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Our Ref:

Mrs Kay Elson MP
Chair
Standing Committee on Agriculture, Fisheries and Forestry
Parliament House
Canberra
ACT
2600

1/11/02

Dear Mrs Elson

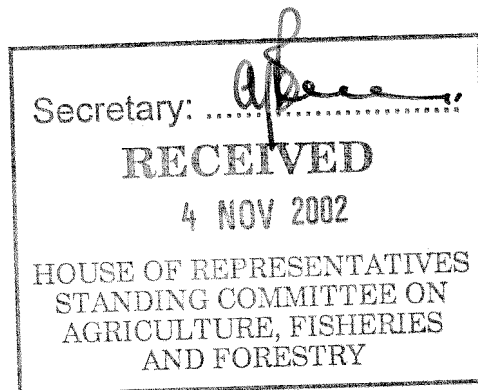
Re: Inquiry Into Future Water Supplies for Rural Industries and Communities

The Public Interest Advocacy Centre wishes to make this formal submission to the Committee's inquiry into rural water supplies. We trust our comments will be of assistance to the Committee during its deliberations.

PIAC would welcome the opportunity to give further evidence through public hearings or to provide any further information which the Committee may require.

Yours sincerely
Public Interest Advocacy Centre

Jim Wellsmore
Policy Officer



1. Introduction

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in Sydney. Established in 1982, it strives to foster a fair and just society by empowering disadvantaged citizens, consumers and communities through strategic legal and policy intervention in public interest issues.

PIAC has established the Utility Consumers' Advocacy Program (UCAP) with funding from the NSW Government.

The main aims of the project include:

- developing policy;
- advocating on behalf of residential consumers of gas, electricity and water services;
- identifying systemic problems with utility service providers;
- ensuring that consumer protection mechanisms work effectively; and
- facilitating the development of partnerships between stakeholders in utility service provision.

A community based Reference Group supports the development of policy by UCAP.

The Public Interest Advocacy Centre (PIAC) welcomes the focus of this inquiry on the future of water supplies for rural communities and the role to be played by the Commonwealth through its policies and programs. Our view is that an ongoing and strengthened role for the Commonwealth is crucial in ensuring reliable and adequate water supply to rural and regional communities.

This submission will discuss the interests of households within the rural water supply system and not agricultural or industrial end-users. PIAC also has a particular concern for the circumstances of Indigenous communities.

2. Role of the Commonwealth

The difficulty facing the Commonwealth in ensuring equity for all Australians in the supply of water services is that in recent times it has ceded much of its ambit to market structures and the other jurisdictions. This has followed the broader economic policy of competitive reform of major infrastructure industries, including domestic water services.

Under national competition policy (NCP) the creation of markets for water has been given a greater priority than the delivery of desirable social outcomes. The Council of Australian Governments (CoAG) 1995 Water Resources Policy¹ stressed that competition reforms should allow for the water industry to 'maximise its contribution to national income and welfare'. This is to be done through delivery agencies being required to have a commercial focus. The Water Resources Policy went on to prescribe that each state and territory would be left to determine whether this commercialised approach would best be achieved through contracting out, corporatisation or privatisation.

¹ National Competition Council, *National Competition Policy Agreements* April 1995 p.99

This relinquishing of responsibility mirrors the process of reform in other industries under the CoAG agreements and the national competition framework. Experience in the national electricity industry suggests that at least some jurisdictions will resist moves by the Commonwealth to assert for itself a role in the water industry - even one aimed at ensuring equity between all Australian communities.

It is important to note that competition reform has the potential to cause significant damage to the interests of Australia's Indigenous peoples. The emphasis on economic value and delivery of services through the market already has been shown to place Indigenous communities at a great disadvantage. The Aboriginal and Torres Strait Islander Commission (ATSIC) has pointed out recently that the national water reform agenda has failed to acknowledge Indigenous interests, for example in relation to native title rights to existing water sources².

3. Governments in the global economy³

A further significant challenge to a renewed role for the Commonwealth is posed by current developments in trade policy. Internationally, governments are facing pressure from global 'services' corporations to agree to reductions in their right to regulate industries such as water. These corporations and certain national governments have identified a trillion dollar industry in water services and are using the current negotiations around the development of the current General Agreement on Trade in Services (GATS) to seek access for private capital to new markets.

In the past, many governments have recognised that regulation of the water industry (for both price and safety), and even public provision, is essential in ensuring equitable access to water. The World Trade Organisation (WTO) November 2001 Ministerial Meeting committed to the removal of all barriers to trade in environmental services. For example, it has been proposed that a 'least trade restrictive' test be applied to national regulation in the areas of licencing and technical standards. This would allow challenges under the WTO disputes process to Australian rules concerning, for example, health standards on the grounds that these present barriers to trade.

