

NATIONAL COMPETITION COUNCIL

**SUPPLEMENTARY SECOND TRANCHE
ASSESSMENT**

Water Reform

30 SEPTEMBER 2000

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ABBREVIATIONS

ANZECC	Australian and New Zealand Environment and Conservation Council
ARMCANZ	Agriculture and Resource Management Council of Australia and New Zealand
CoAG	Council of Australian Governments
CPA	Competition Principles Agreement
CSO	Community Service Obligation
NCC	National Competition Council
NMU	Non-major urban authority
NCP	National Competition Policy
NT	Northern Territory
NWQMS	National Water Quality Management Strategy
PAWA	Power and Water Authority (NT)
SA	South Australia
TER	Tax Equivalent Regime
WACC	Weighted Average Cost of Capital
WSAA	Water Services Association of Australia

SUMMARY AND RECOMMENDATIONS

National Competition Policy (NCP) is a comprehensive mix of economic policy and measures to provide for social needs. Agreed by all governments in 1995, the NCP program builds on the pro-competitive reform process which commenced with the Trade Practices Act of 1974.

Governments established the National Competition Council to assess, among other things, their progress against the agreed NCP reform program. There are three tranches of assessments: prior to July 1997, July 1999 and July 2001. The Council also undertakes supplementary assessments where jurisdictions achieve progress against reform objectives but have not achieved full implementation at the time of the tranche assessment.

Under the NCP Agreements, the Commonwealth makes funding available to the States and Territories on the basis that they make satisfactory progress against NCP reform objectives. A maximum of \$1.106 billion in NCP payments is available for the second tranche period (1999-00 to 2000-01), with the payments allocated by the Federal Treasurer taking account of the advice of the Council.¹ The recommendations in this report form the basis of advice to the Federal Treasurer on the allocation of NCP payments for 2000-01.

Where the Council's assessments find that governments are continuing to progress all matters consistent with agreed NCP obligations, the Council recommends that relevant governments receive full NCP payments.² However, where the Council identifies areas where reform activity has not satisfactorily met obligations, and the breach is non-trivial, the Council considers whether a reduction in NCP payments, or a suspension of payments pending further work by the jurisdiction, is appropriate.

Unless there is work clearly documenting the cost of the breach to the community, the Council expresses its recommendations in terms of a percentage of the NCP payments available to the jurisdiction. In determining the quantum of any reduction or suspension, the Council takes account of the relative importance of the reform, the extent of progress the jurisdiction has achieved, the complexity of the matter and the time which has been available for implementation. The Council also takes into account the need for the recommended reduction or suspension to provide a sufficient incentive for the jurisdiction to rectify the identified

¹ See Attachment 1 for a desegregation of second tranche NCP payments by jurisdiction.

² The Council also assesses progress by the Commonwealth, which is a party to the NCP Agreements. However, NCP payments are not relevant to the Commonwealth.

breach. The Council's objective in expressing the quantum of any reduction or suspension as a percentage of NCP payments is to ensure equivalent treatment of jurisdictions in respect of breaches which the Council considers to be of the same order of magnitude.

The June 1999 second tranche assessment in water reform showed that in general, governments were making progress against their NCP commitments. However, the Council identified several outstanding issues where governments' activity had not sufficiently met obligations. Given that jurisdictions had reform action proposed or underway in many areas, rather than propose reductions in second tranche NCP payments, the Council recommended supplementary water assessments, in December 1999, June 2000, and September 2000 to give jurisdictions more time to advance their programs.³

The Council's September supplementary assessment shows that actions taken by South Australia and the Northern Territory meet the concerns identified in June 2000 and virtually complete the outstanding matters to be addressed for the second tranche NCP water commitments for these jurisdictions.⁴ The Council has, however, identified transparency in the regulation of water pricing through independent prices oversight measures as a key issue that it will need to address with South Australia for the third tranche assessment.

Changes aimed at improving the efficiency with which Australia uses water are a key component of the NCP program. The following table summarises the Council's findings and recommendations arising from the three supplementary second tranche assessments in water.

FINDINGS AND RECOMMENDATIONS FOR WATER REFORM: SECOND TRANCHE SUPPLEMENTARY ASSESSMENTS: 31 DECEMBER 1999, 30 JUNE 2000 AND 30 SEPTEMBER 2000	
Supplementary Second Tranche Assessment - 31 December 1999	
Relevant Jurisdiction(s)	NCC Findings and Recommendations
(Queensland, South Australia, Tasmania, Northern Territory)	Suspension of <u>Queensland</u> NCP payments lifted following resolution of concerns regarding new rural schemes . Supplementary assessment of guidelines by 30 June 2000.

³ The December 1999 supplementary assessment has been previously reported by the Council, and the outcomes are presented here in summary only (see NCC 1999b). The June 2000 supplementary has been released concurrently with this report and hence the outcomes are also presented in summary only (NCC 2000).

⁴ The Northern Territory will have another Supplementary water assessment by 31 December 2000 to ensure that legislation already introduced into the Assembly seeking to implement institutional reform has been passed and is substantially in force. New South Wales, Queensland, and Western Australia are also scheduled for December 2000 supplementary assessments.

	<p>Progress of pricing reforms in <u>Queensland, Tasmania and Northern Territory</u>. Further supplementary assessment for <u>Queensland, South Australia, Tasmania and Northern Territory</u> prior to 30 June 2000.</p> <p>Commitment to devolve irrigation management met by <u>Tasmania</u>. Further supplementary assessment for <u>Queensland</u> prior to 30 June 2000.</p> <p>Further supplementary assessment regarding institutional arrangements for <u>Queensland</u> and <u>Northern Territory</u> prior to 30 June 2000.</p> <p>Further supplementary assessment regarding legislative framework for water allocation and trade for <u>Northern Territory</u> prior to 30 June 2000.</p>
Supplementary Second Tranche Assessment - 30 June 2000	
Relevant Jurisdiction(s)	Findings and Recommendations
<p><u>New South Wales</u></p> <p>Legislation to establish appropriate water allocation framework</p> <p><u>Queensland</u></p> <p>Legislation to establish appropriate water allocation framework, implement institutional separation and provide for devolution of irrigation management</p> <p>Urban water pricing reform</p>	<p><u>New South Wales</u></p> <p>No suspension or reduction in NCP payments. Supplementary assessment in December 2000 to ensure legislation consistent with the water framework is substantially in force, otherwise a reduction in 2000-01 NCP payments of 5% (for the period July to December 2000, approx. \$7.5m) will be recommended. In addition, a suspension of 5% (for period January to June 2001) will be recommended; total of 10% of NCP payments affected.</p> <p><u>Queensland</u></p> <p>No suspension or reduction in NCP payments. Supplementary assessment in December 2000 to ensure legislation consistent with the water framework is substantially in force, otherwise reduction in 2000-01 NCP payments of 7.5% (for the period July to December 2000, approx. \$6.5m) will be recommended. In addition, a suspension of 7.5% (for period January to June 2001) will be recommended; total of 15% of NCP payments affected.</p> <p>Suspension of 5% of 2000-01 NCP payments (approx. \$4.3m) until 31 December 2000 for insufficient progress with implementation of two-part tariffs where cost effective by Townsville City Council although slow progress in Johnstone and Cooloola is also of concern. Further assessment at this time and if progress remains unsatisfactory reduction in payments.</p>

