



National Irrigators' Council

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Submission to the draft Productivity Commission report: Market Mechanisms for Recovering Water in the Murray- Darling Basin

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Introduction

The National Irrigators' Council (NIC) is the peak body representing irrigators in Australia. The NIC's objective is to develop projects and policies to ensure the efficiency, viability and sustainability of Australian irrigated agriculture and the security and reliability of water entitlements. NIC currently has 21 member organisations covering a variety of states, regions and commodities.

While this document has been prepared by the NIC, each member reserves the right to independent policy on issues that directly relate to their areas of operation, or expertise, or any other issues that they may deem relevant.

Overview

NIC welcomes the Productivity Commission's contribution to the current debate over water management in the Murray Darling Basin. The Commission's draft report casts a critical eye over the reform process and seems to largely understand the "real world" in which irrigation businesses operate.

In large part, the NIC agrees with the findings and recommendations made by the Commission, in particular its strong references to "community preference" and "opportunity cost" in the development of the Basin Plan and returning increased environmental flows to the rivers.

NIC does not oppose the Restoring the Balance (RTB) program or the development of a Basin Plan. However we are extremely concerned that these programs will "over-correct" in attempting to rebalance the needs of the environment with consumptive use, to the great detriment of irrigators, their communities, food production and, ultimately, all Australians.

Therefore we strongly support the Commission's draft finding 4.2 which states that allocating water based only on good science:

"...is not a sufficient basis for achieving the best outcome for the community. Community preferences should be considered where tradeoffs are required between different environmental outcomes, and between environmental and consumptive outcomes."

It is our view that the opportunity cost of diverting more water to the environment at the expense of food and fibre production, and the consequent impacts on irrigators and their communities, is not being properly considered. This is a fundamental flaw in the *Water Act 2007 (Cth)* which we believe places far too much emphasis on the environment, at the expense of irrigators and food production.

NIC also supports the Commission's view that the current "no regrets" approach to buyback runs the risk that the wrong amount or type of water entitlements may be purchased, significantly disrupting rural communities and diminishing the efficiency of the buyback process.

On the issue of investment in infrastructure investment, the NIC strongly disagrees with the Commission's finding. We believe public investment in irrigation infrastructure efficiency is a win-win situation, providing extra water for the environment and irrigators and leaving a legacy of a more modern, efficient irrigation system for remaining users. When the benefits of ongoing food and fibre production and robust rural communities from upgraded systems are considered, it is clear that there are strong grounds for government investment in infrastructure.

NIC does not support the view that investments should only be made where the cost per megalitre of water is similar to the market price. To do so would render the infrastructure programs ineffective and remove the wider benefits of infrastructure investment as outlined above.

Specific comments on findings and recommendations

Allocating environmental water

Draft finding 4.1

Water recovered in the northern Basin will usually result in limited environmental benefit for the southern parts of the Basin, given hydrological constraints. Water recovery within the northern catchments that are effectively disconnected should be driven primarily by environmental priorities within those catchments. Conversely, the southern Basin — including the Murrumbidgee, the Murray and the Goulburn rivers — is highly interconnected, allowing considerable flexibility in sourcing and delivering water for environmental purposes.

NIC agrees with this finding and notes that some of these catchments, in particular the Gwydir and the Macquarie, end in terminal wetlands where very little water will flow through to the Darling and the wider system except in big floods. It is a concern that these two valleys are among those most heavily targeted in the buyback so far as this is where the greatest potential for the Commonwealth to “overshoot” in its purchases will lie.

In addition, NIC notes that the wetlands at the end of these systems are predominantly privately owned and wonders whether this has been fully considered by the Commonwealth. How does the Commonwealth intend to deal with environmental assets if they are privately owned? If purchases of irrigation water ultimately end up simply watering private grazing country, then the Commonwealth will look very foolish and environmentalists and irrigators will naturally be very concerned.

Draft finding 4.2

Decisions on allocating water between competing uses in the Basin should be based on good science. But this is not a sufficient basis for achieving the best outcome for the community. Community preferences should be considered where tradeoffs are required between different environmental outcomes, and between environmental and consumptive outcomes.

Draft finding 6.1

Under the Water Act 2007 (Cth), the Murray-Darling Basin Authority is required to determine environmental watering needs based on scientific information and to consider least cost ways of meeting these needs in setting sustainable diversion limits. This way of allocating water between environmental and consumptive uses does not take into account community preferences, the opportunity cost of water or the role of other inputs such as land management. As the sustainable diversion limits will be used to guide future water purchasing under Restoring the Balance, the effectiveness and efficiency of this program are likely to be compromised.