There is some ambiguity as to the extent to which all public services are covered by all the GATS rules. Water treatment and sewerage already are listed within the scope of 'services' defined by the GATS. Those supplied on a commercial basis or in competition with other service providers also appear to be fall within these rules.

However, the Australian Government is supporting a European Union proposal to include water services in a broadened definition of environmental services within the GATS. The GATS rules would then be enforceable against water services under the WTO disputes system. This would mean that the policies and programs of all Australian governments with respect to water services would be open to challenge.

² ATSIC and the Lingiri Foundation, *Onshore : Water Rights Discussion Booklet*, published by the Lingiri Foundation, 2002 p.10

³ This section is drawn from a speech titled *Trading Away Our Water* delivered by Dr Pat Ranald, Convenor, Australian Fair Trade and Investment Network (AFTINET) to a seminar for World Water Day 22/03/02, Parliament House, Sydney.

The European Commission, which represents 15 nations in the WTO negotiations, has demanded that Australia agree to the listing of water services as traded goods⁴. This threatens public ownership and price regulation of water services which ensure these remain accessible and affordable to all Australians. The Australian Government has argued that it does not have to agree to these demands. However, as was pointed out by the EU Trade Commissioner, Pascal Lamy, in a visit to this country in July, European nations expect Australia to give ground in relation to the water industry (as well as foreign ownership of Telstra) in return for concessions on barriers to agricultural trade⁵.

It should be noted that Australia signed the GATS Agreement in its current form with little public debate in Australia. While WTO agreements are tabled in Parliament the decision as to which agreements should be entered rests solely with Federal Cabinet.

4. Markets and essential services

The application of national competition policy to the Australian water industry was intended to create a greater reliance on markets for the provision of water services, including to residential users. This inquiry is to examine the prospects for achieving stable and adequate supply for rural households. Implicit in this is the notion of horizontal equity - that consumers should not be forced to accept different levels and standards of service from those enjoyed by their counterparts elsewhere in Australia. It is accepted that some physical and geographical limitations exist to the practical realisation of this principle. Yet, the failure to consider horizontal equity is one of the significant weaknesses of national competition as it is applied to the water industry.

The goal of the CoAG water resources agreement was a larger national market for water. The agreement foresaw a significant level of cross-border trading. However, it ignored the problems posed by the states and territories devising different regulatory frameworks and the problem of social and environmental protections introduced in one jurisdiction being undermined by the rules or practices introduced in another.

This is not a significant issue for urban domestic consumers given that in most cases they enjoy provision by large statutory bodies as well as the operation of sophisticated regulatory oversight of the provision and pricing of this essential service. Rural households, on the other hand, depend on a diverse range of providers – in most cases agencies of local government but certainly within the purview of such authorities. They also are forced to rely on far weaker regulatory protections⁶.

It must be of concern, then, that obligations Australia may accept in the future under a revised GATS would have the effect of restricting the scope of regulatory protection for residential users of water and forcing still more households to depend on the vagaries of the market place for their supply of this essential service. PIAC contends that markets cannot be relied on to deliver positive social outcomes such as adequate, reliable and

⁴ The European Commission document was leaked in April 2002 and reported in the *Sydney Morning Herald*, 17/4/02, p2. It is available at <http://www.gatswatch.org/requests-offers.html>

⁵ *Australian Financial Review*, 'EU wants limits on Telstra lifted', 19/7/2002

⁶ In New South Wales, for example, local government pricing behaviour is discussed only by regulatory principles handed down by the Independent Pricing and Regulatory Tribunal (IPART). Direct regulation under the *Local Government Act (NSW)* is concentrated on standards for the building of supply networks and connections to those networks.

affordable water supply. In particular, markets are demonstrably unable to provide equitable outcomes for the poorest and most vulnerable in our communities.

Our view is that the shortcomings of markets in providing water services to domestic users are well illustrated by historical experience in Australia. The strength of our view is supported by the many decades of public investment in water infrastructure throughout Australia. This public investment arose from the earlier failure of private capital to meet the needs of the broader community. It is not the purpose of this submission to argue for an abandonment of competition reform. However, a decision to rely increasingly on the market to provide water to domestic users flies in the face of the historical evidence of market failure.