<p><u>Western Australia</u></p> <p>Legislation to establish appropriate water allocation framework</p>	<p><u>Western Australia</u></p> <p>No suspension or reduction in NCP payments. Supplementary assessment in December 2000 to ensure legislation consistent with the water framework is substantially in force, otherwise reduction in 2000-01 NCP payments of 5% (for the period July to December 2000 approx. \$2.3m) recommended. In addition, a suspension of 5% (for period January to June 2001) will also be recommended; total of 10% of NCP payments affected.</p>
<p><u>South Australia</u></p> <p>Further implementation of urban water and sewerage pricing reform:</p> <ul style="list-style-type: none"> • trade waste charges • sewerage charges • free water allowances • commercial charges 	<p><u>South Australia</u></p> <p>Suspension of 5% of 2000-01 NCP payments (approx. \$1.8m) until 30 September 2000 for insufficient progress with urban water pricing reforms. Further assessment at this time and if progress remains unsatisfactory reduction in payments.</p>
<p><u>Tasmania</u></p> <p>Legislation to establish appropriate water allocation framework</p> <p>Urban water pricing reform</p> <p>Progress with pricing reform and CSOs provided by local government</p>	<p><u>Tasmania</u></p> <p>Reform commitments met.</p> <p>Sound progress with implementation of two-part tariffs achieved, revisit in third assessment.</p> <p>Reform commitments met.</p>
<p><u>Northern Territory</u></p> <p>Bulk water charging</p> <p>Legislation to provide for Institutional separation</p>	<p><u>Northern Territory</u></p> <p>Second tranche commitments met, revisit in third tranche assessment.</p> <p>Suspension of 2½% of 2000-01 NCP payments (approx. \$120 000) until 31 October 2000. Further assessment at this time. If legislation not before Parliament, reduction of this amount. Supplementary assessment in December 2000 to ensure legislation consistent with the water framework is substantially in force. If still not before Parliament, further reduction of 2½%. If before Parliament and not commenced a reduction of 2½% (if applicable, where legislation was before Parliament by 31 October 2000) and a suspension of a further 2½% (for period January to June 2001) will be recommended; total of 5% of NCP payments.</p>

Legislation to establish appropriate water allocation framework	Reform commitments met.
Supplementary Second Tranche Assessment - 30 September 2000	
Relevant Jurisdiction(s)	Findings and Recommendations
<p><u>South Australia</u></p> <p>Further implementation of urban water and sewerage pricing reform:</p> <ul style="list-style-type: none"> • trade waste charges • sewerage charges • free water allowances • commercial charges <p><u>Northern Territory</u></p> <p>Legislation to provide for institutional separation</p>	<p><u>South Australia</u></p> <p>Second tranche commitments met and suspension of 5% of 2000-01 NCP payments imposed by June 2000 assessment (approx. \$1.8m) lifted.</p> <p>The Council will address the issue of transparency of pricing regulation and independent prices oversight with South Australia for the third tranche assessment.</p> <p><u>Northern Territory</u></p> <p>Second tranche commitments met and suspension of 2½ % of 2000-01 NCP payments (approx. \$120 000) imposed by June 2000 assessment lifted.</p> <p>Further supplementary in December 2000 to ensure legislation is substantially in force. If legislation is not substantially in force a reduction of 2½ % and a suspension of a further 2½ % (for period January to June 2001) will be recommended; total of 5% of NCP payments affected.</p>

1 ABOUT THE SUPPLEMENTARY NCP SECOND TRANCHE ASSESSMENTS

Governments introduced Australia's National Competition Policy (NCP) in 1995, with the objective of developing a more dynamic, competitive and innovative economy. The program is a balanced mix of economic policy and measures to deliver social needs, including protection of the environment.

The NCP reforms, which are delivered through three inter-governmental agreements, focus on:

- infrastructure monopolies such as electricity transmission grids and rail networks, many of which have been, or are, government monopolies, where competition concerns are addressed through the infrastructure access regime under Part IIIA of the Trade Practices Act 1974 (TPA);
- monopolistic activities addressed through extension of the reach of the TPA under the Conduct Code Agreement; and
- legislated restrictions, where pro-competitive reforms are considered under clause 5 of the Competition Principles Agreement (CPA).

NCP has two other key elements. It:

- addresses concerns about the performance of government businesses through the obligation on governments to apply competitive neutrality principles to significant government businesses under clause 3 of the CPA and, to review the structure of public monopolies under clause 4 of the CPA; and
- requires governments to focus broadly on the management of Australia's water industry, to ensure appropriate use of water including for the environment.

Under the Agreement to Implement the National Competition Policy and Related Reforms (Implementation Agreement), the National Competition Council is required to conduct three assessments of the progress achieved by governments against the reform obligations in the NCP Agreements.⁵ Governments asked the Council to assess progress recognising that Australia is in essence a national market, and that consistent progress by all jurisdictions rather than a piecemeal approach is the key to maximising the benefits to the community.

The Commonwealth makes payments to the States and Territories for implementing the NCP reform package. Satisfactory progress against the obligations in the NCP Agreements is a pre-requisite for States and Territories to receive these payments.

The Council assesses progress in three tranches (prior to July 1997, July 1999 and July 2001) and makes recommendations on payments to the Federal Treasurer. Approximately \$1.106 billion in NCP payments are available in the second tranche period (1999-00 to 2000-01). The Council also assesses the Commonwealth

⁵ The three NCP Agreements are reproduced in NCC 1998.

Government's progress (the Commonwealth is a party to the NCP Agreements), although there are no implications for NCP payments.

In addition to the three tranches of assessments, the Council also conducts supplementary assessments. Supplementary assessments are undertaken where governments had achieved progress against reform objectives but had not implemented the objectives in full at the time of the tranche assessments. Because NCP is a comprehensive program often demanding on resources of governments, the Council prefers to use the supplementary assessment process to allow additional time where a reform is progressing but not complete at the time of the tranche assessment rather than to recommend a reduction in NCP payments. Where the Council considers a supplementary assessment is warranted, it often defers recommendations for reduced NCP payments pending the supplementary assessment.

The Council recommended several matters for supplementary second tranche assessment, to occur at different times during the 18-month period following the 30 June 1999 second tranche assessment. The Council determined the timing for the supplementary assessments after considering progress at the time of the second tranche assessment and subsequent supplementary assessments and the extent of the remaining reform task.⁶ The matters identified for supplementary second tranche assessment are summarised in Table 1.1 on the following page.

The Council's December 1999 supplementary assessment of progress with water reform has been released by the Commonwealth Treasurer and is a public document (NCC 1999b). The June 2000 Supplementary is to be released with this report (NCC 2000).

This report covers those matters that were considered in the June 2000 supplementary assessment and found not to be implemented in full. Further, it includes a summary of the Council's earlier supplementary assessments covering matters relevant to the water industries. Satisfactory progress, addressing concerns with NCP compliance identified in the June 1999 assessment, is a pre-requisite for the Council recommending to the Federal Treasurer that jurisdictions receive full NCP dividends for 2000-01.

⁶ For a full statement of the reform obligations, see: NCC 1998.

