Chapter 3

Issues to do with water access entitlements

3.1 A long standing item of the water reform agenda has been the perceived need for more secure rights to water. This contrasts with the historical situation where water has been granted by periodic licence, and government could refuse to renew the licence, for whatever reason, without compensation.

3.2 Secure title is necessary to encourage investment in efficiencies of water use: farmers must have confidence that if they invest in efficiencies, the water they save will not be taken away without compensation. Secure title, with separation of water rights from land, is a prerequisite to wider trading: it must be clear what the property is that is being traded.

3.3 The IGA commits the States to create a system of 'water access entitlements' separate from land. An entitlement is to be a 'perpetual or open-ended share of the consumptive pool of a specified water resource, as determined by the relevant water plan' . Water access entitlements will be:

- exclusive;
- able to be traded, given, bequeathed or leased;
- able to be subdivided or amalgamated;
- mortgageable;
- enforceable; and
- recorded in a publicly accessible reliable water register. (IGA, s28ff)

3.4 The last point is important to expedite informed trading. Prof. Young commented that actions so far to separate water rights from land have had the unfortunate effect of recreating 'old systems title' for the water, with all the costs and uncertainties that this creates for transfers. He recommended, and the Committee agrees, that a Torrens title system is preferable.[1] The Committee notes that the NSW government wishes to have this in place within three years.[2]

3.5 Submitters to this inquiry, who were mostly rural interest groups, approved the move to more secure title (although some did have concerns about the related

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1 Prof. M. Young, *Committee Hansard* 11 December 2002, p.27. Torrens title: a system in which the law declares that ownership of land is as shown in a register maintained by the state. This removes the need for buyers to check the entire previous chain of transactions in order to be sure that the seller has good title.

2 Mr P. Sutherland (NSW Department of Infrastructure, Planning & Natural Resources), *Committee Hansard* 15 July 2004, p.789.

matter of water trading, considered in chapter 4). The Committee comments on some concerns that have been raised elsewhere:

- whether secure title will impede environmental management needs;
- concerns about giving public property to farmers.

Whether secure title will impede environmental management needs

3.6 Some environmentalists have criticised the scheme of water access entitlements from a fear that it will lock in a certain amount of irrigation water use, and this will make it harder to reclaim water for the environment in future.[3]

3.7 The concern appears to rest on a misconception that the proposed entitlement is to a certain fixed amount of water. This is not the case. There are places in the world where rights are to a fixed volume, but Australia is not one of them.[4] In Australia an entitlement has been, and will continue to be, a right to a certain *share* of the 'consumptive pool'. The consumptive pool is the water allowed for consumptive use, as determined by government decision having regard to the season and the rules in the relevant water sharing plan. The consumptive pool varies from year to year, and the year's *allocation* to entitlement holders varies correspondingly.[5] Security of *entitlement* does not change that principle.

3.8 It is the rules in the water sharing plan which reflect the trade-offs between competing interests, and which ought to take into account environmental needs. These trade-offs will be decided by the normal process of political debate. The Intergovernmental Agreement attempts to codify and harmonise water planning, and it entrenches the principle that the purpose of water planning is to provide for both ecological outcomes and resource security outcomes.[6] However it cannot decide, nor does it try to decide, those detailed debates.

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3 For example: Greens MP Ian Cohen said… the long term future of rivers remained in jeopardy as long as there were inflexible, perpetual water licences. 'Knowles backs away from water levels', *Sydney Morning Herald*, 18 March 2004, p.2.

4 For example, 'rights (other than riparian) in California and Colorado are defined for access to a specific volume of water. Water is supplied to right holders in order of their date of appropriation — 'first in time' has priority — until all available water is taken.' Productivity Commission, *Water Rights Arrangements in Australia and Overseas*, 2003, p.xviii.

5 'Expressing surface water rights as a share … allows the risks of a shortage to be spread across all users. All right-holders will receive some level of supply in lower than average rainfall years…. For example, an individual who holds a one per cent share of the available flow is guaranteed to receive that one per cent, regardless of whether the one per cent converts to 10 litres or 10 ML.' Productivity Commission, *Water Rights Arrangements in Australia and Overseas*, 2003, p.99.

6 *Intergovernmental Agreement on a National Water Initiative*, 25 June 2004, s37.

Concerns about giving public property to farmers

3.9 The Committee notes concerns that perpetual entitlements are in effect giving public property to farmers.[7] The Committee does not see this as a problem. The consumptive pool, though public property in law, has long been used by farmers under licence. They have made investments in private infrastructure needed to use it, and rural communities have been built up around that use. Giving current users longer term security has no opportunity cost for the state, because there is no other way the state could use the water.[8] Thus it does no injustice to the broader public. It has the overriding purpose of encouraging greater efficiency in water use, which will benefit the economy and the environment.

3.10 A related concern is that making entitlements more secure may give the holders windfall gains - presumably when the value is realised on sale.[9] This is a reasonable concern. It raises the same equity and public interest issues as other situations where an asset appreciates not because of the personal exertion of the owner or the natural working of the economy, but merely because of a government decision.[10] To what extent should the state try to recoup the gain?