To illustrate our comments we refer to the example of historical water supply in Broken Hill⁷. Faced with growing pressure from the thriving mining town community the NSW Government in 1889 had legislated for a private monopoly. Within two years the new company was transporting water from South Australia by rail. A local reservoir was built but by 1903 the private company again was failing to meet demand leading to the NSW Public Works Department absorbing both the company and its infrastructure in 1915. In the interim the local Chamber of Commerce had resorted to employing the services of a private 'rainmaker' to boost the availability of water for town supply. Finally a local Water Board was created by statute in 1939.

In this case market failure triggered public intervention. If private investment is to be relied on in place of public provision then market failure can be avoided only if investment is directed towards the widest range of possible activities and sites. The imperative for governments in such cases is to offer the greatest return on that investment. Thus prices tend to be set by the 'highest common denominator' and irrespective of the capacity to pay exhibited by consumers. This becomes a particular problem when the market is relied on for the provision of an essential service and (as largely is the case with water) a natural monopoly.

In Ghana, the World Bank and International Monetary Fund have provided aid in return for the national government instituting a number of public-private partnerships including in the water industry. Following demands for 'market level' prices the Ghana Water Company announced in late 2001 that tariffs would rise by 300%⁸. This has been likened to charging prices for water equivalent to those in London for a country where many families are surviving on less than US\$1 per day.

In Bolivia in late 1999 the privatisation of the water company in the regional city of Cochabamba was promised to bring improvements in the water supply system. However, the company subsequently announced that it would support the raising of capital for new works by raising water prices an average of 30%. The protests against water prices combined with other social issues culminated in two days of violent street blockades⁹.

⁷ Lloyd, C. and Howell, D. 'Institutional Arrangements for Water in Australia' in Johnson, M. and Rix, S. *Water In Australia*, Public Sector Research Centre, University of NSW, 1993 p.55

⁸ Christian Aid, *Master or servant? : How global trade can work to the benefit of poor people*, November 2001, available at www.christian-aid.org.uk/indepth/trade.htm

⁹ *The Economist*, 'Water war in Bolivia', 12/2/2000, p.43

We note that the *Water Resources Policy* similarly prescribes that water charges should be levied at a level consistent with full-cost recovery and achieving positive real rates of return.

Given the impact of markets on social equity there must be serious doubts about the capacity of a market for water to meet social and environmental goals. Indeed, market failure has been observed even in successful and stable markets for essential services. For example, low-income consumers have been excluded from the new markets in competitive energy retailing in NSW and Victoria. Despite the technical existence of a 'choice of retailer' the great majority of households remain in a quasi-monopoly relationship with an incumbent supplier. The explanation is that the majority of households are not commercially viable as customers of private, competing businesses - largely as a result of their comparatively low consumption. The benefits of the market thus are accruing only to those households above a high threshold income and who have a similarly high level of consumption. This mirrors the experience in overseas markets¹⁰.

5. Commonwealth programs

Notwithstanding any obligations Australia may accept under a revised GATS, the Commonwealth already accepts the shortcomings of markets in providing equitable access to services, including in the area of water and sewerage. Indeed, there is a further recognition that the most appropriate model for ensuring equitable access to essential services does not always involve the ceding of responsibility to the states and territories.

The Commonwealth for several years has directly funded a program which enables rural and isolated Aboriginal communities to gain an adequate water supply system. This funding is provided to the Aboriginal and Torres Strait Islander Commission (ATSIC) for its Environmental Health Program as part of the National Aboriginal Health Strategy (NAHS).

By acting to fill the gaps left by the market and the jurisdictions in respect of these communities the Commonwealth has demonstrated that it can and should play a role in implementing the principle of horizontal equity. The original CoAG agreement failed to recognise this opportunity since it focussed on the creation of a market for water ahead of the achievement of positive social outcomes. It might be argued that this follows naturally the reliance on market dynamics prescribed by NCP. This does not, however, change the fact that markets have not been observed to achieve such benchmarks.

The capacity of the Commonwealth to intervene directly with respect to local government agencies is limited by the absence of any valid powers to act over this level of government. However, the framework for the remaining competition payments to the states and territories could be an opportunity to ensure that all rural households can enjoy some measure of uniform entitlements to adequate and stable supplies of water.

¹⁰ In Britain, for example, after a much longer period of retail competition only around one third of households have switched supplier. The most recent figures are available from www.ofgem.gov.uk/prices/switching.htm

6. Design of a water market

A recent non-government review of the introduction of water markets internationally¹¹ made an important point about the wisdom of having the allocation of water rights being determined in the marketplace. It quoted George Wurmitzer, mayor of the Austrian town of Simitz, who argued that:

'It is a sacred duty to help someone who is suffering from thirst. However, it is a sin to transfer water just so that people can flush their toilets and wash their cars in dry areas...It makes no sense and is ecological and economic madness'.