NIC strongly agrees with these two findings. The current process as dictated by the *Water Act* is far too skewed in favour of the environment at the expenses of consumptive users. The Commission rightly identifies the risk that an over-correction will result in a “...situation where serious social and economic costs are imposed for small additional environmental gains.”¹

¹ Productivity Commission 2009, Market Mechanisms for Recovering Water in the Murray Darling Basin, Draft Research Report, December, page XXVII

It is our submission that in prioritising the needs of the environment, the Act contradicts its objective of “management of the Basin water resources in a way that optimises economic, social and environmental outcomes.”²

In determining allocations for the environment, decisions should be made on the basis of good science and then prioritised to create a hierarchy of assets on the basis of greatest environmental benefit per ML of water applied to it. NIC submits that there should be at least an element of local decision-making in this process.

NIC also agrees with the view that the current reform process places emphasis only on the recovery of water, with no regard for how environmental assets can be protected and restored through land management strategies and capital works.

Recovering water through non-market means

Draft recommendation 6.1

All Basin jurisdictions should clarify how the risk assignment provisions set out in the National Water Initiative, as amended in the Water Act 2007 (Cwlth), will apply to the reductions in water availability that are likely under the Basin Plan. This should occur as soon as possible.

Risk assignment is little understood by most in the community and governments and how it will be applied remains shrouded in uncertainty. NIC strongly supports this recommendation and is working with all governments to seek the certainty we need on this issue. It is very difficult for irrigators to weigh up participation in the buyback without clarification of how or if they might be compensated if they lose water under the Basin Plan process.

The Commonwealth must understand that this issue threatens the success of both the buyback and the Basin Plan if not addressed.

Draft finding 6.3

Purchasing water products from willing sellers is generally the most effective and efficient means of acquiring water, where governments are liable for the cost of recovering water for the environment.

NIC supports holders of water entitlement being able to sell to whomever they please. We remain opposed to compulsory acquisition of any type.

Draft finding 6.4

Funding infrastructure upgrades is generally not a cost-effective way for governments to recover water for the environment. It is also unlikely to be an effective or efficient means of sustaining irrigation communities.

Draft recommendation 6.2

Rigorous approval processes should be applied to all projects under the Sustainable Rural Water Use and Infrastructure program. In particular, projects should generally only be approved where

² Water Act 2007, Section 3c, page 2

the cost per megalitre for water entitlements recovered is similar to the market price. Premiums above this price should only be paid in exceptional circumstances.

NIC strongly disagrees with the Commission on this recommendation. We believe public investment in irrigation infrastructure efficiency is a win-win situation, providing extra water for the environment and irrigators and leaving a legacy of a more modern, efficient irrigation system for remaining users.

More efficient on and off-farm irrigation will enable farmers to improve their productivity – to produce more with less, as the Government puts it. When the benefits of ongoing food and fibre production and robust rural communities from upgraded systems are considered, it is clear that there are strong grounds for government investment in infrastructure. In addition, from a taxpayer perspective, maintaining efficient and vibrant irrigation systems provides flow-on benefits for the rest of the community, particularly in employment. While an irrigator who sells his or her water and leaves irrigation has realised capital which they can put to other uses, this is not the case for employees or those employed in secondary and tertiary industries. Surely it is more efficient for the taxpayer to have these people employed in the private sector in Griffith, Shepparton or Goondiwindi, than having them sitting on unemployment benefits with the social and financial costs that can bring to the wider community?

Better irrigation systems will also aid those farmers who do not sell any or all of their water, but will benefit from improved productivity and efficiency.

NIC does not support the view that investments should only be made where the cost per megalitre of water is similar to the market price. To do so would render the infrastructure programs ineffective and remove the wider benefits of infrastructure investment as outlined above. We agree that there must be some consistency applied in terms of pricing, but believe that some premium is necessary if the wider community is to achieve the objectives of more water for the environment at the same time as leaving a legacy of more modern, efficient irrigation systems.

Designing a portfolio of water products

Draft finding 7.1

Purchasing unregulated water entitlements can provide environmental managers with different environmental watering possibilities to holding storage-backed entitlements. Although less reliable, holding unregulated entitlements can help managers to restore natural flows in river systems. However, their effectiveness and efficiency can be compromised by complexities involved in shepherding environmental water downstream. These third-party effects may need to be addressed through negotiating with groups of irrigators, or through administrative changes to environmental flow rules.

Irrigators understand the complications involved in sourcing environmental flows in unregulated systems and support moves to develop rules that would allow shepherding. However we would be strongly opposed to any system that treats environmental entitlements differently to those of consumptive users. The development of processes to allow shepherding would facilitate markets in unregulated systems and such rules should be available to all entitlement holders.