Table 1.1: Schedule of Supplementary Second Tranche Assessments

NCP Reform	Relevant Jurisdictions	Date of Assessment
Electricity: implement regulatory arrangements recommended by structural review	South Australia	31 December 1999
Various elements of the second tranche water reform package	Queensland, South Australia, Tasmania, Northern Territory	31 December 1999
Other remaining elements of the second tranche water reform package	New South Wales, Queensland, Western Australia, South Australia, Tasmania	30 June 2000
National gas reform: implement recommendations of the review of the Cooper Basin (Ratification) Act 1975	South Australia	31 December 1999 with a further supplementary assessment 30 June 2000
National gas reform: application of the National Gas Access Code	Queensland	30 June 2000
Remaining elements of the NCP second tranche road reform package	Commonwealth, Queensland, Western Australia, South Australia, Tasmania, ACT, Northern Territory	31 March 2000
Road reforms not completed at 31 March 2000	Commonwealth, Queensland, Western Australia, Northern Territory	30 June 2000
Legislation review: dairy industry	New South Wales, Queensland, Western Australia, ACT	30 June 2000
Legislation review: domestic rice marketing arrangements	New South Wales	30 June 2000
Legislation review: compulsory third party insurance for motor vehicles	Victoria, Tasmania	30 June 2000
Legislation review: workers' compensation arrangements	Victoria	30 June 2000
Legislation review: professional indemnity insurance for solicitors	Victoria	30 June 2000
Legislation review: Australian Postal Corporation Act 1989	Commonwealth	30 June 2000
Various elements of the second tranche water reform package	South Australia, Northern Territory	30 September, 31 October 2000
Various elements of the second tranche water reform package	New South Wales, Queensland, Western Australia, Northern Territory	31 December 2000

2 SUMMARY OF OUTCOMES OF EARLIER SECOND TRANCHE SUPPLEMENTARY ASSESSMENTS FOR WATER

June 2000 Assessment

The Water Industry: New South Wales, Queensland, Western Australia, South Australia, Tasmania and Northern Territory

Background

The Council's December 1999 second tranche supplementary assessment against the CoAG water reform framework (CoAG 1994) found that, while there was strong progress across all jurisdictions, further time was needed to implement outstanding reforms by jurisdictions. The December supplementary second tranche assessment lifted the suspension of Queensland's NCP payments following resolution of concerns regarding new rural schemes. It also flagged the following matters for supplementary assessment in June 2000:

- Queensland's progress on the establishment of guidelines to determine economic viability for new infrastructure development, pricing reform, devolution of irrigation management, and institutional reform;
- further progress in pricing reforms for South Australia;
- further progress in pricing reforms for Tasmania; and
- Northern Territory progress in pricing reform, institutional reform and legislation for water allocation and trade.

Assessment in June 2000

New South Wales

The Council's supplementary assessment sought to examine legislation establishing a water allocation and trading framework. The *Water Management Bill 2000* was introduced into the NSW Parliament in June and is proposed to be debated in the second half of the year. The Council therefore recommended a further supplementary by 31 December 2000. If the legislation consistent with NCP obligations is not passed by that time, the Council recommended a 10 percent suspension of NCP payments.

Queensland

Despite Queensland's ongoing progress in addressing reform commitments, the Council remained of the view that many reform

commitments were not met. In particular, the following second tranche commitments were still outstanding:

- implementing two-part tariffs where cost effective by Townsville City Council although slow progress in Johnstone and Cooloola is also of concern; and
- passage of the *Water Bill 2000* to establish appropriate water allocation framework, and implement institutional separation and provide for devolution of irrigation management.

The Council recommended that a suspension of 5 percent of Queensland's NCP payments until 31 December 2000 be imposed for insufficient progress on the two-part tariff issue, and a further supplementary assessment be conducted by 31 December 2000 on the remaining issues. If legislation consistent with NCP commitments is not passed, the Council recommended a 7½ percent reduction and a 7½ percent suspension of NCP payments.

Queensland also provided guidelines for economic viability for investment in new rural schemes. The Council was satisfied that the guidelines were consistent with the reforms.

Western Australia

The June 2000 assessment examined the progress of Western Australia in developing legislation to establish an appropriate water allocation and trading framework. The Revised Bill is before Parliament and is to be debated during the Spring session. The Council recommended a supplementary assessment by 31 December 2000 to ensure passage of the amended legislation. If legislation is not passed, the Council recommended a 5 percent reduction and a 5 percent suspension of NCP payments.

South Australia

This assessment looked at the progress of South Australia in implementing urban pricing reforms with regard to trade waste charges, sewerage charges, free water allowances, and commercial charges. The Council recommended a 5 percent suspension until 30 September for insufficient progress on this issue and a further supplementary at that time. The Council also found the outstanding commitments with regard to bulk water pricing had been met.

Tasmania

For Tasmania, the June assessment considered progress in implementing legislation to establish a water allocation and trading framework, further implementation of two-part tariffs, and progress with pricing reform where CSOs are provided by local government. Reform commitments were met in all areas. The Council will revisit the issue of progress in

implementing two-part tariffs, and institutional reform for the third tranche assessment.

Northern Territory

The assessment for the Northern Territory looked at progress in implementing bulk water charging and introducing legislation to provide for institutional reform and a water allocation framework. The Council found that the Northern Territory had met its commitments with regard to bulk water charging and the water allocation framework. However, there was insufficient progress in establishing a legislative framework to implement institutional reform. The Council recommended a 2.5 percent suspension and a further supplementary assessment by 31 October 2000.

December 1999 Assessment

The Water Industry: Queensland, South Australia, Tasmania and Northern Territory

Background

The Council's June 1999 second tranche assessment against the CoAG water reform framework (CoAG 1994) found that, while there was strong progress across all jurisdictions, only Victoria and the ACT had met required commitments. It also flagged the following matters for supplementary assessment in December 1999:

- Queensland's progress on reform commitments in relation to urban cost recovery, pricing and institutional arrangements. During this time, the Council also noted its further assessment of issues concerning the assessment of economic viability and ecological sustainability of rural schemes. The Council had recommended a suspension of 25 per cent of Queensland's 1999-00 NCP payments in respect of this matter.
- South Australia's commercial water pricing following announcement of the State's retail water pricing policy.
- Tasmania's progress on the implementation of two-part tariffs for urban water supply and devolution of irrigation management.
- The Northern Territory's reform progress in relation to urban cost recovery, bulk water pricing, cross-subsidies, water allocations and trading and institutional reform. The Council also noted that it would assess the timetable on action to be taken in relation to priority river and ground water systems.

Assessment in December 1999

Queensland

The Council's supplementary assessment reported the ongoing progress of Queensland in addressing reform commitments. The Council, however, remained of the view that many reform commitments were not met. In particular, the following second tranche commitments were still outstanding:

- for urban cost reform and pricing, the failure to progress reform in smaller local governments; and
- institutional separation of the roles of water service provision and resource management, standard setting and regulatory enforcement.

The Council recommended that both these matters be the subject of a further supplementary assessment in June 2000.

Queensland also provided information on investment in new rural schemes and undertook to further develop guidelines for analysis of economic viability and ecological sustainability of new projects. These guidelines were to be assessed in June 2000. In summary, the Council was satisfied that relevant rural schemes had proceeded in a manner consistent with reform commitments, had not proceeded or, if they had proceeded, should not result in a reduction in NCP payments. The Council recommended that the suspension of 25 per cent of Queensland NCP payments for 1999-00 be lifted and the suspended payment be reimbursed.

South Australia

South Australia released a discussion paper in December 1999 as part of a public consultation process targeting the future direction of water pricing, including commercial water pricing. However, at this time, South Australia stated that it would not finalise its approach to commercial water pricing without a period of public consultation. Acknowledging the importance of public consultation, the Council recommended a further assessment of South Australia's progress with commercial water pricing reform in June 2000.