Some policy makers and economists see water trading as a solution to the problems of growing urban populations throughout the world being faced with constrained water supply¹². Australian cities are confronting this problem with the communities of both Sydney and Melbourne already debating the future balance between supply and demand. This raises the possibility that water markets in Australia could be a means to enable metropolitan residents to purchase more of their water needs from rural areas and thus consume still greater volumes and at lower cost. While economically viable perhaps, such an outcome surely would be extremely damaging to the wider environment.

Studies of water markets in the United States show that in most cases water is being moved from agricultural activities to urban use¹³. One analysis of this pattern of trading would suggest that the movement of water simply is following the path of efficiency - from low-value traditional agricultural use to higher value use by urban consumers and industry. On the other hand, the high level of consumption by some agricultural activities (irrigation for example) might make it inevitable that early trading would move water in this direction.

Analysis of water trading in Australia suggests that in our case the new water market is following a different pattern from that of the United States. A review of an initial two year pilot trading program in the Murray-Darling system indicates that trading primarily has taken place between agricultural activities rather than moving water away from primary production to urban consumption or industrial uses¹⁴.

It is suggested that a major reason for this pattern of trading had been a period of major growth in viticulture. On the other hand, the authors of the review noted that the trial had revealed trading activity involving only a very small proportion of the total volume of water rights available. Other studies of trading behaviour and expectations on the part of water rights holders have suggested that the Australian market is characterised by conservative attitudes towards trading.

¹¹ Barlow, M. *Blue Gold : The Global Water Crisis and the Commodification of the World's Water Supply*, Council of Canadians, 2001

¹² Holden, P. and Thobani, M., *Tradable Water Rights : A Property Rights Approach To Resolving Water Shortages and Promoting Investment*, Policy Research Working Paper 1627, World Bank July 1996

¹³ Gollehon, N. 'Water Markets : Implications for Rural Areas of the West' in *Rural Development Perspectives*, vol. 14 no.2. U.S. Department of Agriculture, September 1999 p.57

¹⁴ Young, M., Hatton, D., Stringer, R. and Henning, D. *Inter-State Water Trading : A Two Year Review*, CSIRO Land and Water, December 2000 pp.13-16

This might lead some to prescribe a more aggressive approach by Australian governments towards stimulating an active water trading market. Demands for further action by the Commonwealth in this regard would mirror those currently being aired in respect of the national electricity market. As with electricity, there may well be resistance from some jurisdictions to further intervention and regulatory activity by the Commonwealth in the electricity industry. Certainly PIAC does not believe that there is a need for direct intervention to drive up the level of trading.

However, an opportunity does exist for the Commonwealth to act to ensure that the market does not operate in a way which distorts the future choices of rural communities or which might create disadvantage amongst consumers.

7. Impact of trading

The CoAG agreement on water policy stipulates that the primary consideration in water trading should be the 'highest economic value use'. As noted above, 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 which promises that water will continue to be available and affordable for rural households.

For example, New South Wales has based its market on a system of prior allocations to such uses as town water and environmental flows. It is not certain that consumers in other jurisdictions will be guaranteed the same safety net of water being allocated to domestic use ahead of commercial trading.

Environmental concerns and the health of water sources receive some consideration in the CoAG agreement. The New South Wales arrangements under the State's *Water Management Act 2000* reflect the requirements of the national policy. These requirements can be traced back to the doctrine of 'public trust' which insists that governments hold such water in trust for the entire community. Yet, the premise of the national policy on water trading is that it is the market which rightly should determine the sharing of water and its movement between activities of different economic values. So the market is as likely to move water to more thirsty, and environmentally challenging, crops such as rice and cotton as it is to promote more environmentally sensitive use of water.

Already there have been political claims made for compensation by agricultural producers who see their traditional access to water being threatened by the system of prior allocations. It is arguable that the absence of a market has meant a traditional undervaluing of these historic water rights. However, the norms of the market result in the economic value of water being prioritised ahead of the environmental gains from water being used for more sustainable purposes. Furthermore, there has been no acknowledgement that the movement of water away from unsustainable activities could generate a considerable windfall for some primary producers, perhaps irrigators chief amongst them, as they sell their now valuable rights in an open market.

Such claims for compensation point once more to the limitations of markets in relation to social outcomes. While trading may create economic efficiency, the movement of water away from current activities cannot be presumed to give equal benefit to all members of the community. Indeed, given the dominance of economic power within markets it is highly likely that the social costs and benefits will accrue to different sections of the community. It has been suggested that trading needs to be undertaken within a framework which allows for each stakeholder to identify their respective costs and benefits in each transfer¹⁵. Several jurisdictions in the western United States have a system for the vetting of water transfer contracts which allow for third parties who would suffer deleterious effects from a proposed trade to lodge objections.