Draft recommendation 7.1

The Australian Government should adopt a portfolio approach to purchasing water products, and not focus solely on water entitlements. Other products, such as seasonal allocations, leases on entitlements, options contracts and contracts for environmental services, have advantages in specific contexts and should be considered.

NIC supports this recommendation and encourages the government to consider such options. While outright purchase of entitlements may be the most appropriate mechanism for providing water for the environment in most cases, the government should expand its approach to include other products as outlined above.

NIC believes options that allow water to stay in productive use until a certain level when needed for the environment would result in a win-win outcome for the community, ensuring the balance that is referred to by the Commission above, is reached.

Mechanics of the buyback

Draft finding 8.1

Where active markets for water entitlements exist, acquiring water entitlements directly from those markets is likely to be more efficient than utilising alternative purchase mechanisms.

NIC supports the finding and submits that the current tender process is not the most efficient mechanism for the buyback, either for sellers or for the government (where there is an existing market).

Draft finding 8.4

The efficiency of the conveyancing process could be improved by:

- *exchanging the contracts of sale before the due diligence process commences*
- *assessing the current due diligence process for potential duplication with current state approval processes and removing the sources of duplication*
- *introducing a formal requirement on the Department of the Environment, Water, Heritage and the Arts to notify tender participants of any delays in the process and the reasons for the delays.*

NIC supports any moves that would improve the efficiency of the tender process and reduce the administrative burden on sellers.

While we support the principle of a requirement on DEWHA to formally notify sellers of delays in the process, we note that it is possible that any such requirement might increase the paperwork burden for the Department and only exacerbate the delays. Any such requirement should be balanced against this concern.

Draft finding 8.5

Using the buyback to address indirect objectives, such as achieving distributional goals, system rationalisation, and reducing the salinity impacts of water use is likely to compromise its

effectiveness and efficiency. Other more direct instruments would generally achieve those objectives at lower cost.

NIC has grappled with this issue for some time but has concluded that rationalisation or reconfiguration of irrigation systems is best dealt with from the “bottom-up” – that is, decisions about the future of irrigation systems should be made by irrigators themselves, not imposed on them from above. This does not negate ongoing concern from irrigators about the social and economic change and damage being inflicted by the buyback.

We agree that a targeted approach is not the best way to achieve environmental objectives such as reducing salinity impacts.

Governance and institutional issues

Draft finding 9.1

Transparency in environmental water recovery by the Commonwealth would be improved by providing clear and public information summarising the existing and planned holdings of environmental water across the Basin, and explicitly explaining how Commonwealth water recovery is being coordinated between the two Commonwealth water recovery programs (Restoring the Balance and Sustainable Rural Water Use and Infrastructure), and with other environmental water holdings.

NIC supports improved transparency in relation to environmental water holdings, but more particularly the use to which they are to be put. Irrigators find it hard to understand that the Commonwealth has purchased more than 740 GL of entitlements so far and yet there has not been a list produced of environmental assets and their watering requirements. Irrigators will lose faith in the Basin Plan process if there is not an open and frank debate about the assets that should be protected, their watering requirements and the measures of success.

Draft finding 9.2

Current governance arrangements for the management of environmental water in the Basin are fragmented between various state and local environmental water managers and the Commonwealth Environmental Water Holder. Governance arrangements for coordinating environmental watering activities are unclear.

Draft finding 9.3

Recovering water is necessary in most cases, but is not always sufficient to achieve desired environmental outcomes in the Basin. Other inputs, such as capital works to manage and direct environmental flows, and changes to land management practices, may also be required. Yet the focus of the Basin Plan, and the Australian Government’s buyback and infrastructure programs is solely on recovering water, without regard for the role of these other inputs. Better systems are needed to coordinate the mix of water purchases with other actions and inputs to achieve the desired environmental results.

NIC concurs with both of the above findings.

Request for information

Based on good governance principles, what do you think are the appropriate institutional structures for:

- *conducting the purchase of entitlements under the Restoring the Balance program*
- *purchasing the suite of water products that the Commonwealth Environmental Water Holder will need, to meet varying environmental demands in the interim before the Basin Plan takes effect*
- *purchasing environmental outcomes through new programs aimed separately at private providers and public environmental managers?*

What do you think the role of the Commonwealth Environmental Water Holder should be in holding and trading in water products once the Basin Plan has been fully implemented?

It is our submission that the questions put the cart before the horse. It is difficult to identify the best institutional structures until it is known what the outcomes sought from environmental watering are and the relevant measures of success. The Commission's statement on page 199 that "there has been little guidance given on how much water is required and where" remains the case. Until there is an environmental watering plan and clear objectives for such a plan, irrigators and the wider community remain in the dark about the full purpose of the buyback plan.