3.11 The Committee agrees that in principle there is no reason why individuals deserve windfall gains resulting from the state's administrative decisions. In practice, as in many comparable situations, it may be hard to do much about it. It may be hard to distinguish appreciation resulting from more secure entitlement from appreciation resulting from a more mature water market, or the general long term appreciation resulting from the balance of supply and demand.

3.12 On the other hand, there are situations where the state gives water to users extremely cheaply. For example, the Committee heard that water harvesters of the lower Balonne River in south west Queensland pay $3 per megalitre for water.[11] It would not be right for the state to give entitlements at fees that represent cost recovery pricing, which individuals might then be able to onsell at enormous profits.

3.13 For the state to charge more than cost recovery for water would effectively be appropriating a resource rent. In theory this is detrimental to economic efficiency. However, the water is a community resource, and if rent is going to be made is should

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7 For example, 'Say NO to water licences in perpetuity. NCC cannot see the sense in offering $6.8 billion worth of water to a private industry…' Nature Conservation Council of NSW at http://www.nccnsw.org.au/ , July 2004.

8 Whether more water should be given to the environment is an *earlier* argument. The consumptive pool is the water left for users *after* allowing for environmental needs to the extent that the community deems adequate.

9 For example, *COAG water test for Carr*, media release, Nature Conservation Council of NSW, 24 June 2004.

10 For example, when land appreciates because of a rezoning decision.

11 Mr J. Grabbe, *Committee Hansard* 25 August 2003, p.48.

belong to the community as a whole, not to individuals who happen to be in the right place at the time when tradeable entitlements are given out.

3.14 The Intergovernmental Agreement is silent on the question of who tradeable water access entitlements should be given to, and at what price.

3.15 Windfall gains would be prevented by auctioning entitlements, rather than giving them out, in the first instance. This idea of course will not win the favour of water users. A more politically acceptable option would be to find some way of clawing back excessive gains when an entitlement is first sold.

3.16 Trade of entitlements will be subject to capital gains tax. However the Committee does not think that this is a sufficient answer to the problem. The problem is not the normal gradual appreciation of an asset, which capital gains tax is directed at. The problem is a transitional problem concerning a possible sudden jump in value when an existing licence is converted to a secure tradeable entitlement. The problem only relates to the first sale of the entitlement.

3.17 The Committee believes that COAG should consider ways of preventing windfall gains on first sale of tradeable water access entitlements.

Conditions under which entitlements may be cancelled

3.18 Under the Intergovernmental Agreement water access entitlements may only be cancelled '…at ministerial and agency discretion where the responsibilities and obligations of the entitlement holder have clearly been breached'. (IGA, s32(i)).

3.19 The Committee has a concern that the concept of 'cancelling' an entitlement seems to run counter to the principle of secure title. In other situations the penalty for prohibited act does not usually include confiscation of property. For example, if a property owner builds an illegal structure, this might result in a fine or an order to demolish the structure. It will not result in the land being confiscated.

3.20 A matter of concern is how the risk of cancellation would affect banks' willingness to use entitlements as security for loans.

3.21 The Committee urges COAG to clarify the intention of this section and the situations in which it might be used. Policies on this point will have to be nationally consistent.

Effects of separate water title on land values and council rates

3.22 The Local Government and Shires Association of NSW raised concerns that if water is separated from land, the land value would be reduced - sometimes dramatically. This would reduce *ad valorem* council rates.[12]

3.23 This is an important issue. Increasing the general percentage rate on land values to compensate could seriously disadvantage those who have land only already. It implies the need to give every parcel of land a notional 'land without water' value (comparable to the unimproved capital value of urban land), to value water entitlements applicable to the land separately, and to levy rates on both.

3.24 This may restore the status quo in respect of land with water, but of course it does not solve the problem of the declining land value and rating base where water is traded out of a district. That is a matter for structural adjustment assistance.[13]

3.25 As well, the Committee has a concern that that water entitlements valued separately may have a value more volatile than the value of land, since the value of entitlements is subject to the uncertainties of future government decisions to do with water plan reviews or allocation decisions. This could make Local Council budgets less reliable.

3.26 The Committee notes the approach to the problem in the recent Victorian White Paper, *Securing Our Water Future Together:*

> After unbundling, the Valuer General intends that valuations take into account the *capacity* of land to be irrigated (covering such matters as the existence of a delivery service, on-farm irrigation works, and access to drainage). This will capture some of the value presently derived from water rights, though not all.
>
> Councils will be able to maintain rate revenue by adjusting rates in the dollar, but without other action the rate burden would shift slight from irrigated properties to dryland farms and towns.

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12 Cr W. O'Mally (LGSA of NSW), *Committee Hansard* 15 July 2004, pp.734-5. Similarly Mr D. Aber (Moree Plains Shire Council), *Committee Hansard* 26 August 2003, p.110. Mr N. Shillabeer (South Australian Murray Irrigators Inc.), *Committee Hansard* 20 April 2004, p.524.

