process of periodic review.⁹

4.11 In its submission to the Inquiry, Murray Irrigation Limited expressed dissatisfaction with the system of reviewable rights operating in New South Wales:

Irrigators argue that NSW's legislation does not provide the certainty required by farm businesses to operate. The National Australia Bank has recently indicated their concern with uncertainty of water entitlement tenure and its effect on financing arrangements for the rural sector.¹⁰

4.12 On the other hand, the Queensland Conservation Council (QCC), has opposed the call of farmers and irrigators for perpetual property rights, recommending that:

The Commonwealth government resists calls for entrenched property rights over land and water resources in order to maintain its capacity to deal effectively with environmental problems and in fairness to other members of the community, future generations and other species in the environment.¹¹

4.13 According to the QCC:

Farming organisations are currently mounting a sustained attempt to gain statutory rights to automatic compensation when regulations designed to protect the environment affect the way they use the land, or, specific to the topic of this Inquiry, when regulations affect farmers' access to and use of water. Their arguments are largely based on some dubious and erroneous assumptions about the nature of rights and the nature of property.¹²

8 Transcript of evidence, p. 157; Submission no. 116, p. 6.

9 Transcript of evidence, p. 159.

10 Submission no. 161, pp. 8–9.

11 Submission no. 126, p. 16.

12 Submission no. 126, p.10.

- 4.14 The Committee is in accord with farmers' desire to have security of access to water, believing that security of access is vital to the economic and social development of regional communities. Water entitlements should be granted in perpetuity. This does not preclude effective environmental management, as these entitlements will be subject to environmental planning processes. These planning processes should be inclusive and transparent.
- 4.15 Clearly defined, perpetual water entitlements are fundamental to the whole rural water reform process. This issue has gone unresolved too long. The Committee recommends that the Commonwealth Government, together with its COAG partners, make the establishment of a national system of perpetual water access entitlements a top priority under the National Water Initiative.

Compensation

- 4.16 For water users, the question of defining rights is critical not only for defining use, but also for defining what is lost when entitlements are removed and how that loss will be compensated.
- 4.17 In its submission to the Inquiry, the VFF indicated its strong belief that where access rights are reduced compensation 'at the going market value of water' should be paid.¹³ At the Committee's hearing in Deniliquin, Mr Bill Hetherington, Chairman of Murray Irrigation Limited, stated, that water rights were 'the No. 1 priority with us', and that 'Structural adjustment and compensation is the No. 2 priority. Just terms compensation needs to be spelt out by the Commonwealth right now'.¹⁴
- 4.18 Mr Chris Davis, Chief Executive Officer of the Australian Water Association, used moral arguments to make the case for compensation:
- ...in many instances the farmers were there because government encouraged them to be there and they would not have set up independently without that promotion and assistance to do it. From that point of view, morally you would say that the government actually owe them because they were responsible for putting them up.¹⁵

13 Submission no. 73, p. 1.

14 Transcript of evidence, p. 479.

15 Transcript of evidence, p. 551.

- 4.19 Mr Ian Thompson of the Department of Agriculture, Fisheries and Forestry (DAFF), put the Federal Government's view when he told the Committee:

The position that our minister and the department have is that, if water is to be obtained for public purposes, those who own the water now should not be worse off after the public has obtained it.¹⁶

- 4.20 Despite there being no provision for compensation under South Australian legislation, Mr Peter Hoey, Executive Director, Murray Darling Division, of the South Australian Department of Water, Land and Biodiversity Conservation, told the Committee: 'There is no certainty in anything, but if governments consciously make decisions that affect livelihoods I think there is a strong case[for compensation].¹⁷ He went on to emphasise the need for Federal-State cooperation and coordination on this issue. He was 'convinced that there is a key role for the Commonwealth in working with the state or the states over that issue and getting some consistency across the country'.¹⁸

- 4.21 In its submission, however, the Queensland Conservation Council (QCC) questioned whether compensation is appropriate:

Inherent in calls for compensation is the view that what has traditionally been permitted (and fostered in some cases) by government constitutes a compensable right if no longer permitted. This viewpoint fosters a very static view of society and land use practices. Thus, historical negligence, ignorance or the predominance of certain values about the environment have generated expectations about the future which farming organisations want to turn into rights. But frustrated expectations are *not* equivalent to withdrawn compensable rights. Rather, one could argue that many landholders have benefited at the expense of the environment and society through damaging farming practices. We don't argue that these landholders should compensate the environment and society (although it is logically sound); we argue, rather, for the adoption of reasonable practices with community sharing of the costs of transition in some cases.¹⁹