Tasmania

The Council was generally satisfied that the process adopted by Tasmania to assess and implement two-part tariff reforms demonstrated genuine commitment to urban pricing reform. The Council recommended that actual implementation of tariffs be the subject of a further assessment in June 2000.

The Council was also satisfied that devolution of irrigation management in relevant schemes was consistent with second tranche reform commitments.

Northern Territory

The Council was satisfied that second tranche commitments were met by the Northern Territory in relation to the following aspects of urban price reform: full cost recovery, rates of return, and cross-subsidies. It recommended a further assessment of progress on the implementation of internal bulk water charges by the Power and Water Authority in June 2000.

The Council assessed the implementation program for allocations in priority water resources and processes for assessing the economic viability of new rural investment as being consistent with second tranche reform commitments.

The Northern Territory, while demonstrating progress in establishing arrangements for water allocations and trading arrangements and institutional separation, had not completed this process by December 1999. The Council recommended that a further assessment be conducted in June 2000 to confirm that appropriate legislation has been passed by the Legislative Assembly.

3 THE SEPTEMBER 2000 ASSESSMENT

Introduction

This part of the second tranche supplementary assessment considers the progress of South Australia and the Northern Territory in addressing issues raised by the Council in the June 2000 assessment in implementing the CoAG water reform framework.

The Council's previous considerations of progress against water reform commitments is contained in Volume 2 of the second tranche assessment report (NCC 1999a), the December 1999 supplementary assessment report (NCC 1999b), and the June 2000 supplementary assessment report which has been released currently with this report (NCC 2000).

As the September 2000 supplementary assessment is concerned with progress against outstanding water reform commitments, the same assessment framework as was used in conducting the previous assessments has been adopted. The framework is contained as an attachment to this report.

A flexible framework

The Council's assessment demonstrates that the CoAG water reform objective of arresting widespread natural degradation is being addressed by each State and Territory in a distinct manner.

The framework is sufficiently flexible for governments to undertake changes in a manner that best meets the economic, environmental and social conditions of their communities.

Each state has approached water resource planning in a distinct manner. While they share common elements of tradeable water rights separated from land title and recognition of the environment's right to water, the precise mechanisms of achieving these differ.

Further, the framework provides for tariff reforms in urban areas only where this is cost effective. This ensures that reforms are implemented only where the relevant community will benefit.

The Council's role is to assess reforms by each government against the water reform framework, not to assess one State or Territory against another. Hence, the Council has been satisfied that reforms have, or may be, met through different means. While the Council may form a view as whether some arrangements are superior to others, this is not the benchmark used in assessing reform.

A flexible assessment process

This report demonstrates that the Council's assessment process, which focuses on both timeliness and good reform outcomes, can respond to the

circumstances of particular States and Territories while retaining the integrity of the NCP payments as dividends for achieving reform.

While NCP payments may assist in driving timeliness, they should not be used as an excuse for curtailing a full public debate. The recommendations in the supplementary assessment report particularly with regard to the need for consultation with industry on new charging arrangements to be implemented in South Australia demonstrates how these competing interests are balanced by the Council.

That said, some commitments are still being implemented well outside the timetable agreed by CoAG. This is especially the case for some aspects of urban pricing reforms, institutional separation, and passage of legislation to establish water allocation and trading frameworks. Where there is an ongoing failure to implement change where a suspension has been recommended, the Council is presently of the view that a reduction in NCP payments will be recommended at the end of a suspension period.

Supplementary assessment issues

Urban pricing reform

The Council notes the ongoing reform of urban water pricing. Pricing is the primary means of allocating scarce resources; water is now clearly recognised by all communities as a scarce resource.

There is now sufficient evidence to say that the CoAG reforms are delivering more efficient services and a greater customer focus. They are also giving consumers more control over their water bills: consumers are increasingly making conscious decisions about how much water they use and therefore pay for.

Urban water reforms were an important consideration in the Council's 1999 second tranche assessment. While the Council believes that much has been achieved, some outstanding areas remain. Given the clear benefits to communities and government of implementing the arrangements agreed to under CoAG, the Council will continue to closely monitor ongoing achievement of urban water pricing reforms in the period until the third tranche assessment.

Institutional separation

It is the nature of regulation that, as new challenges arise, new responses are required. The Council has seen the debate around appropriate institutional arrangements develop to encompass matters such as the setting of drinking water standards, the need for prices oversight especially for large monopoly providers, and detailed consideration of departmental arrangements.

Good institutional arrangements will ensure that the gains made by communities in water management over the past six years are not wound back. Reforms, due in 1998, remain outstanding in some States and

Territories. In addition, reports and information released or brought to the Council's attention since June 1999 will mean that the ongoing implementation of institutional arrangements will continue to be an issue in the third tranche assessment.

Tradeable water allocations

A key reform that is the subject of much of the June 2000 supplementary assessment is the introduction of tradeable water allocations. The intense debate around defining the environment's water rights, the rights of businesses dependent on water and the rights of downstream users emphasises the importance for all governments and their communities to achieve an equitable and sensitive legislative framework for water allocations.

Tradeable water allocations provide the best mechanism for distributing water for the benefit of the environment and the economy. While reductions in water allocation will harm some businesses, the failure to implement reform would result in degradation such that existing entitlements would decline in value and utility.

The Council notes the achievement of legislative frameworks in the Northern Territory. A further supplementary assessment for New South Wales, Queensland and Western Australia in December 2000 should see new allocations systems implemented across Australia. This significant achievement will provide a sound basis for sustainable management of water into the future.

The importance of community consultation

Complex reforms require detailed community consultation. This is recognised in the 1994 water reform framework itself, wherein CoAG agreed:

- to the principle of public consultation by government agencies and service deliverers where change and/or new initiatives are contemplated involving water resources; and
- that where public consultation processes are not already in train in relation to recommendations regarding urban and rural water pricing, water allocations and water trading in particular, such processes will be embarked on.

The Council has recognised this throughout its assessment process. It is again reflected in this assessment, especially for new arrangements for setting new trade waste charges. In particular, the Council has not recommended reductions in, or suspension of, payments where a clear reform path has been identified by Government, including tabling of relevant legislation before Parliament. That said, the need for new arrangements is urgent. The Council would consider that, should

outstanding second tranche arrangements not be in place by the end of 2000, this would constitute a clear failure against reform commitments.

The Council has recently contributed to the broader community's understanding of the CoAG water reforms through papers explaining, in a clear and concise manner, the reforms themselves and the benefits they offer to metropolitan, regional and rural communities. These papers, covering urban and rural water reform, have been widely distributed.

In addition to meeting with governments, Council Secretariat officers have met with a number of irrigator, environmental and other community groups during the past six months. The discussions have provided valuable information about reform challenges and government responses. The Council will continue these discussions in the period prior to the third tranche assessment.

Assessment of Progress by Jurisdiction

South Australia

COST REFORM AND PRICING

Outstanding issues: trade waste charges, free water allowances and property based water and sewerage charges

Clause 3(a)(i) of the CoAG water reform framework notes governments' commitment to the adoption of pricing regimes based on the principles of full cost recovery and consumption based pricing. The CoAG framework also states that where cross-subsidies continue to exist they be made transparent and notes the desirability the removing cross-subsidies which are not consistent with efficient and effective service use and provision.

