MURRUMBIDGEE IRRIGATION

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John Cosgrove
Presiding Commissioner
Productivity Commission
Impact of Competition Policy Inquiry
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Dear Commissioner,

Please accept the following submission to your inquiry into the impact of National Competition Policy. This adds to our 3 September 1998 submission to the Senate Committee.

Our comments relate mostly to the Council of Australian Governments (COAG) water reforms and the consequent work by the COAG Task Force on Water Reforms, Agriculture and Resource Management Council of Australia and New Zealand (ARMCANZ) and the standing committee of senior ARMCANZ personnel (SCARM).

I can now provide proof of my comments when you were at Leeton that the electricity reforms have also thrown up another unforeseen problem for rural water users in a drought. Competition Policy reduced electricity prices last year and forcing Snowy Hydro to forgo generation (attached extracts, pages 1 & 9, SMHEA 97/98 Annual Report) which has resulted in above target water reserves in its storages. As a result it has only released the minimum agreed volume to Murray and Murrumbidgee water users 1062 and 1026 GL rather than the average long term release of approximately 2,400 GL normally associated with above target storage (attached extracts, pages 1 & 10). This has reduced the normal security allocation for our irrigators this year by at least 5% at a time when initial allocations were the lowest on record. In Murrumbidgee Valley, allocations are still only 81%, reducing farm output and therefore regional wealth creation.

Beneficial Competition Policy impacts in the electricity industry has resulted in adverse economic impacts on irrigated agriculture in the Murray and Murrumbidgee valleys. Is this another wealth transfer to the cities, where most electricity consumers are, to the detriment of these inland valley communities?

Yours faithfully

Cedric Hoare
Chief Executive Officer

2 December 1998

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There may be some upside for country people under COAG, Hilmer and Competition Policy, but unfortunately governments are hell bent on introducing all the downside first.

Property rights to water are still down the track, but full cost recovery could not wait.

While a tax equivalent regime has been introduced so the so called Government entities don't have an unfair advantage over private enterprise, it has been allowed to happen in reverse. Private irrigation companies are able to receive the diesel fuel rebates but Murrumbidgee Irrigation was refused because as a SOC we are a government business.

The COAG water reforms have spawned a lucrative industry for bureaucrats and economists as each of the reform principles is subjected to detailed studies to determine what it really means and how it should be implemented.

One consultancy has undertaken the same study in three states, ostentably to see why water trading is not as wonderful as COAG predicted. A far less expensive option would have been to ask any irrigator. The answer is simply that without property rights to water allocations nobody knows what they are buying and they are unlikely to buy when reliability is being manipulated by environmentalists.

We have been given the opportunity to comment on some of these studies during their consultancy stage but we have been denied any role in setting the work program, reviewing the continuing relevance of the principles or ensuring their equitable implementation. It is most frustrating that recommendations to encourage efficiency and competition result in huge price rises for consumers while policy developers waste money and time adding to the cost structure.

ARMCANZ has issued a draft set of seven guidelines on water pricing, which apparently the National Competition Council is already using. The following comments address those draft guidelines.

We continue to be disappointed at the superficial community input before these documents find their way to COAG. Too little concern is being shown for those most impacted by government decisions. Minister and bureaucrats are so focussed on earning their share of the $16 Billion they are neglecting those who are being sacrificed in the process.

GUIDELINE 1 - APPLICATION IN PRACTICE

The reality of application of a regulatory regime of pricing in our diverse business, political and economic environment is questionable.

How appropriate is it to put forward the guidelines when some irrigation schemes operators are private co-operatives and companies with their own price governance objectives.

Do the guidelines suggest jurisdictional regulators should impose principles on the internal pricing regimes of these bodies. We can only assume no. If not, then it is unreasonable to impose them on the state owned schemes operations or on private diverters supplied from state run rivers, as this will artificially distort price and thus cost differentials between competing producers, and distort competitive neutrality.

GUIDELINE 2 - ASSET VALUATION

It is dangerous to get too hung up on the valuation of assets which were the result of policies and investments of the past. The only valid use for asset valuation in the area of pricing is in the value that needs to be recovered over the life of the asset to maintain and replace its operational capacity for as long as it is needed, or the value of new investments that require funding.

The value of existing assets is irrelevant to today and tomorrow's pricing as there is no alternative use of the capital or asset. The investment is sunk and the inherent value of that investment is itself a function of the revenue derived from water prices.

GUIDELINE 3 - ANNUITIES

We have no issue with this guideline provided flexibility is available to use the most appropriate mix of forward provision and debt financing, given the liquidity demands on the business, its customers relative wealth, and the magnitude of the individual asset.

There should be a concerted campaign by ARMCANZ and other involved experts to have Australian Accounting Standards reviewed to make them relevant to long life assets in the irrigation industry.

With major river infrastructure like dams and weirs, there are more beneficiaries than consumptive extractors and Government has a responsibility to fund a proportional share of future annuities in cash rather than on a needs basis. We have all experienced the results of past unwillingness to put cash away and then be unprepared to increase taxes to fund replacement infrastructure.

Accumulating sinking funds for asset renewal can lead to waste or misuse of those funds or to over-engineering of replacement works. A proper balance between the benefitting generations must be maintained and accumulated funds must be protected from abuse. That requires the customers and the business managers to work closely together with full transparency and accountability to all concerned.

GUIDELINE 4 - UPPER LEVEL OF RECOVERY

Externalities

We do <u>not</u> accept the views of most in this area. The guidelines describe externalities as environmental and natural resource management costs <u>attributable to</u> and incurred by the water business. It is economically and financially unreasonable to not include the benefit side of the externalities. If it is reasonable to bear cost it is equally reasonable to attract benefit to those who pay for benefits.