16 Transcript of evidence, p. 536.

17 Transcript of evidence, p. 341.

18 Transcript of evidence, p. 341.

19 Submission no. 126, p. 11.

- 4.22 The QCC thought it a dubious argument that the public pay individuals to resist degrading what exists. The public benefited from the continued existence of native vegetation and environmental flows, but should not pay individuals in order for that benefit to be retained. However, there was an argument for paying land managers to manage the environment for public benefit—payment for positive actions.²⁰
- 4.23 The Committee believes that those who hold water licences now should not be worse off if that water is obtained for other purposes. The question is what form that compensation should take.
- 4.24 Amongst farmers there was some scepticism as to the value of structural adjustment payments, and what they would achieve. In evidence before the Committee, Mr Leigh Chappell, Secretary/Treasurer of the Murray Valley Groundwater Users Association, said:
- The compensation that they talk about is just a one-off payment or they talk about structural adjustment. With the rules that they have in place for structural adjustment, you might as well try to get blood out of a stone as get the money for that. It is so unsuitable, because the structural adjustment they give you is for water saving efficiencies ... You cannot make some farms around here any more efficient under present technology. The decision makers are trying to solve our problems with a complete lack of understanding and with misinformation.²¹
- 4.25 Mr George Warne, General Manager of Murray Irrigation Ltd, argued for 'just terms acquisition', with water rights being given the same treatment as land title.²²
- 4.26 Mr Lawrence Arthur, Chairman of Irrigators Inc., told the Committee:
- ...we have often said to New South Wales, 'If you want our water, don't come and take it off us. You buy our water.' So I think sometimes we are guilty of giving a mixed message. We would prefer to keep the water in our districts. But if it comes to a point of across-the-board cuts where, as proposed by the Wentworth Group, the government says, 'We are going to knock one per cent a year off for 10 years without any compensation,' I think you will hear that every irrigator prefers the situation whereby

20 Submission no. 126, pp. 10-12.

21 Transcript of evidence, pp. 495-6.

22 Transcript of evidence, p. 494.

governments do enter the market. We would prefer them to go through a regime of looking at systems savings first and other ranges and actually entering the market as a last resort. But if it comes to that compared with across-the-board cuts, you will find that irrigators are looking for that compensation component.²³

4.27 According to the NSW Irrigators' Council, legislation should compel governments to first explore more innovative investment solutions before resorting to just terms acquisition, including, in order of priority:

- System savings—investment in system and on-farm savings and efficiencies;
- Market schemes—voluntary market-based buyback where government either “stands” in the market or initiates reverse tender schemes;
- Just terms acquisition.²⁴

4.28 The Committee agrees with the desire of farmers to retain their current entitlements, where possible, and to obtain just terms compensation where this is not possible. While it is clear that where over-use of water has reached unsustainable levels then water use must be reduced, it is also clear that dramatic changes to levels of water use will have significant social and economic ramifications. Required water ‘savings’ are best generated firstly, through greater water use efficiency; secondly, through voluntary acquisition using market mechanisms; and finally, through compulsory acquisition with just terms compensation.

4.29 The Committee is particularly aware that the Commonwealth has a constitutional obligation to provide just terms compensation and that States do not have the same obligation. The Committee strongly believes that changes in water availability due to changes in public policy which have a direct and punitive impact on water users should result in financial compensation. It believes that all States should adopt a just terms compensation approach in respect to water issues.

23 Transcript of evidence, p. 486.

24 NSWIC, Submission no. 105, p. 759.

A uniform system of water access rights

- 4.30 The Inquiry received a considerable amount of evidence recommending a greater degree of uniformity or harmonisation of water access rights across jurisdictions.²⁵
- 4.31 According to Mr Theo Hooy of the Department of Environment and Heritage, there were some 20-plus different water products, all with fundamentally different characteristics, across the Murray-Darling Basin, making a fully functioning, free and transparent trading market very difficult. A measure of compatibility between the states is required for trade to occur.²⁶
- 4.32 The need to harmonise entitlements across jurisdictions was stressed by Dr Blackmore of the MDBC. He also gave an example of how the present diverse system could be manipulated :