In South Australia, water charges for commercial and non-commercial customers are based on different pricing structures. For a full description of these structure, see the Council's June 2000 supplementary assessment.

In conducting the June assessment, the Council was concerned that free water allowances are not consistent with the principle of consumption based pricing (clause 3(a)(i)). Free water allowances, property value-based charges, and the absence of a comprehensive trade waste regime provided actual and potential non-transparent cross-subsidies which also are not consistent with clause 3(a)(i). The Council also noted that accurately identifying and reporting any cross-subsidies arising from current arrangements would be a very difficult task given a lack of transparency in the current arrangements.

Based on these issues, the Council recommended a 5 percent suspension of NCP payments in the June supplementary assessment until September

2000 for insufficient progress by South Australia with urban pricing reforms.

Developments since June 2000

Free water allowances

South Australia had, at the time of the June assessment, announced intentions to consider removing free water allowances from future pricing arrangements irrespective of the debate on cross-subsidies. However, the Council had not been provided with a firm government commitment on when, or even if, free water allowances would be removed from commercial customer charges.

South Australia has now informed the Council⁷ of a package of reforms that will remove free water allowances from commercial water pricing via a phased introduction of usage charges. After the initial phase-in period is complete, usage charges for all commercial customers will be the same as those that apply to all other customer groups.

Free water allowances will disappear in the first year (2002-03) when low usage charges for water previously provided for free will be introduced. Given that 2002-03 consumption commences as early as December 2001 under the rolling meter reading program, this means that user pays will commence for all customers between December 2001 and June 2002. After 2002-03, the level of usage charges will increase and access charges decrease annually in line with a 5 year phase-in of full usage charges. The phase-in period reflects the desire to moderate the impact of the reform for customers with bill increases. Over 50 percent of customers can however expect reductions in their total water bill.

South Australia has advised that this reform will be revenue neutral for the commercial sector. That is, the additional revenues raised from usage charges will be offset by a reduction in the level of property rates applied for access. The property rate is expected to fall by approximately 25 percent.

The reform will require legislative changes to the *Waterworks Act*. South Australia anticipates that the legislative changes will be introduced in the Autumn session next year with passage of the amendments by December 2001.

Trade waste charges

In correspondence provided for the Council's June supplementary assessment, South Australia stated that:

⁷ SA correspondence, 5 & 15 September 2000,

'... in the absence of a comprehensive trade waste charging regime, it must be conceded that potential does exist for some large trade waste dischargers to pay less than the incremental costs they impose on the system. For this reason trade waste charges are a key focus of the current review of sewerage pricing.'

While trade waste charges had previously been introduced to 17 of the State's largest waste dischargers, where a charge was applied, no charge was levied for discharges below acceptance limits. Available information at the time of the June 2000 Supplementary assessment suggested that trade waste dischargers paid only \$860 000 of the \$3 million estimated incremental costs. Joint costs are recovered through access charges on trade waste dischargers levied on the same basis as other sewerage customers. For a full description of these arrangements, see the Council's June 2000 assessment.

South Australia is now committed to introducing a broader based trade waste charge to apply to the major dischargers of trade waste based on the recovery of avoidable costs. The charges will apply initially to the largest 50 or 60 dischargers based on threshold measures linked to pollutant mass and volume. This group contributes approximately 90 percent of all avoidable trade waste costs, with some 7000 other trade waste dischargers accounting for the remaining 10 percent. Trade waste imposes avoidable costs of the order of \$3m. The proposals therefore target recovery of \$2.7m (indicative) in avoidable costs from the top 50 to 60 dischargers. In the future, new companies can move in or out of the scheme depending on whether they meet the threshold criteria.

SA Water will offer a discount on trade waste charges to a maximum of one-third of the property based access charge paid by individual customers. This is to take account of the fact that the access charge already incorporates some allowance for the avoidable costs imposed. The discount will be offered as a 50 percent reduction in the per unit discharge fee.

Implementation of the charges will commence in 2002-03 and will be phased in over 5 years to take account of the impact on dischargers that have invested on the basis of the current charging arrangements, and to honour existing contractual agreements which provide exemptions from charges for up to 2 years for some operators.

South Australia has advised that no change in legislation is required to introduce the reforms, although the precise structure of the charges and the implementation program would be further detailed after consultation with industry.

Payment of a CSO for Subsidies to Trade Waste Dischargers

The South Australian Government will provide SA Water with a CSO payment to take account of the phase-in of the trade waste charge. This is because the phase-in precludes the recovery of avoidable costs imposed by some trade waste dischargers. The CSO will be introduced in 2001-02 and will be explicitly identified in SA Water's Annual Report. Over the 5 year phase-in period, the amount of the CSO should be expected to decline as it is offset by increasing revenues from charges. By 2005-06 when the charge is fully implemented, any residual CSO would reflect any exemptions from the full charge granted by government.

Property based sewerage and water charges

South Australia has advised that it has no plans to move away from property based charges that apply to sewerage customers or to commercial water customers (subject to the changes to the free water allowances as above). However, South Australia has made a commitment that there will be no expansion of the use of property based charges beyond commercial water pricing and sewerage pricing, or any reintroduction of property-based charges for non-commercial water customers.

For a full discussion of the existing arrangements for sewerage and commercial water pricing see the Council's June 2000 assessment.

Discussion

Free water allowances

The Council has previously noted the significant free water allowances that existed in South Australia dilute signals for efficient consumption. The Council, therefore, considers the reform proposals to eliminate free water allowances comply with the principle of consumption-based pricing agreed to by jurisdictions under clause 3(a)(i) of the CoAG water framework.

The Council notes the sizeable phase-in period to achieve the abolition of free water allowances reform is based on the need for legislative amendments. These amendments are to be drafted and introduced in the Autumn session next year and are to apply to users from December 2001. The Council will be looking for this timetable to be met.

Overall, the Council is of the view that South Australia has now met its second tranche commitments with regard to this issue.

Trade waste charges

The Council recognised in the June 2000 assessment that South Australia currently has a selective, negotiated trade waste process targeting the State's largest dischargers in place. In that assessment, South Australia

acknowledged that the current arrangements are insufficient to discourage inefficient service use by trade waste dischargers (especially over the short to medium term).

Current pricing arrangements for trade waste dischargers may lead to non-transparent cross-subsidies which are not consistent with clause 3(a) of the agreed CoAG framework. For example, current total revenue from trade waste dischargers is more than \$2 million below estimated incremental costs. The reforms would appear to go along way to addressing this concern.

The Council notes the phase-in period for reform. Given the existence of commercial agreements in this area, the charge will be implemented in 2002 and phased in over 5 years. The phase-in period takes account of the many dischargers who have invested in their businesses on the basis that charges could be avoided by keeping discharges below discharge limits. South Australia has argued that given the significant level of charges for some dischargers, it would not be acting in good faith if it did not provide advance warning of the change in policy. A 2002-03 initial implementation will provide time to consult with dischargers on the detail of the charges and provide up to 12 months notice of the size, structure and phasing of the charge allowing dischargers time to further optimise their practices to limit their trade waste charge commitments.

South Australia's March 2000 discussion paper on sewerage pricing noted that the combination of property values (for services below acceptance limits) and a trade waste charge may result in some customers paying very high charges. The Council has previously suggested that South Australia's concerns highlight the limitations of using property values as a mechanism for charging for water and sewage services. South Australia has dealt with this by a subsidy scheme which has increased the complexity of the issue.