NIC has no strong view on the structures that need to be in place to meet the objectives listed above. We note the Commission's suggestion of the creation of a new, dedicated entity to run the purchasing program but would need to be convinced that this would be efficient. The establishment of a semi-government quango would undoubtedly lead to more costs and subsequently less money available for purchases, probably with little overall benefit to irrigators or the government. The time taken for the establishment of such a body would also be an issue.

We note that DEWHA's Water Efficiency Division, which runs the purchasing program, has clear guidelines under which it must conduct the program. We strongly urge the Minister to review and amend these guidelines in light of the Commission's advice, in particular to allow for the purchasing of a wider portfolio of water products to meet environmental needs (draft recommendation 7.1).

Once the Basin Plan is operational, there might be some advantage in the CEWH taking control of the purchasing plan to ensure that purchases are in line with, but do not exceed, the needs of the environment as set out in the environmental watering plan.

NIC submits that the CEWH should take active part in the water market once the Basin Plan has been implemented, in particular, it should be prepared to sell water temporarily when not needed for the environment. The CEWH will be by far the largest holder of water in the market and it will have a responsibility to offer water for sale to ensure it is put to productive use as often as possible.

Overcoming impediments

Draft recommendation 10.1

The 4 per cent limit on out-of-area trade of water entitlements should be eliminated as soon as possible, rather than phased out by 2014 as currently scheduled. Limits on the amount of entitlements that can be sold to the Commonwealth through the buyback should also be eliminated.

NIC's holds the view that all irrigators should be faced with a level playing field when it comes to buybacks. As such we support the recommendation, noting that the NSW-Commonwealth agreed cap is a response to the Victorian 4 per cent rule, but that eliminating both would prove fairer for all irrigators.

In relation to the 4 per cent rule, we accept the initial reasoning behind its introduction but submit that it is now counterproductive to the interests of Victorian irrigators for at least two reasons:

1. It is an unreasonable restriction on an irrigators' property right and is causing hardship for many irrigators who wish to sell part or all of their water but can't. Supporters might argue it maintains productive capacity in a particular region, but only if the irrigator doesn't go broke in the meantime.
2. It places a cap on the amount of water the Commonwealth can purchase under the RTB program. Given that RTB purchases will offset any reductions under new Sustainable Diversion Limits (SDLs), it is possible that in the longer term Victorian irrigators might lose more water in one fell swoop than they otherwise might have had there been no 4 per cent rule. So while it is designed to allow irrigation communities time to adjust, in fact it might only lead to a more dramatic, immediate adjustment when new SDLs are implemented.

Draft finding 10.2

Moving to cost-reflective pricing for water delivery is likely to improve the efficiency of water trading. Irrigation infrastructure operators that implement this reform will reduce the risk that geographically dispersed sales into the buyback could harm the competitiveness of their irrigation area.

This finding assumes that the cost of water is the only relevant determinant of the success of an irrigation business. The Commission will understand that this is clearly not the case. As water is only one component of irrigation businesses it would be difficult to see how "pricing-out" some irrigators would be effective or efficient. More importantly, if the principle were to be extended to a whole of system basis the cost of delivery to the lower reaches including areas such as Sunraysia, the Riverland and the rest of South Australia, would be prohibitive.

NIC believes individual operators should have the choice to apply types of pricing at their discretion, in consultation with irrigators, which may or may not involve "postage stamp" pricing. The ACCC has laid down water charge rules for operators which focus on full cost recovery for systems as a whole where the benefits are economies of scale and "communal".

Draft recommendation 10.2

The Murray-Darling Basin Authority should commission an independent study into ways of expanding the ability of water users to carry over water, while adequately managing third-party impacts. This study should consider options that treat environmental entitlements and consumptive use entitlements the same and options that treat them differently.

NIC does not object to the idea of such a study however we would strongly oppose any move to change the characteristics of entitlements held by environmental water holders. All entitlements should be treated equally, regardless of ownership or their intended use. Preferential treatment of CEWH or other environmental entitlements goes against all commitments given by government to date that this would not happen. It would be difficult to see how different treatment for

environmental entitlements would not lead to negative third party impacts on irrigators. Such a move would likely result in a complete loss of irrigator faith in ongoing water reform.

Other matters

NIC would like to draw the Commission's attention to an apparent error in Box 4.7 on page 71 of the draft report. The box includes an excerpt of the original NIC submission, and appends the following line at the end:

“... an interim purchasing strategy ought be developed that identifies a bandwidth for key environmental assets.”

This last comment was not part of the NIC submission and the report should be corrected before final publication.

END OF SUBMISSION