There needs to be a sense of harmony about the access provisions in the states so we do not have distortions. New South Wales have a 15-year licence, but with a 10-year review, and a set of rules on how that will be operated. Victoria have no such review provisions. In South Australia the minister can call a review at any time that suits him and make an adjustment without compensation. To give you an example, let's say I am a New South Wales irrigator and I have set up interstate trade. I am at year 9 in the New South Wales cycle and I say, 'Hang on, I do not know what New South Wales are going to do.' So I trade 100 per cent of my water to somebody in Victoria, into a holding company ... I wait to see what New South Wales do: they will either increase or decrease the allocations ... I wait until that dust settles and then I trade 100 per cent of my water back and I have kept it.²⁷

25 Groups which supported uniform water entitlements included the Australian Water Association (transcript p. 542); Twynam Group (transcript p. 608); Irrigators Inc. (submission no. 109); and Environment Business Australia (submission no. 173).

26 Transcript of evidence, p. 445.

27 Transcript of evidence, p. 401.

- 4.33 In its evidence before the Committee, the South Australian Farmers Federation (SAFF) urged the Commonwealth to push for ‘uniform property rights’, although a precise model was not defined. Moreover, the difficulties in creating a uniform system were fully recognised, SAFF noting that the different states all have slightly different views of what uniform rights would mean, particularly their implications for compensation.²⁸
- 4.34 The views of the Victorian Farmers Federation (VFF) with regard to uniform property rights illustrates that uniformity is not seen as a positive step by all concerned. Victorian farmers see the push for uniformity as a threat to their security of tenure. Mr Manners told the Committee:
- In general terms the VFF support the system of water rights and allocations that has been in operation in Victoria for 100 years ... We are a little concerned ... that there is pressure for a national system of water rights. I guess there is apprehension within Victoria that a national system will in some way water down what we have developed and enjoyed in Victoria.²⁹
- 4.35 In the Committee’s view, part of the problem of introducing a system of uniform water rights is that different industries have grown out of the different systems of water rights—imposing a uniform system upon these industries could necessitate considerable structural adjustment. On the other hand, a failure to bring some degree of commonality will prevent trade reaching its full potential and increase the pain of structural adjustment.
- 4.36 The essential difference revolves around different degrees of security which should be a surmountable issue. Entitlements do not have to be identical in order to be traded, but they do require a common framework upon which trading in entitlements with different levels of security can be based.
- 4.37 Professor Mike Young, Director of the Policy Economic Research Unit, Land and Water Division, CSIRO, told the Committee that there were considerable potential dangers with attempting to create a water market under the existing plethora of different entitlements.³⁰ His solution was to return to first principles and rebuild the system of entitlements:

28 Transcript of evidence, p. 326.

29 Transcript of evidence, p. 247.

30 Transcript of evidence, p. 465.

What we clearly need is an entitlement system that steps out of all the mess we have got ourselves into—one that is designed for trading and also includes water quality in the whole process. Setting up a market that does that could ease the costs of adjustment.³¹

- 4.38 In their paper *Robust Separation: A search for a generic framework to simplify registration and trading of interests in natural resources*, Professor Mike Young and J. C. McColl, of CSIRO Land and Water, outline a template for water entitlements that is both simple in conception and robust in construction, having been built on longstanding precedents in property and company law.³²
- 4.39 At the heart of the proposed system is the separation of the different components of a water property right:
- The entitlement—the long-term interest (share) in a varying stream of periodic allocations;
 - Allocations—a unit of opportunity (usually a volume) as distributed periodically; and
 - The use licence—permission to use allocations with pre-specified use conditions and obligations to third parties.³³
- 4.40 A key component of the entitlement process would be registration of interests under the Torrens Title system, which would provide a high degree of specificity and protection to entitlement holders and third parties, such as banks and water traders, with a financial interest in an entitlement. The Torrens Title system is in the process of being implemented in New South Wales and South Australia.³⁴
- 4.41 It is the view of the Committee that the Robust Separation model would provide the necessary framework for a system of tradeable entitlements that could operate efficiently and effectively across State borders.

31 Transcript of evidence, p. 465.

32 M. D. Young & J. C. McColl, *Robust Separation: A search for a generic framework to simplify registration and trading of interests in natural resources*, CSIRO Land & Water, September 2002. This was presented as an attachment to Submission no. 59.

33 Young & McColl, *Robust Separation*, p. 27.

34 Young & McColl, *Robust Separation*, pp. 35–6; Productivity Commission 2003, *Water Rights Arrangements in Australia and Overseas*, Commission Research Paper, Productivity Commission, Melbourne, p. 115.