The Council agrees with the broad thrust of the reform to target the largest 50-60 dischargers who account for around 90 per cent of trade waste. The establishment of thresholds for applying the charge means the reforms will provide an ongoing basis for discharge management. However, the Council has had difficulty in establishing the basis for the setting of the charge given that penalties will be applied in some areas and discounts in others. This further emphasises the need for transparent pricing mechanisms. South Australia will further consult with industry on the specifics of the charges.

On balance, the Council is of the view that the broader based trade waste charge meets the outstanding requirements for the second tranche assessment. The Council will revisit the detail of how these are set for the third tranche assessment in the context of South Australia's general regulatory approaches to pricing.

Property Based Sewerage and Commercial Water Charges

The Council's June 2000 supplementary assessment discussed at length the full range of arguments on this issue, including the lack of transparency and the potential for cross-subsidies in the South Australian system based as it is on property based charges for sewerage customers and commercial water users.

This assessment concluded that where the potential for cross-subsidies is identified, the Council will look for the cross-subsidy to be transparently reported or mechanisms put in place (such as independent regulation) to ensure the issue is addressed in an ongoing and transparent fashion. There is a potential for cross-subsidies in the South Australian system to exist for some groups of commercial users given areas with relatively high property values may pay sewerage and commercial water charges greater than the stand alone costs of the services they receive. While South Australia disputed this finding, the Council concluded that the lack of transparency in current arrangements made a definitive answer on this issue virtually impossible.

The issue of transparency of pricing arrangements and cross subsidies in general has not been addressed by South Australia as part of the recent reforms. Given the issue in this area relates to the Council's concerns in other aspects of regulation in pricing, it may be better to address these issues in aggregate and, therefore, consider them in the third tranche assessment.

General Comment - The Need for Independent Prices Oversight

The Council believes that on a conceptual level the reforms will bring benefits to future consumers and, as such, the package must be seen to be a move in the right direction. However, the South Australian Government is making reform proposals that are mostly amendments to the current pricing framework, and the Council is on the record as having some concerns in determining whether this framework meets the CoAG commitments with regard to transparency, cross-subsidies and pricing principles.

An appropriate framework for natural monopoly service pricing starts with a required revenue target that reflects the efficient costs of providing the services demanded and then set prices within that framework. The South Australian proposals appear to make ad hoc adjustments to the current pricing structure which has no transparent reference to revenue targets nor underlying supply costs. This approach does not increase the Council's confidence that full costs will now be recovered. In fact the recent reforms could be seen to exacerbate the transparency problems the Council has already experienced in South Australia's pricing regime.

The Council is looking for the South Australian Government to establish a framework based on efficient costs of supply and then establish prices within that framework. The Council would have confidence that this task is being achieved if there was some form of independent prices oversight for water. There is a number of options available to South Australia to meet this objective. These range from appointing a regulator with appropriate guidelines, independence and pricing skills, to commissioning an independent audit function that releases a public report that is submitted with Departmental advice to the South Australian Cabinet for price determinations. The Council has previously raised the issue of independent prices oversight for water with South Australia, including in relation to the June 2000 assessment.

The Council notes that all other jurisdictions now have some form of independent prices oversight of the water industry, with the exception of one other jurisdiction that has committed to looking at this issue for the third tranche assessment.

The Council will be addressing the issue of independent prices oversight with South Australia for the third tranche assessment.

Assessment

It is now 15 months since the Council noted that it was not satisfied that CoAG commitments had been met in relation to water and sewerage pricing.

South Australia has taken a number of steps to meet the Council's concerns as outlined in the June 2000 assessment. Indeed, putting aside the issue of transparency and cross-subsidies, the abolition of free water allowances, the introduction of a broader based trade waste charge, the payment of a transparent CSO to SA Water, and the commitment to not increase the use of property based charges are reforms that are welcomed by the Council.

The Council is now of the view that South Australia has done enough to meet its outstanding second tranche commitments. Therefore, the Council considers that the appropriate recommendation is to lift the suspension of NCP payments imposed by the June 2000 assessment and reinstate any suspended payments.

The Council will be addressing the issue of general transparency in pricing through the establishment of some form of independent prices surveillance with South Australia for the third tranche assessment. The Council will revisit many of these issues again for that assessment.

Northern Territory

REFORM COMMITMENT: INSTITUTIONAL SEPARATION

Outstanding issue, June 2000

In June 2000, the Council was concerned that PAWA was responsible for setting its own service standards and that regulatory functions remained to be transferred. The Northern Territory had completed a review of legislation but had yet to make a government commitment to implementing the findings.

Developments since June 2000

Review of Water and Sewerage Legislation

As outlined in the Council's June assessment, the Northern Territory has completed a review of the Water Supply and Sewerage Act (the Act) under the NCP legislation review program. The review conducted by Marsden Jacob Consultants found that PAWA had retained regulatory responsibilities including setting the terms and conditions of supply via by-laws, standard setting, and powers to declare a district, sewered area and water supply area. In addition, the review found that the pricing process was not independent, consultative or transparent.

In broad terms, the review recommended:

- separation of PAWA's service provision role from standard setting and regulatory enforcement;
- licensing of all service providers by the Utilities Commissioner. The licence would include a duty to supply in specified areas, clarity of performance standards, monitoring by the Commissioner or other relevant agency and Customer Contracts or Charters; and
- prices oversight by the Utilities Commissioner.

The Water Supply and Sewerage Services Bill 2000

The Northern Territory Government has now advised that it has endorsed the recommendations of the review. In particular, the Government has agreed to transfer regulatory responsibilities from PAWA to the Utilities Commission. The regulatory functions including price regulation for water and sewerage will move from PAWA and the Minister for Essential Services to the Minister responsible for the Utilities Commission (the Regulatory Minister). The Utilities Commission will also be responsible for advising on PAWA's CSO arrangements. The Council notes it is the Northern Territory's intention to make the reports of the Utilities

Commission publicly available to emphasise transparency and accountability.

PAWA and other suppliers will also be required to hold a licence to operate services within a defined geographical area and be required to comply with service and supply conditions of the licence as set by the Regulatory Minister. With regard to price regulation, the Regulatory Minister will set out procedures for regulating the price of water and sewerage services equivalent to those that now apply with respect to non-contestable electricity customers under the *Electricity Reform Act 2000*.

The *Water Supply and Sewerage Services Bill 2000* will give effect to the recommendations and was introduced into the Legislative Assembly in the week of 16 October 2000. Upon passage, the Act will come into operation on 1 January 2001.

The Second Reading Speech of the Bill cites the following benefits of the reforms:

‘... Through the combination of these reforms, the government is seeking to provide a long-term industry and regulatory framework which ensures that PAWA concentrates on commercial objectives. This is essential if PAWA is to achieve the \$30 million per annum financial improvement target which the government has set for it.

In addition, the framework will allow more appropriate scrutiny of PAWA by the Government by, for example, requiring better definition of service standards, and monitoring of compliance. In turn, this should help ensure that improvements in efficiency at PAWA do not come about at the expense of appropriate standards of service for Territorians.’

Other benefits to be generated by the reforms include licence conditions to be imposed on PAWA that will require acceptance of trade waste which complies with pre-determined guidelines. Existing arrangements have allowed PAWA discretion as to whether to accept trade waste and on what terms, effectively providing no rights to customers. Finally, PAWA (and other suppliers) will be obliged by licence conditions to develop robust asset management plans that balance performance and investment in the medium to long term.

