



19 January 2007

Mr Greg Watkinson  
Director, References and Research  
Economic Regulation Authority  
PO Box 8469  
PERTH BUSINESS CENTRE WA 6849

Dear Mr Watkinson

### **ECONOMIC REGULATORY AUTHORITY INQUIRY ON HARVEY WATER BULK WATER PRICING**

The Department of Agriculture and Food, Western Australia (DAFWA) welcomes the opportunity to comment on the Draft report of the Economic Regulatory Authority (ERA) Inquiry on Harvey Water Bulk Water Pricing. In summary:

1. The Water Corporation's capital works program should be reviewed for cost-effectiveness and to ensure that its approach to risk management is consistent with expenditure on other community safety programs.
2. The ERA analysis underestimates the financial impact of increasing dam safety charges on dairy farmers (and other irrigators) by underestimating dam safety costs per ML (by basing rates per ML on potential rather than actual irrigation water use) and by including Australian Government restructure payments as farm income for 10 years after payments will cease.
3. The development of an equitable cost sharing mechanism for dam safety provides an opportunity to develop pricing models incorporating incentives that aim to encourage more efficient use of water by irrigators.

#### **Costs of safety upgrade**

The ANCOLD Guidelines lead to greater investment in dam safety per statistical life saved than on other areas of safety improvement within the community. This would impose an inequitable cost burden on water users compared to users of other State Government infrastructure.

Water Corporation's dam safety program should be reviewed for cost-effectiveness and subjected to comparison with alternative risk management strategies. DAFWA supports the Department of Treasury and Finance (DTF) recommendation that dam safety expenditure needs to be placed within a common framework to guide consistent public expenditure on safety issues.

It may also be appropriate that the Western Australian Government legislates for an alternative framework for managing the risks associated with dams as suggested by DTF.

## Estimated impact on farm profit and dairy farm adjustment pressures

The Western Australian dairy industry has been under considerable adjustment pressure since the deregulation of the liquid milk market in July 2000. Deregulation has delivered a real reduction in consumer milk prices of around 15c/L (worth more than \$35 million pa to Western Australian consumers) but has seen average farm business profit on dairy farms reduced from \$50,735 in 1999/2000 (ABARE, 2001) to \$1,575 in 2004/2005 (ABARE, 2006). The number of dairy farm businesses in the Harvey Irrigation Area has declined from around 120 to 70 during that time.

As noted by ERA, ABARE estimates that about half of WA dairy farms had a negative Farm Business Profit in 2004/05.

The draft ERA report presents a range of dam safety charges to Harvey Water from \$0.8 M to \$3.2 M pa at different levels of Present Value for capital expenditure (ERA Table 5.1). The charges per ML derived from those values appear to spread across water sales of around 130,000 ML pa reflecting total water allocation to Harvey Water rather than actual water sales. Harvey Water's annual report for 2004/2005 shows average sales of 77,218 ML pa between 1996 and 2004. The charges per ML presented in ERA Table 5.1 may therefore be a substantial underestimate of the true cost per ML to irrigators.

Per megalitre dam safety charges based on sales of 77,000 ML pa (and the Total Payments from ERA Table 5.1) are presented in Table 1 below. Estimates of the resulting average dam safety charges per dairy farm at different levels of dam safety charge to Harvey Water (based on an estimated average water use of 500 ML pa per farm) are also shown in Table 1.

The ERA estimate of the impact of increasing dam safety charges on Farm Business Profit on dairy farms includes payments under the Dairy Structural Adjustment Program (DSAP) as a component of Farm Business profit (ERA note 82). The final payments under that scheme will be made in 2008. It is therefore not appropriate to include continuing DSAP payments in an analysis examining the impacts of water pricing to 2017.

Table 1 shows an estimate of annual Farm Business Profit (based on data from ABARE, 2006) at different levels of total dam safety charge to Harvey Water excluding DSAP payments. Estimates of the proportion of irrigated dairy farms with a positive farm business profit (from the mean and SE values reported in ABARE, 2006) at different levels of dam safety charge are also shown.

**Table 1. Impacts of dam safety charges on water charges and profitability on dairy farms**

Total charge (\$M)	3.2	2.6	2.4	2.0	1.6	1.4	0.8
Charge (\$/ ML) <sup>1</sup>	\$41.56	\$33.77	\$31.17	\$25.97	\$20.78	\$18.18	\$10.39
Charge / farm <sup>2</sup>	20779	16883	15584	12987	10390	9091	5195
Mean farm profit <sup>3</sup>	-19204	-15308	-14009	-11412	-8815	-7516	-3620
% profitable <sup>4</sup>	35	38	39	41	43	44	47

<sup>1</sup>At Harvey Water's 1996-2004 annual sale level of 77,000 ML pa.

<sup>2</sup>Based on estimated average dairy farm use of 500 ML pa.

<sup>3</sup>Assuming all other income and costs remain constant.

<sup>4</sup>Based on standard deviation of Farm Bus Profit of \$50,000 derived from ABARE (2006).

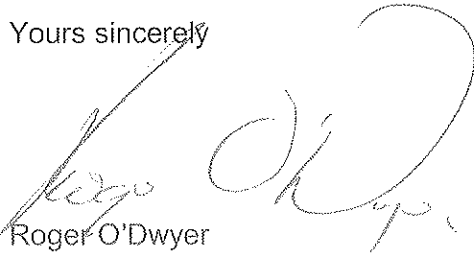
This compares with ABARE estimates that currently about half of WA dairy farms had a negative Farm Business Profit in 2004/05.

Dairy farmers in the South West Irrigation Area have experienced low levels of profitability since deregulation (ABARE, 2006). A 2006 Dairy Australia (DA) survey indicated that 40% of farmers in the Harvey Irrigation area are unlikely to be dairy farming by 2009. It is likely that any rapid transition to full recovery of the costs of compliance with ANCOLD guidelines would hasten the exit of milk producers from an industry that is already subject to intense adjustment pressures.

Dairy farmers faced with steep increases in water costs have the opportunity to increase water use efficiency through adoption of newer technology such as centre-pivot irrigators to replace the traditional surface irrigation method of overland flow. However increasing irrigation water charges in an environment where profitability is already marginal will reduce farmers' ability to make the capital investments needed for significant improvements in water use efficiency. The 2006 DA survey reported that none of the farmers interviewed had made capital investment in irrigation equipment during the previous year and that only 11% planned to do so in the coming year. None of the farmers interviewed had attended training or skills development to increase water use efficiency in the previous year. Neither did they plan to do so in the coming year.

The development of an equitable cost sharing mechanism for dam safety provides an opportunity to develop pricing models incorporating incentives that encourage more efficient use of water by irrigators. This may help mitigate adjustment pressures, contribute to the sustainability of the industry and support other State and National goals related to the efficiency and effectiveness of water use. I recommend that the ERA give some thought to broadening its approach to consider such complementary benefits.

Yours sincerely



Roger O'Dwyer  
EXECUTIVE DIRECTOR  
INDUSTRY AND RURAL SERVICES

For

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DIRECTOR GENERAL