- 4.42 In its detailed submission to the Inquiry, the New South Wales Irrigators' Council (NSWIC) described a system of water rights and the principles underlying it, which appeared similar in nature to the Robust Separation model.³⁵
- 4.43 The Committee believes that the National Water Initiative should aim for a system of tradeable entitlements that can operate efficiently and effectively across State borders. The Robust Separation model, in conjunction with other Committee recommendations, appears to meet the expectations set out by the NSWIC, and others such as the Southern Riverina Irrigation District Council³⁶ providing both security and flexibility while establishing a common basis for the current array of entitlements. The Committee recommends that this model be carefully assessed by the National Water Initiative.

Recommendation 10

- 4.44 **The Committee recommends that the Commonwealth urge the Council of Australian Governments to give top priority to the establishment of a clearly defined and robust system of perpetual water access rights under the National Water Initiative, and that the Robust Separation model proposed by the CSIRO be evaluated as a possible system for establishing such water access rights.**

Water trading

- 4.45 Professor Cullen identified trade as another vital aspect of the COAG water reform process that had not come fully to fruition. He told the Committee:

We frankly do not have a trading system at the moment that lets water move from low value use to high value. We do not have a transparent market that lets water move around—for example, the Murray–Darling Basin—and facilitates interstate trade ... The trading needs a bit more work to get an operating market, in my view.³⁷

35 Submission no. 105, p. 10.

36 Submission no. 106.

37 Transcript of evidence, p. 2.

- 4.46 Although most of the evidence received by the Committee supported the concept of water trading, some opposed it. For example, in its submission to the Inquiry, Burdekin Shire Council announced itself ‘strongly opposed’ to the transferability of water allocations, stating that ‘Council considers that there may be detrimental environmental impacts if water allocations are transferred’.³⁸
- 4.47 On the other hand, Hydro Tasmania was an ardent advocate of trade:
- It is now necessary to refine the existing policies, processes and infrastructure to encourage water to be transferred via commercial trades between competing water users. Any such transfer should be between willing parties. A water market is the only viable means of reallocating water between conflicting uses, both existing and future, as it allows and encourages the transfer of water from less efficient or productive uses to other higher value uses ...
- A functioning water market allows new irrigators to obtain water for high value initiatives and encourages movement away from inefficient water use practices. This can be achieved without the need for new regulation and external intervention.³⁹
- 4.48 Ms Deborah Cope of the NCC outlined the principal benefits to be derived from water trading. She suggested that from an economic gain point of view, water would go to those particular crops where you got the biggest return from the water, which, she noted, ‘is particularly important when we are talking about a very scarce resource. We want to make sure that we use it in a way that maximises the gains from it for Australia’. Water trading would mean that the people who got high returns from the use of water would tend to be the people who bought and used water.⁴⁰
- 4.49 Mr Thompson (DAFF) also emphasised the benefits of trade as a mechanism for allowing industries to evolve without the need to pick winners. He did not think governments should say, ‘We don’t have this industry; we do have that one. Water will move from here to there from on top’.⁴¹

38 Submission no. 15, p. 1.

39 Submission no. 40, pp. 1-8.

40 Transcript of evidence, p. 237.

41 Transcript of evidence, p. 537.

- 4.50 In its submission, the National Farmers Federation argued that it ‘is vital that a competitive and efficient market for water is achieved’.⁴² Likewise, the South Australian Farmers Federation supported the pricing and trading of water according to market principles.⁴³
- 4.51 The Victorian Farmers Federation endorsed water markets, but with caveats as to transparency of operation and price:
- The VFF is supportive of the application of market mechanisms for the efficient allocation of the nation’s limited water resources. But, water trading must occur through clearly defined water markets that are open and transparent.⁴⁴
- 4.52 Mr Manners of the VFF spoke of the growing sophistication of the water market in Victoria, and emphasised the positive benefits of water trading for water use efficiency:
- There is a financial incentive for a farmer to improve his water use efficiency in a tradeable market with water. This year it was worth \$500 a megalitre at the peak, which is a very strong financial incentive to farmers to improve their water use efficiency, to sell what they save or whatever. The dollar is a very strong driver.⁴⁵
- 4.53 Mr Ian Johnson (QFF) also gave his support to water trading, while emphasising the physical limits to trading in Queensland.⁴⁶
- 4.54 Even as there are considerable benefits to be derived from water trading, the Committee acknowledges there are also potential risks which need to be properly assessed. While supporting water trade in principle the NSWIC was concerned that trade not be viewed as the ‘solution to all our problems’, or ‘as a substitute (a poor one) for necessary structural adjustment processes’.⁴⁷
- 4.55 Mr Doug Miell, Executive Director of the NSWIC, emphasised that the water market, like any other market, required appropriate rules for its successful operation.⁴⁸ Professor Cullen also identified the need to establish rules to prevent undue economic and social impacts arising from
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42 Submission no. 168, p. 3.