Assessment

Proposed reforms

The Council notes the reform path the Northern Territory has now adopted in implementing reforms to institutional arrangements.

The Council congratulates the Northern Territory on implementing these reforms that will result in a major overhaul of the way in which water services are provided in the Northern Territory. The Council strongly supports the conferral of regulation powers, including licensing and price regulation, on an independent authority. Such an arrangement fully

complies with the water reform framework. It will provide for ongoing improvements to the water services provided by PAWA and others to Northern Territory communities.

The Council in its June 2000 assessment stated that it endorsed the findings of the review as providing a clear path forward for the Northern Territory to meet its commitments. However, at that time the Government had not yet made a commitment to implementing the recommended reforms. The Council therefore felt that the only appropriate course of action was to recommend a suspension of NCP payments given the failure to make significant further progress on this 1998 commitment. The Council recommended the suspension be put in place until 31 October 2000 whereby the Council would conduct another supplementary assessment.

The June 2000 assessment required the introduction of legislation addressing the institutional reform issues into the Northern Territory Legislative Assembly by 31 October 2000. Given the progress made by the Northern Territory Government on this commitment and the introduction of the Amendment Bill before the Assembly, the Council is now of the view that the suspension of NCP payments be lifted and the suspended payments be reinstated.

Further supplementary assessment

Given the Bill is yet to be passed, the Council recommends a further supplementary assessment by 31 December 2000. For that assessment, the Council notes:

- its expectation that legislation consistent with CoAG commitments would be substantially in force for the Northern Territory to commence the reforms on 1 January 2001 to meet its commitments;
- that should the legislation not be substantially in force, this would constitute an ongoing failure to meet reform commitments:
 - at that time, given the payments were not reduced for this assessment the Council is of the view that an appropriate recommendation would be that:
 - NCP payments for the year 2000-01 be reduced by 2.5 per cent for the failure to have legislation substantially in force between July and December 2000; and
 - 2.5 per cent of NCP payments for the year 2000-01 be suspended for the period 1 January to 30 June 2001.
- Should reforms not be passed by the third tranche assessment, the Council would consider whether a reduction in NCP payments of at least 5 per cent should apply until legislation consistent with CoAG water reform commitments is passed.

Appendix 1: Payments under the Second Tranche of National Competition Policy

NCP payments are dividends paid by the Commonwealth to the States and Territories for reform performance consistent with the obligations in the three inter-governmental NCP Agreements.

For the first three financial years (up to and including 1999-00), NCP payments comprised two elements: maintenance of the real per capita value of the Financial Assistance Grants and NCP payments. However, from 2000-01, as a result of the change in Commonwealth/State financial arrangements whereby States and Territories are to receive revenue raised through the GST (Goods and Services Tax), only the Competition Payment element will apply. Nonetheless, the States and Territories, as direct recipients of GST revenue, will continue to receive dividends from implementing NCP, through increased GST revenues arising from economic growth.

Maximum NCP payments across all States and Territories under the second tranche are \$1.106 billion. The maximum amounts which each jurisdiction could receive, assuming satisfactory reform progress, are set out in Table A1 below. Each State and Territory received maximum NCP payments in 1999-2000.

State/Territory	1999-2000	2000-2001
New South Wales	210.9	155.9
Victoria	153.2	114.7
Queensland	119.9	86.0
Western Australia	62.3	45.6
South Australia	53.9	36.0
Tasmania	19.0	11.2
ACT	10.9	7.5
Northern Territory	14.6	4.7
Total for year	644.6	461.7

Source: Commonwealth Treasury, June 2000.

Appendix 2: Second Tranche Water Reform Assessment Framework

REFORM COMMITMENT: COST REFORM AND PRICING

Major Urbans and Non-Metropolitan Urbans

Drawing on the advice of the Expert Group and complying with the ARMCANZ full cost recovery guidelines, jurisdictions are to implement full cost recovery.

Water businesses must price between a floor price which allows for the continuing commercial viability of the system and a ceiling price which incorporates asset values and a rate of return but does not include monopoly profits:

- the floor price includes provision for future asset refurbishment or replacement using an annuity approach where service delivery is to be maintained; and
- the ceiling price includes provision for asset consumption and cost of capital calculated using a weighted average cost of capital (WACC).

Within the band, a water business should not recover more than operational, maintenance and administrative costs, externalities, taxes or tax equivalent regimes (TERs), the interest costs on debt, and dividends (if any) set at a level that reflects commercial realities and simulates a competitive market outcome.

The level of revenue should be based on efficient resource pricing and business costs. In determining prices, community service obligations (CSOs), contributed assets, the opening value of assets, externalities including resource management costs, and TERs should be transparent. The deprival value methodology should be used for asset valuation unless a specific circumstance justifies another method.

Jurisdictions must implement consumption based pricing. Two-part tariffs are to be put in place by 1998 where cost effective. Metropolitan bulk water and wastewater suppliers should charge on a volumetric basis.

Jurisdictions are to apply two-part tariffs to surface and groundwater comprising a fixed cost of access component and a volumetric cost component.

Metropolitan bulk water and wastewater suppliers must establish internal and external charges to include a volumetric component or two-part tariff with an emphasis on the volumetric component to recover costs and earn a positive real rate of return.

Jurisdictions are to remove cross subsidies, with any remaining cross subsidies made transparent (published).

For the purposes of the framework, a cross subsidy exists where a customer pays less than the long run marginal cost and this is being paid for by other customers. An economic measure which looks at cross subsidies outside of a Baumol band, which sets prices between incremental and stand alone cost, is consistent with the CoAG objective of achieving economically efficient water usage, pricing and investment outcomes. To achieve the CoAG objective, potential cross-subsidies must be made transparent by ensuring the cost of providing water services to customers at less than long run marginal costs is met:

- as a subsidy, a grant or CSO; or
- from a source other than other customer classes.

Where service deliverers are required to provide water services to classes of customers at less than full cost, this must be fully disclosed and, ideally, be paid to the service deliverer as a community service obligation.

All CSOs and subsidies must be clearly defined and transparent. The departure from the general principle of full cost recovery must be explained. The Council will not make its own assessment of the adequacy of the justification of any individual CSO or cross-subsidy but will examine CSOs and cross-subsidies in totality to ensure they do not undermine the overall policy objectives of the strategic framework for the efficient and sustainable reform of the Australian water industry.

Publicly owned supply organisations should aim to earn a real rate of return on the written down replacement cost of assets for urban water and wastewater.

Jurisdictions are to have achieved progress toward a positive real rate of return on assets used in the provision of all urban water supply and wastewater services.

Rural Water Supply and Irrigation Services

Where charges do not currently cover the costs of supplying water to users (excluding private withdrawals of groundwater),⁸ jurisdictions are to progressively review charges and costs so that

⁸ Private withdrawals of groundwater include private providers and small co-operatives who extract water from bores for private use, but does not include large co-operative arrangements (including trusts) that act as wholesalers supplying water as a commercial venture and that are subject to control or directions by government or receive substantial government funding.

they comply with the principle of full cost recovery with any subsidies made transparent.

Jurisdictions should provide a brief status report, consistent with advice provided to ARMCANZ, on progress towards implementation of pricing and cost recovery principles for rural services.