It is also worth mentioning that the community derive ongoing benefit from the so called degradation caused by irrigation production. In many cases it is simply a consumption of resources and not degradation. It is relevant that many past practices were recommendations of Government Resource Management Agencies.

We must be vigilant to ensure the cost of externalities are an efficient cost within the general definition, and should only be included where there is a charge made for something useful done. We want no more of the nefarious "cost" that is notionally attributed to our activities, by those who have other agendas. For reasons of lack of trust, we require an audit role over expenditure to ensure fairness and compliance

If any issue of cost or charge arises then it must be as a result of remedying degradation within the area of impact of those who are billed.

Demand management through penalty pricing or monopoly rents is not on.

Cost of Capital

Pricing to cover the cost of capital should only apply to capital invested in new assets and not sunk investments, nor their renewal or replacement.

This latter renewal or replacement is already funded by customers through annuity contributions. Where the capital for new investment is funded in customer pricing there is no justification for recovering any cost of capital over its interest and debt servicing cost.

To recover in excess of the actual cost to the business is to tax consumers.

GUIDELINE 5 - LOWER LEVEL OF RECOVERY

Dividends

There is no justification for setting any dividend let alone one which is seen to reflect commercial realities and stimulate a competitive market outcome. If we are to foster development in rural Australia, Government investment must be continued in infrastructure, and the justification for this investment, besides recognising social growth, must recognise the indirect returns to Government as part of the revenue stream from the investment.

The theory on dividends may sound right but it is a nonsense in practice. What useful outcome is sought from this unwarranted inclusion ? What is the commercial reality of a dividend in an irrigation system from Dam to farm where irrigators pay their share of operation, maintenance and administration costs, externalities, taxes and renewal of infrastructure. Economic theory fails !

What competitive market outcome will be simulated ? Farmers out of business, monopoly rent, third party dam and river regulation ? Dividends are the province of the owner of the business. Governments use them in businesses they own to fund social programs not to improve the economics of their business or of their customers. Any dividend to Government for other than loan servicing is a tax.

GUIDELINE 6 - EFFICIENT RESOURCE PRICING

It is impossible to see this having any application to private irrigation scheme operators. Raising prices to limit consumption in the irrigation business has been shown to be a failure. Economics is not a perfect science and forceful application of economic theory is not good business.

GUIDELINE 7 - TRANSPARENCY ISSUES

The issue of contributed assets has not received the level of informed thought that it should. It covers:-

- new service assets provided by customers or developers individually;
- replacement assets funded from government dowries in recognition of past neglect;
- replacement of new assets funded from customer contributed annuities.

In each case the rational economic process has been supplanted by a decision by someone other than the entity providing the funds.

Accounting standards offer little help in consideration of this issue. Wise people who know the business need to meet to draw it out. We refer also to page 9 of the August 1997 report for Draft Guidelines on Determining Full Cost Recovery dealing with contributed assets. We agree with the three dot points made:

- support the development of a national approach to the question of whether a rate of return should be sought on contributed assets;

- agree that in the future water authorities separately identify both contributed assets and developer charges in their accounts in terms of both revenue and assets;

- support the need for water authorities to be cognisant of the implications that the choice of whether or not to earn a return on privately contributed or funded assets may have on charges and cross subsidies.

In closing, we point out that the guidelines attempt to cover the whole of the water industry - major metropolitans, rural towns and irrigation schemes. This leads to incompatible tests. There is no such "industry". It is imperative that irrigation businesses be addressed in their own right, free from the influence of the very different urbans and that there be clearly expressed the distinctions between the bulk water (river) system and the collective schemes.

The amenities provided by the presence of irrigation allows communities to develop and allows tourism, recreation and allied activity to piggyback on the irrigation investment (private and corporate or government). Without the founding irrigation profitability the others will wither.

It seems clear to us that the earlier COAG principles in connection with its planned water reform agenda need urgent review. This must include users and scheme operators at the highest level. It must reflect the competitive influence of schemes now being in private hands. It must aim to promote the efficient use of existing irrigation investment and at the same time, enhance the prospects of irrigated agriculture development through research, development, and a market focus.

SNOWY MOUNTAINS

HYDRO-ELECTRIC

AUTHORITY

Key outcomes

	93/94 Results	94/95 Results	95/96 Results	96/97 Results	97/98 TARGET	97/98 RESULTS
Energy Generation						
Energy Production (energy sent out gigawatt hours)	5,480	5.526	4.752	4.958	5.851	3,871
Black Start Reliability (successful annual test)	Passed	Passed	Passed	Passed	Pass	Passed
Water Management						
Water Releases (gigalitres from headworks M1&T1 Power Stations)	2.658	2.749	2,183	2,340	2,858	1,943
Water releases (percent of long term average)	110	114	91	97	119	81

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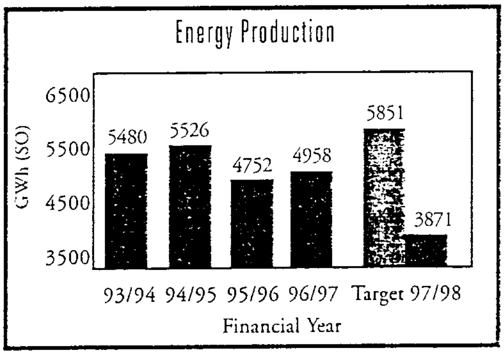
ENERGY

Energy production and water releases for the year were well below those projected in the Scheme's Annual Operating Plan as a result of low electricity market prices. However, minimum water releases agreed by Snowy Mountains Council were achieved.

Black start tests were conducted and passed at all five power stations with black start capability.



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WATER

The Authority manages the regulation of water in accordance with the Annual Operating Plan and provides minimum notified releases when approved by Snowy Mountains Council. Releases for 1997-98 were 81 percent of long term average.