43 Transcript of evidence, pp. 328–9.

44 Submission no. 73, p. 1.

45 Transcript of evidence, p. 251.

46 Transcript of evidence, pp. 164–5.

47 Submission no. 105, p. 20.

48 Transcript of evidence, pp. 576.

trade. The market would not be 'a free-for-all'. It would have to be 'a highly managed market' to minimise any negative impact on regional communities.⁴⁹

4.56 Strong reservations about open-ended water trading were expressed by irrigator representatives the Committee met at its public hearing in Deniliquin.

4.57 Mr Warne of Murray Irrigation⁵⁰ told the Committee that his company 'had been actively involved in water trade for almost a decade, and operated Australia's only internet exchange that is live and accessible 24 hours a day during the irrigation season'.⁵¹ He explained that his shareholders are 1,600 irrigators and they had decided early on to prohibit the sale of water out of the district. He said:

So communities and farmers alike have realised that bringing water into your farm business or into your community increases the potential wealth of the community and there is enormous enthusiasm for trading water in, but there are barriers in almost every irrigation community, district and river system to trading water out. A lot of those barriers are not physical; they are simply the community recognising that they want the water retained in that community for its future prosperity.⁵²

4.58 Mr Warne mentioned the negative socio-economic impacts on the Kerang region due to the permanent sale of eight or nine percent of its water out of its region.⁵³ Mr Michael Barlow representing Moira Private Irrigation District endorsed Mr Warne's comments. He confirmed that trading of water out of his group was prohibited on the basis that water was essential for the future well-being of the farms which made up Moira Private Irrigation. He explained:

Once we start getting rid of water out of our system, it would become uneconomical because the costs would become prohibitive, and the whole system would slowly collapse.⁵⁴

49 Transcript of evidence, pp. 6, 13.

50 Murray Irrigation Limited is the largest privatised irrigation company in NSW. MIL is now owned by 1,600 family farm businesses and provides irrigation and drainage services to 2,400 farms in an area covering nearly 800,000 hectares.

51 Transcript of evidence, p. 482.

52 Transcript of evidence, p. 482.

53 Transcript of evidence, p. 482.

54 Transcript of evidence, p. 484.

4.59 Mrs Deborah Kerr, representing Irrigators Inc., downplayed the perceived benefits of trade, both as a mechanism for moving water to higher value production and as a mechanism for structural change. Moreover, irrigators understood the intrinsic value of their water to their businesses and livelihood. They would not sell water, unless forced to do so, for short term gain:

Irrigators believe that their licence is intrinsic to their property, to their livelihood, to the profitability of their enterprise and they are not going to willy-nilly sell their licence just because somebody is offering them a higher price, because they know long term their farm is going to suffer. Irrigated agriculture is the highest value agriculture in Australia. Most of it is produced off one per cent of the arable land. A lot of those factors are not taken into consideration in any of these arguments.⁵⁵

4.60 Mrs Kerr, Mr Hetherington and Mr Arthur all highlighted the profitability of the rice industry as an example of the success of a crop which is commonly perceived as 'low value'.

4.61 Mr Warne observed that permanent water trade had been dominated by desperate sellers and opportunistic buyers, and that the prices realised were a poor reflection of the real value of water to farm enterprises.⁵⁶ Mr Hetherington and Mrs Kerr, told the committee that the real value of water to their farm enterprises was in the vicinity of \$3500 per megalitre (at least)—'we are not going to bail out for \$200, head off somewhere and think we are going to live a life of luxury after that and leave a district in ruin—no way'.⁵⁷

4.62 The Committee acknowledges these concerns about the assumed benefits of trade. Obviously, both as a mechanism promoting economic growth and structural change, water trading has still some way to evolve, and the ramifications will not be all positive. Nonetheless, the potential benefits from trade remain, and the Committee endorses the aims of the National Water Initiative in encouraging 'the expansion of water markets' with clear trading rules and robust water accounting, and a clear eye to identifying and dealing with any negative consequences which may arise.

