

Friday, July 30, 1999

Mr John Cosgrove
Presiding Commissioner
Productivity Commission
Locked Bag 2
Collins Street
East Post Office
MELBOURNE VIC 8003

Dear Mr Cosgrove

Re Supplementary Submission to the Productivity Commission

Murray Irrigation Limited would like to reinforce some of our arguments presented to the Productivity Commission in Albury and provide additional comments on aspects of your draft report into the impact of Competition Policy Reforms on Rural and Regional Australia.

The focus of these comments is the water reforms associated with the National Competition Policy.

Water Pricing Principles

Murray Irrigation Limited is increasingly frustrated by the failure of the Commonwealth to recognise criticism of some elements of the Council of Australian Governments water pricing framework made by both industry and independent economists.

Murray Irrigation Limited believes the Productivity Commission is ideally placed to provide incisive comment and recommendations on weaknesses and ambiguities in the water pricing principles advocated as part of the National Competition Policy.

Rate of return on existing infrastructure

Murray Irrigation Limited's considers the capital costs of existing water infrastructure are sunk. No contribution to a rate of return should be expected. The capital invested in headworks and water distribution infrastructure has no alternative use and the investment is sunk.

Governments made a decision in the past to invest in headworks and water distribution infrastructure. Agricultural production and other uses have developed on the basis of these past investments. The original costs bear no relationship to the current use of the assets.

Many irrigation assets have few alternative uses and are characterised by natural monopoly elements. Public authority dividends are a reflection of anti-competitive behaviour rather than something that can be justified by the market. Furthermore, public sector assets would have to be valued before a rate of return was struck. The value of the assets depends upon expected costs and returns from their use. It is impossible to accurately value the assets of the irrigation system without some estimate of the price of water.

Consequently, the relationship between value of the assets and price is circular. The value of assets can be adjusted to determine the rate of return and justify any desired pricing policy.

Murray Irrigation Limited believes that including a rate of return on assets in the price of irrigation water is a form of taxation and should be rejected outright by the Productivity Commission.

These arguments have been accepted by the NSW Independent Pricing and Regulatory Tribunal which is the most independent and robust process for determining water prices and water pricing principles in Australia.

Future asset refurbishment

Long-lived irrigation infrastructure needs to be maintained to extend its life indefinitely. Either depreciation or sinking fund charges, not both can meet future costs of maintaining this infrastructure. Murray Irrigation Limited's preference is for a forward looking approach that is based on independent engineering assessment of the future costs of asset refurbishment and replacement.

Depreciation approaches such as renewals accounting and the deprival values approach require valuation procedures that are costly and theoretically flawed.

Murray Irrigation Limited considers it is not technically feasible to accurately assess asset and refurbishment costs for longer than 10 year periods and recommends a mixture of equity (sinking fund contributions) and debt funding to finance future refurbishment.

Water prices will increase because of competition reforms

Murray Irrigation Limited is concerned with the enthusiasm of the Productivity Commission to accept increased water prices as an outcome of National Competition Policy. The Government owned and operated water monopolies were as inefficient as other Government monopolies for example, gas and electricity. Murray Irrigation Limited's predecessor the Government owned and operated Murray Irrigation Area and Districts is evidence of this inefficiency. Achievements made by Murray Irrigation Limited in the transformation of a Government owned monopoly were outlined in our earlier submission.

Murray Irrigation Limited encourages the Productivity Commission to recognise the importance of an independent regulatory environment that ensures monopolies run transparent and efficient organisations.

Progress with the implementation of property rights

Murray Irrigation Limited encourages the Productivity Commission to recognise the importance of clearly defined property rights in water for both water users and the environment. Currently environmental allocations are not a fixed point in the water debate and the green goal posts are constantly shifting. This situation is causing significant uncertainty in NSW and will only be resolved by the introduction of clearly defined entitlements for water users and the environment including in-stream uses. A delay in the introduction of property rights is undesirable.

In the case of over committed resources, Murray Irrigation Limited considers the only equitable and efficient way of reallocating over committed resources is to purchase entitlements and allocate these entitlements to specific, defined environmental purposes.

Progress with the implementation of the reform

Murray Irrigation Limited considers that the progress in NSW towards pricing reform is greater than outlined in the draft report and again encourages the Productivity Commission to contact the NSW Independent Pricing and Regulatory Tribunal for a detailed description of the achievements in NSW.

It is also important to note there are significant differences between NSW and Victoria in the way they are approaching property rights. The NSW approach is slower than Victoria's and offers little certainty to water users of the security of their future water supply. In contrast the Victoria bulk water entitlements in the Goulburn and Murray systems address irrigation security but have not comprehensively addressed in-stream uses or end of system flows.

I hope you find these additional comments helpful and look forward to receiving your final report.

Yours sincerely

George Warne
General Manager