The question of economic power is especially pertinent to isolated Aboriginal and Torres Strait Islander communities or those adjacent to rural centres and towns. Unfortunately, there is ample evidence that planned provision of water supplies too often has failed to serve the interests of Aboriginal people¹⁶. This should not be seen to encourage the use of commercially based solutions for the supply of water to Indigenous communities. As noted above, the impact of commercial development of water supply to communities such as these can be expected to be damaging, at least in terms of the cost of access.

In the short term it seems unlikely that rural households generally will lose out in the market place to agricultural and industrial demands for water. The CSIRO review of the initial two year water trading period found the vast bulk of trading dealt with 'new' water - that not previously being used for any purpose. This contrasts with some international experience. For example, in Arizona water market reforms resulted in a contraction of agriculture as water rights were secured for proposed urban housing developments¹⁷. However, the reality of a market is that some communities will have a greater economic power and hence capacity to purchase the water rights. This raises the possibility of one group of residential consumers being 'squeezed out' from accessing water at an affordable price.

For rural consumers, lacking the regulatory oversight of prices enjoyed by urban consumers, the longer term concern is the 'gatekeeper effect' as competition drives up prices for access and supply. The competition reforms to the water industry already have been evidenced in changes to many household bills with increases in costs for water and sewerage services.

The CoAG agreement emphasised competitive market outcomes and the use of full cost pricing in order that private capital not be excluded from these markets. A revised GATS could strengthen this requirement further. As Professor John Quiggin has explained¹⁸, the introduction of private investment generally results in consumers paying higher prices. Briefly, this is a function of the higher rates of return demanded by private business by comparison with public investment. Where privatisation of, for

¹⁵ Gollehon p.63

¹⁶ See, for example, the case study of Dareton in HREOC, *Water : A Report on the Provision of Water and Sanitation in remote Aboriginal and Torres Strait Islander communities*, Federal Race Discrimination Commissioner, Human Right and Equal Oppportunity Commission, May 1994 p.291

¹⁷ Gollehon p.61

¹⁸ Quiggin, J. 'Sums starting to sink in' in *The Australian Financial Review*, 1/8/02 p.63

example, water supply systems has resulted in lower prices being reported it appears this has been achieved at the expense of providing fewer services or lower quality¹⁹. The notion that competition (or proxies for privatisation such as corporatisation) invariably leads to consumers paying lower prices for services was shown long ago to be a fallacy. The then Industry Commission was predicting in 1995 that competition reforms in water would see residential consumers in Australian cities facing price hikes as large as 20%²⁰. Privatisation of water enterprises in Britain in the late 1980s was followed by price increases for domestic users as high as 108%. This in turn forced adjustments to government welfare payments.

In the short term, reforms to the Australian water industry are unlikely to cause changes as dramatic as these. Yet, the Victorian Government has had to respond in a similar fashion to the outcome of competition in the retail electricity market. A program of subsidies to rural households has been introduced to compensate for increases in prices which have begun to occur after the commencement of full retail competition in energy. This will be an ongoing commitment of the Government and is expected to cost some \$118 million in the first year alone. In South Australia all residential consumers, rural and urban, face electricity price hikes of 25% after the State's independent released its plan for a fully competitive energy market²¹.

¹⁹ Holden, P. and Thobani, M. p.12

²⁰ See Ranald, P. 'National Competition Policy' in *Journal of Australian Political Economy* no.36, December 1995

²¹ South Australian Independent Industry Regulator, *Electricity Retail Price Justification : Final Report*, September 2002

Lyons, Marlene (REPS)

From: Brien, Andrew (REPS)
Sent: Friday, 1 November 2002 12:51 PM
To: Lyons, Marlene (REPS)
Subject: FW: PIAC sub on rural water

Another sub.

-----Original Message-----

From: jim [mailto:jwellsmore@piac.asn.au]
Sent: Friday, 1 November 2002 12:36 PM
To: Brien, Andrew (REPS)
Subject: PIAC sub on rural water



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Dr Brien,

Please find attached two copies of our submission to the Committee. One is a Word document and the other is a pdf (Acrobat) file. I also can send a hard copy if that is preferred. This has ended up being not as long as I anticipated - but I think we are happy with the quality. I hope the Committee will find it of value.

I also wanted to thank you for your assistance in understanding the needs of the Committee members. I think it has made for a better submission.

As we discussed over the phone, PIAC certainly is willing to appear before the Committee if and when a decision is taken that this would be appropriate.

Regards,

Jim Wellsmore
Policy Officer

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