55 Transcript of evidence, p. 489.

56 Transcript of evidence, p. 496.

57 Transcript of evidence, p. 495.

Other potential problems with water trading

- 4.63 The Committee received other evidence on potential problems which could arise as a result of the development of water trading. These included: the likely problems arising from any failure to standardise entitlements; the issue of ‘sleepers and dozers’; possible social costs; the potential for ‘water barons’ to emerge; trading in environmental allocations; and the potential problem of ‘stranded assets’.

Adjusting the system of entitlements

- 4.64 In his evidence before the Committee, Professor Mike Young, the Director of the Policy Economic Research Unit, Land and Water Division, CSIRO, told the Committee that there were considerable problems with attempting trade under the current system of entitlements:

If you specify trading arrangements and entitlements in a flawed way, the market will deliver you a flawed outcome. That is guaranteed. Markets reveal what you have specified, rather than your intention. If you look at the way we have designed water entitlements, you see that we just bolted on trading arrangements without going back and designing a system that had a thorough understanding of several key things. This includes the way water flows through a system and what determines water yield; the connections between ground water and surface water; and the fact that, when people irrigate inefficiently, a large proportion of the water flows back into the river and is available downstream. If you do not build all of these things in, you can trade into trouble.⁵⁸

- 4.65 Professor Young’s solution was to return to first principles and rebuild the system of entitlements (i.e. using the robust separation model):

What we clearly need is an entitlement system that steps out of all the mess we have got ourselves into—one that is designed for trading and also includes water quality in the whole process. Setting up a market that does that could ease the costs of adjustment.⁵⁹

58 *Transcript of Evidence*, p. 465.

59 *Transcript of Evidence*, p. 465.

- 4.66 The Committee concurs with the view that an effective water market requires defined, secure and readily transferable and tradable water access entitlements.

Recommendation 11

- 4.67 **The Committee recommends that the Commonwealth Government, working through the Council of Australian Governments, ensures that the system of uniform water access entitlements adopted under the National Water Initiative are fully transferable and tradable, where practical.**

Sleepers and dozers

- 4.68 A drawback of water trading is that it has activated previously little used or unused entitlements. In its submission, Environment Business Australia highlighted the problem:

The move to market-based resource allocation through water markets, with separation of water rights from land, has been successful in lifting the value of the water and redirecting it to higher value uses. However, a consequence of the higher value and greater mobility provided by the markets has been to expose the level of over allocation of water resources. Previously unused or under-used licenses have been ‘awakened’ and traded, the ‘sleepers’ and ‘dozers’, who now find their previously unused licences of significant value. The impact of the activation of these licences has been to increase demand on an already capped water supply at the expense of the existing regular users, whose allocations have been reduced to provide water for these newly activated licences.⁶⁰

- 4.69 Mr Warne explained how water trading had activated previously unused water:

...the MDBC pilot study looked at the trading permanently of water interstate downstream of Nyah on the Murray system. I think the study analysed 51 trades that had occurred, and 49 of those trades were people selling water that had never been used.

60 Submission no. 173, p. 5.

So when you are talking about water going from low value to high value, it was going from never being used as a windfall gain to someone who was obviously going to use it because they were paying quite a lot of money for it, and that water just came out of the pool that was generally available for all other irrigators in the three states.⁶¹

- 4.70 The Committee believes that it would be beneficial if any remaining unused entitlements were removed from the system—if nothing else, this would diminish perceptions of over-allocation. Sleeper and dozer entitlements however are now realisable assets with a market value. They cannot simply be confiscated. The process of identifying and removing such entitlements should be a joint Commonwealth–State responsibility carried out under the auspices of COAG.

Recommendation 12

- 4.71 **The Committee recommends that the Commonwealth ask the Council of Australian Governments, as part of the National Water Initiative, to develop a strategy in consultation with stakeholders, which deals with ‘sleeper’ and ‘dozer’ entitlements.**

Social impacts of trade

- 4.72 In its submission, the Public Interest Advocacy Centre (PIAC) highlighted the potential impact of water trading upon rural residents. While trading might create economic efficiency, the movement of water away from current activities could not be presumed to give equal benefit to all members of the community:

The CoAG agreement on water policy stipulates that the primary consideration in water trading should be the ‘highest economic value use’ ... this approach entrusts to the dynamics of the new market the protection of the interests of smaller and vulnerable water users. However, positive social outcomes clearly are assigned a lower priority than the operation of the market itself. As a result there is nothing in the current water trading framework