13 The comment assumes that water would be rated if it is owned by a person who also owns the land it is used on. The problem arises of whether or how to rate water entitlements owned by non-residents. It would be possible, as part of initialising the system, to tag every water entitlement to a local government area. An absentee owner would pay water rates just as an absentee landlord pays land rates. However this implies that every entitlement, no matter where the water is used, carries an obligation to pay rates to the *source* LGA indefinitely. The scenario is comparable to proposals that farmers in irrigation areas wishing to sell out should pay exit fees equivalent to the ongoing levies they would pay to maintain the shared infrastructure. Both scenarios, in the long term, would probably impede the economic efficiency gains from water trading.

> Shire Councils have managed to spread rate burdens equitably by striking differential rates. At present, some councils strike a special, lower rate for irrigated farms. When water rights are not in valuations, they may in some cases decide that a higher rate is fair.[14]

3.27 Logically the 'capacity to be irrigated' approach to valuation should consider not only the *physical* capacity, but also

- whether the use would be environmentally permissible under use licence rules (in the case of already irrigated land, presumably the answer would usually be 'yes'); and
- whether water would be available in the market and at what price.

3.28 In a situation where water can be bought (whether as entitlement or annual allocations), the value of irrigation land without an entitlement would not suddenly drop to the value of dry land (as some witnesses seemed to fear). The value would be expected to reach a level which reflects its irrigation potential, subject to a discount which is the cost of the water that must be paid for separately. The situation is analogous to the situation where the value of urban vacant lots will track the value of developed properties providing it is permissible to build on the land, and subject to a discount which is the cost of the building that must be paid for separately.

3.29 The amount of the discount would still reduce the property value; so if the differential rate approach is not taken, the water would still have to be valued and rated separately if the aim is to preserve the same relative rate burden on irrigation and dryland farmers.

3.30 The Committee draws attention to the urgent need for governments to address this problem and develop a uniform approach.

Effects of review of water plans

Risk sharing rules

3.31 The value of an entitlement, in economic terms, will be the value of the water that can be drawn under it, as decided by government from year to year pursuant to the rules in the relevant water sharing plan.

3.32 The IGA has risk sharing rules to limit the effect on users of uncertainty about future changes to allocations. Users will bear the risk of reduced allocations resulting from seasonal or long term changes in climate, or natural events such as fire or drought. Users will bear the risk of reductions required by 'bona fide improvements in the knowledge of water systems' capacity to sustain particular extraction levels', up to 2014. Therafter, users will bear the risk of up to 3% reduction in allocations per 10 years; government will bear the risk beyond that. Government will bear the risk of

14 *Securing Our Water Future Together*, Victorian Government White Paper, June 2004, p.71.

reductions required by changes in government policy (for example, new environmental objectives) (s46ff).

3.33 These rules do not apply to recovering water in response to cases of known overallocation or overuse. Arrangements for this are either covered by National Competition Council endorsed implementation plans, or left for further consideration (s41ff).

3.34 Recovering water which is at the government's risk will presumably be based on buying entitlements or allocations in the market (IGA, s79(ii)(a)).[15] Thus changing allocation rules in revised water sharing plans may have a direct cost to government. This raises the risk the governments may be tempted to understate environmental needs in order to avoid the cost. It implies the need for a clear budget for recovering environmental water in the longer term. Mr Cosier of the Wentworth Group suggested there needs to be a 20 year investment plan.[16] It has been argued that the current $500 million 5 year 'First Step' project for addressing overallocation in the Murray-Darling Basin is just a start.

3.35 It will be important to provide continuity of action after the 'First Step' program expires, noting that the need is not limited to the Murray-Darling Basin. The Committee recommends that COAG should negotiate an ongoing shared program for funding the IGA reforms.

Recommendation 2

3.36 COAG should negotiate an ongoing shared program for funding the reforms in the Intergovernmental Agreement on a National Water Initiative.

Timing of reviews of water plans

3.37 Review of water sharing plans, if it foreshadows changed (presumably reduced) allocations, may be expected to influence the market value of entitlements. There is a need to coordinate review of plans interstate to prevent speculative trading across borders in the hope of profiting from differently timed changes.

3.38 The IGA has agreed guidelines for water plans, and it says, 'A plan duration should be consistent with the level of knowledge and development of the particular water source' (schedule E). However it does not suggest a standard plan duration or any commitment to coordinate reviews. The NSW Department of Planning, Infrastructure and Natural Resources noted that it is discussing coordination with Queensland and Victoria.

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15 The IGA also envisages government recovering water by investing in efficiencies (s79(ii)(a)). However governments should not expect to get bargains by this route, since if there were bargains to be had farmers would presumably do the investment themselves to sell the saved water.

16 Mr P. Cosier (Wentworth Group) *Committee Hansard* 11 December 2002, p.3

3.39 The Committee draws attention to the importance of coordinating reviews of plans, as least over areas within which water may be traded.