The Council will assess jurisdictions as having complied with the pricing principles applicable to rural water supply where jurisdictions:

- have achieved full cost recovery; or
- have established a price path to achieve full cost recovery beyond 2001 with transitional CSOs made transparent; or
- for the schemes where full cost recovery is unlikely to be achieved in the long term, that the CSO required to support the scheme is transparent; and
- cross-subsidies have been made transparent.

Jurisdictions are to conduct robust independent appraisal processes to determine economic viability and ecological sustainability prior to investment in new rural schemes, existing schemes and dam construction. Jurisdictions are to assess the impact on the environment of river systems before harvesting water.

Policies and procedures must be in place to robustly demonstrate economic viability and ecological sustainability of new investments in rural schemes prior to development. The economic and environmental assessment of new investment must be opened to public scrutiny.

Jurisdictions must demonstrate a strong economic justification where new investment is subsidised.

Jurisdictions are to devolve operational responsibility for the management of irrigation areas to local bodies subject to appropriate regulatory frameworks.

All impediments to devolution must be removed. Jurisdictions must demonstrate that they are encouraging and supporting devolution of responsibility, including through education and training.

REFORM COMMITMENT: INSTITUTIONAL REFORM

Institutional Role Separation

As far as possible the roles of water resource management, standard setting and regulatory enforcement and service provision should be separated institutionally by 1998.

The Council will look for jurisdictions, at a minimum, to separate service provision from regulation, water resource management and standard setting. Jurisdictions will need to demonstrate adequate separation of roles to minimise conflicts of interest.

Metropolitan service providers must have a commercial focus, whether achieved by contracting out, corporatisation, privatisation etc, to maximise efficiency of service delivery.

Incorporate appropriate structural and administrative responses to the CPA obligations, covering legislation review, competitive neutrality, structural reform.

Performance Monitoring and Best Practice

ARMCANZ is to develop further comparisons of interagency performance with service providers seeking best practice.

Jurisdictions have established a national process to extend inter-agency comparisons and benchmarking. Benchmarking systems are to be put in place for the NMU and rural sectors, "WSAA Facts" is to be used for major urbans, and service providers are to participate.

The Council will accept compliance for the three sectors subject to the Productivity Commission confirming consistency with the Report of the Steering Committee on National Performance Monitoring of Government Trading Enterprises, "Government Trading Enterprises Performance Indicators" (Red Book). The Productivity Commission has already confirmed the consistency of "WSAA Facts" for the major urbans. The Council recognises the first reports for the NMU and rural sectors are likely to be a rough cut in the initial years.

REFORM COMMITMENT: ALLOCATION AND TRADING

There must be comprehensive systems of water entitlements backed by separation of water property rights from land title and clear specification of entitlements in terms of ownership, volume, reliability, transferability and, if appropriate, quality.

A 'comprehensive' system requires that a system of establishing water allocations which recognises both consumptive and environmental needs should be in place. The system must be applicable to both surface and groundwater.

The legislative and institutional framework to enable the determination of water entitlements and trading of those entitlements should be in place. The framework should also provide a better balance in water resource use including appropriate allocations to the environment as a legitimate user of water in order to enhance/restore the health of rivers. If legislation has not achieved final parliamentary passage, the Council will recognise the progress towards achieving legislative change during its assessment of compliance.

Jurisdictions must develop allocations for the environment in determining allocations of water and should have regard to the relevant work of ARMCANZ and ANZECC.

Best available scientific information should be used and regard had to the inter-temporal and inter-spatial water needs of river systems and groundwater systems. Where river systems are overallocated or deemed stressed, there must be substantial progress by 1998 towards the development of arrangements to provide a better balance in usage and allocations for the environment.

Jurisdictions are to consider environmental contingency allocations, with a review of allocations 5 years after they have been initially determined.

Jurisdictions must demonstrate the establishment of a sustainable balance between the environment and other uses. There must be formal water provisions for surface and groundwater consistent with ARMCANZ/ANZECC “*National Principles for the Provision of Water for Ecosystems*”.

Rights to water must be determined and clearly specified. Dormant rights must be reviewed as part of this process. When issuing new entitlements, jurisdictions must clarify environmental provisions and ensure there is provision for environmental allocations.

For the second tranche, jurisdictions should submit individual implementation programs, outlining a priority list of river systems and groundwater resources, including all river systems which have been over-allocated, or are deemed to be stressed and detailed implementation actions and dates for allocations and trading to the Council for agreement, and to Senior Officials for endorsement. This list is to be publicly available.

It is noted that for the third tranche, States and Territories will have to demonstrate substantial progress in implementing their agreed and endorsed implementation programs. Progress must include at least allocations to the environment in all river systems which have been over-allocated, or are deemed to be stressed. By the year 2005, allocations and trading must be substantially completed for all river systems and

groundwater resources identified in the agreed and endorsed individual implementation programs.

Arrangements for trading in water entitlements must be in place by 1998. Water should be used to maximise its contribution to national income and welfare.

Where cross border trade is possible, trading arrangements must be consistent between jurisdictions and facilitate trade. Where trading across State borders could occur, relevant jurisdictions must jointly review pricing and asset valuation policies to determine whether there is any substantial distortion to interstate trade.

Jurisdictions must establish a framework of trading rules, including developing necessary institutional arrangements from a natural resource management perspective to eliminate conflicts of interest, and remove impediments to trade. The Council will assess the adequacy of trading rules to ensure no impediments. If legislation has not achieved final parliamentary passage, the Council will recognise the progress towards achieving legislative change during its assessment of compliance.

As noted above, for the second tranche, jurisdictions should submit individual implementation programs, outlining a priority list of river systems and groundwater resources and detailed implementation actions and dates for allocations and trading to the Council for agreement, and to Senior Officials for endorsement. This list is to be publicly available.

Cross border trading should be as widespread as possible. Jurisdictions are to develop proposals to further extend interstate trading in water.

REFORM COMMITMENT: ENVIRONMENT AND WATER QUALITY

Jurisdictions must have in place integrated resource management practices, including:

- ***demonstrated administrative arrangements and decision making processes to ensure an integrated approach to natural resource management and integrated catchment management;***
- ***an integrated catchment management approach to water resource management including consultation with local government and the wider community in individual catchments; and***
- ***consideration of landcare practices to protect rivers with high environmental values.***

The Council will examine the programs established by jurisdictions to address areas of inadequacy. Programs would desirably address such areas as government agency co-ordination, community involvement, co-

ordinated natural resource planning, legislation framework, information and monitoring systems, linkages to urban and development planning, support to natural resource management programs and landcare practices contributing to protection of rivers of high environmental value.

Support ANZECC and ARMCANZ in developing the National Water Quality Management Strategy (NWQMS), through the adoption of market-based and regulatory measures, water quality monitoring, catchment management policies, town wastewater and sewerage disposal and community consultation and awareness.

Jurisdictions must have finalised development of the NWQMS and initiated activities and measures to give effect to the NWQMS.

REFORM COMMITMENT: PUBLIC CONSULTATION, EDUCATION

Jurisdictions must have consulted on the significant CoAG reforms (especially water pricing and cost recovery for urban and rural services, water allocations and trade in water entitlements). Education programs related to the benefits of reform should be developed.

The Council will examine the extent and the methods of public consultation, with particular regard to pricing, allocations and trade. The Council will look for public information and formal education programs, including work with schools, in relation to water use and the benefits of reform.

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