61 Transcript of evidence, p. 487.

which promises that water will continue to be available and affordable for rural households.⁶²

- 4.73 Indeed, the PIAC believed that given the dominance of economic power within markets it was highly likely that the social costs and benefits of trade would accrue to different sections of the community. It suggested that trading needs to be undertaken within a framework which allows each stakeholder to identify their costs and benefits in each transfer.⁶³
- 4.74 Concerns about possible social impacts on rural communities were also raised at the public hearing at Deniliquin. Mr Clark (SRIDC) described the social impact the Cap had on his community in the Murray Darling Basin.⁶⁴ Furthermore, Mr Hetherington told the Committee:
- We [Murray Irrigation Ltd] have been the biggest traders in Australia, so trade is going to stay there. But I would remind the Parliamentary committee to have a hard look and start coming down to the areas where the trade is going to take place. Most of these trading rules have been set up by AFFA and company and bureaucrats in Canberra that really do not have a feel for the social implications that are going to follow—the social disillusionment of a lot of the communities in shires, drying out areas and breaking up various productive areas. People such as those might lose in trade, but it is a big debate that has to take place in a proper consultative way. At the moment, we are really afraid.⁶⁵
- 4.75 It is the Committee's belief that if trade is to succeed as an instrument of economic development and environmental protection, then those engaged in affected industries and communities must have a say in the way that markets are established and trading rules operate. Markets must be established in consultation with rural communities and industries, and the progress of change tempered to the needs of community consultation and adjustment.

62 Submission no. 100, p. 8.

63 Submission no. 100, pp.8-9.

64 Transcript of evidence, p. 496.

65 Transcript of evidence, p. 483.

Water barons

4.76 A significant concern about separating water entitlements from land title is the possible entry into the water market of ‘water barons’—rich speculators who buy and sell on the market for profit rather than use.

4.77 This is regarded as a difficult issue and, in some eyes, a real risk.⁶⁶ Mr Theo Hooy (Department of Environment and Heritage), however, downplayed the risk, suggesting that speculators would be ‘fairly brave investors’ to risk the vagaries of the water market:

If you buy water, to take a small example, in a jurisdiction where there are no carryover provisions and you are a water speculator, you have to make sure that that water is off your books. By the end of every irrigation season you will have to have sold it. If you have a wet year and you are a water trader—a person who derives income purely from trading—you will be in a pretty difficult position. I am not sure at all that there are windfall profits to be made by water traders.⁶⁷

4.78 On the other hand, according to Mr Hooy, there are definite risks in restricting ownership to water users:

The property valuers have found it extremely difficult to value a product where tenure, ownership and longevity are uncertain. The banking industry has a legitimate concern. If you introduce fairly bland restrictions on ownership of water by parties other than farmers, for example, it would be very difficult for banks to loan against the water licence, because the normal procedure is that, if a bank loans against property and if there is failure to repay the debt, the bank recalls the land. If the bank cannot claim ownership of the water, it cannot loan against the water right.⁶⁸

4.79 Professor Young (CSIRO) also warned of the difficulties inherent in the proposition that only farmers should own water.⁶⁹

66 Transcript of evidence, pp. 7, 487.

67 Transcript of evidence, p. 447.

68 Transcript of evidence, p. 446.

69 Transcript of evidence, p. 468.

- 4.80 Mr Thompson (Department of Agriculture, Fisheries and Forestry) noted that the key to preventing unhealthy concentration of ownership or speculative trade was establishing a well regulated water market:

In establishing a market for water—an operating market like any other market—it has got to have some regulatory underpinnings to make sure it operates effectively. There are roles in there for bodies like the NCC or the ACCC on how people are behaving in a market so that there is not undue market influence or concentration. They are some of the issues that have got to be worked through in developing an effective market.⁷⁰

- 4.81 Mr Andrew Campbell, Executive Director of Land and Water Australia, acknowledged the risk of concentration of ownership in a free market situation, but did not necessarily see this as a negative as big business has certain strengths:

Certainly it is a particular policy challenge because of the issue of potential concentration of resources, but I do not think it necessarily bad for water management on the whole. The degree of professionalism and the degree of investment in long-term sustainability that those sorts of enterprises can afford puts them in a better position in the long run. The policy framework needs to be cognisant of them but I do not think it should see them as necessarily any better or worse than other water users.⁷¹

- 4.82 The Committee believes that the risks of excessive concentration of ownership in the water market are small, and do not outweigh the problems involved in restricting ownership. Nonetheless, the possible consequences of ‘water barons’ (both private and public sector) dominating the market are serious enough to require effective oversight and regulation of any water market.

Recommendation 13

- 4.83 **The Committee recommends that the Commonwealth, as part of the National Water Initiative, ask the Council of Australian Governments to assess the need to develop policies and measures to prevent undue concentration of ownership of water entitlements in the marketplace.**
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70 Transcript of evidence, p. 534.

71 Transcript of evidence, p. 24.

Asset stranding

4.84 Another concern raised by witnesses was the problem of asset stranding, where water was traded out of a district leaving infrastructure underutilised and, therefore, unremunerative. Mr John Palmer, Manager of the Pioneer Valley Water Board, expressed concern that his organisation was vulnerable to such a scenario under current trading rules, but had little power to do anything about it.⁷² Similar concerns were expressed by Mr Michael Barlow, Chairman of the Moira Private Irrigation District, on the River Murray in New South Wales. He told the Committee that ‘once we start getting rid of water out of our system, it would become uneconomical because the costs would become prohibitive, and the whole system would slowly collapse’.⁷³

4.85 One possible solution to the problem is the use of excision fees to cover infrastructure costs when water users opt out of irrigation networks. However, this option was rejected by Mr Mark Bramston, Chief Executive Officer, Coleambally Irrigation Cooperative Ltd. He told the Committee:

We have done some modelling of those sorts of numbers and we cannot get them to add up in the long term.

Just by way of background, irrigation corporations plan for 50 to 100 years and then sometimes 200 years when we run our infrastructure annuity funds. If you run a discounted cash flow analysis, you can only make it work over 20 years. People put some money into the infrastructure fund and they fund it on a 20-year basis. They do not tend to look at the ongoing operational maintenance costs over the long term. We cannot make excision fees pay the disbenefit it has for the community, and it is tough to make it pay for the infrastructure. I do not see excision fees as a viable model to overcome the disbenefits caused for communities.⁷⁴

4.86 Dr Beare (ABARE) suggested two-part tariffs as a solution to the problem of asset stranding:

That is fixable. One has to recognise that water rights are not just things in dams. Water rights are rights to infrastructure, and water rights are the way you are being charged for your infrastructure and access. That is bundled up in your rights. If you do not do two-part charging on infrastructure charges, you will get stranded

72 Transcript of evidence, p. 110.

73 Transcript of evidence, p. 484.

74 Transcript of evidence, p. 485.

assets. That will happen. If I am in your irrigation area and I sell my water out, the balance of the fixed charges are now levied on a reduced population and the charges go up...The correct water right says that if you are in an irrigation area and you have a fixed set of charges—those charges that are not volumetric sensitive, such as channels et cetera—you cannot escape those charges by selling your water out.⁷⁵

- 4.87 The Committee supports the introduction of two-part tariffs as a remedy to the problem of asset stranding. However, while the Committee is anxious to avoid unnecessary restrictions on trade, there is no doubt that even with two-part tariffs, asset stranding could still be a potential problem. Even where infrastructure is maintained, particularly in gravity fed systems, it is conceivable that once a certain amount of water is traded out of a system it will become unviable. Where this occurs as a result of water trading, there may be a case for structural adjustment assistance for remaining water users.

Conclusion

- 4.88 Having considered all the evidence, in the Committee's view water trading is a key mechanism in ensuring that water is used more efficiently. Water markets allow industries to make better and more flexible use of limited water resources and provide the opportunity for new investment in high value-added agriculture. Trade helps individual irrigators to adjust to changing circumstances and to manage risk. A well-developed water market can stimulate the movement of water to higher value, more sustainable use.
- 4.89 The Committee believes that the Commonwealth could have some powers under the corporations trading powers of Section 51 (xx) of the Constitution, which could allow the Commonwealth to play a leading role in the establishment of a national water market. However, the Committee acknowledges that there is some doubt how this would align with Section 100 of the Constitution. Whilst there is clearly a need for a national approach to establishing a national water trading regime, this is probably best achieved through established COAG processes.

75 Transcript of evidence, p. 391.

Recommendation 14

4.90 The Committee recommends that the Commonwealth ask the Council of Australian Governments, as part of the National Water Initiative, to:

- **facilitate the expansion of water markets and water trading to the greatest extent possible;**
- **establish appropriate trading rules and administrative systems in full consultation with market participants and rural communities; and**
- **establish trading in water free from constraints, other than in accordance with the prescribed trading rules.**