



## **Submission to the Economic Regulation Authority's Discussion Paper**

Inquiry into Water Resource Management and  
Planning Charges

31 August 2009



## 1. Introduction

The Water Corporation (Corporation) offers this submission in response to the Discussion Paper prepared by the Economic Regulation Authority (ERA) as part of its Inquiry into Water Resource Management and Planning Charges.

The Corporation is the major supplier of potable water in Western Australia, and is therefore one of the primary beneficiaries of the water resource management and planning activities performed by the Department of Water (DoW).

In its response to the ERA's Issues Paper, the Corporation indicated that it would be willing to support the introduction of water resource management and planning charges, subject to them being:

- based on the efficient cost of delivering the services; and
- applied equally to all licence holders, so that public water supply customers do not bear a disproportionate percentage of the costs based on a perceived higher capacity to pay.

In addition, the Corporation recognised that the introduction of appropriate water resource management and planning charges would represent an opportunity to ensure greater transparency and accountability in water resources management.

## 2. Overview

The Corporation generally supports the economic principles raised by the ERA in its discussion paper. These economic principles should form a sound base for the recovery of efficient and transparent costs associated with the DoW providing private goods, while the costs associated with the DoW providing public goods will continue to be appropriately recovered through general taxation.

However, when applying the economic principles to an actual pricing mechanism, the Corporation wishes to highlight the following practical issues that were not specifically raised in the discussion paper:

- i. Whether charges are based on state-wide average costs or resource-specific costs;
- ii. Clearly defining the roles and responsibilities of the DoW before implementing a charging mechanism; and
- iii. Recognising activities performed by licence holders that fall within the official responsibilities of the DoW.

Without considering the complexities associated with the practical issues listed above, the charges paid by individual licence holders may not reflect the outcomes sought by the economic principles proposed in the discussion paper.

In addition, it should be recognised that the opportunity for market efficiency gains through the introduction of water resource management and planning charges would be limited to new licence applications. Recovering the DoW's costs associated with providing ongoing functions to existing licence holders would largely be an issue of equity.

### **3. Practical Considerations**

#### **3.1 State-wide vs. Resource-Specific Charges**

In determining the most appropriate method to recover costs from licence holders the ERA Discussion Paper notes that “in an efficient market, costs are generally allocated to those who cause the costs to be incurred.”

The DoW's costs are not evenly spread across all water resources and are not necessarily related to the volume of water extracted by licence holders. The characteristics and geographical location of a water resource will typically determine the costs associated with its management and planning. Generally speaking, ground water sources in lower rainfall areas with a large number of licence holders e.g. Gngangara mound, will generate higher potential externalities and greater DoW costs than surface water sources in high rainfall areas with a small number of licence holders e.g. Ord River Dam.

Therefore, in order to appropriately allocate the costs to licence holders causing the costs to be incurred, licence holders should pay a charge based on the costs associated with the specific water resource they are drawing from.

Given the large number of water resources throughout Western Australia, the calculation of a resource-specific charge for individual licence holders would potentially be cumbersome and costly to administer. A band structure similar to the Corporation's charges for country commercial water customers may be appropriate in this instance. The cheaper water resources would be in a lower band and have lower charges, while the more expensive water resources would be in a higher band and have higher charges.

A charge based on a state-wide average cost would be relatively straightforward to calculate and administer. However, the trade-off for having a lower administrative burden is that the charges would be less cost reflective for individual licence holders. In determining the appropriate charges for its Draft Report, the ERA will therefore need to consider the balance between accuracy and administrative cost.

The Corporation would support charges based on resource-specific costs. Charges based on state-wide costs will introduce the possibility of cross-subsidies, licence holders paying for services they do not use and licence holders paying twice for the same service. Each of these issues is discussed further in Section 3.2 and Section 3.3 below.

### 3.2 Clearly Defining the Role of the Department of Water

The DoW is not a monopoly provider of water resource management and planning activities in Western Australia. A proportion of the DoW's recognised functions are currently being carried out by other organisations (including the Corporation) either through imposed licence conditions or where there is a limited capacity at the DoW to undertake urgently needed activities.

The following example describes a situation where the Corporation would potentially be performing recognised functions of the DoW:

#### *Example 1 – Ord River System*

The Corporation holds two water licences in the Ord River System. The first licence is required to abstract a small quantity of water for canal maintenance and for small individual users located off the canal. The second licence is required for the Corporation to store water. This licence includes operating the Ord River Dam and the Kununurra Diversion Dam. The Corporation releases water for multiple licence holders including: Pacific Hydro, Ord Irrigation Cooperative, Argyle Diamond Mine, and other smaller downstream users. The Corporation does not use this water for the provision of any town water supply.

Under its proposed licence conditions in the Ord River System, the Corporation would be required to monitor and maintain all environmental flows downstream of the dams. These activities would be provided for the benefit of other licence holders using the water resource. Responsibility for monitoring and maintaining downstream environmental flows from dams technically falls within the functions of the DoW.

A licence holder should not be charged for activities it is required to perform as part of its licence conditions.

Furthermore, as highlighted in Section 3.1, care should be taken to avoid the licence holder paying the DoW's state-wide cost of performing a particular function, while also paying for the cost of performing that function for a specific resource. A situation should not arise where a licence holder would be required to pay twice for the same service.

Before any charges are implemented, the roles and responsibilities of the DoW need to be clearly defined. There should be a clear and documented understanding of what functions the DoW is expected to perform, and the individual activities that can and cannot be charged for. As customers paying the DoW for its services, licence holders should be entitled to expect a certain level of service (e.g. quality and timeframe of service delivery) and accountability in return.

In defining the roles and responsibilities of the DoW, and the activities that can and cannot be charged for, the Corporation would support the general framework as developed by the National Water Initiative (NWI).

The Corporation also wishes to highlight potential “grey areas” between the roles and responsibilities of the DoW and other agencies such as the Department of Environment and Conservation (DEC) and the Department of Planning (DoP). These areas may present difficulties when seeking to define the individual activities that the DoW can and cannot charge for. Where there is an overlap in functions between departments, there should not be a situation where a licence holder is required to pay twice for the same functions. Potential areas of overlap could include: the enforcement of land use compatibility in public drinking water source areas, and the management of wetlands and waterways.

In addition, the defined roles and responsibilities should be developed whilst being mindful of possible amendments to the legislation, which will change the nature of the DoW’s role and responsibilities. For example, legislative changes will ensure implementation of the NWI outcomes, including more explicitly required statutory water management planning.

### **3.3 Recognising Water Resource Management & Planning Activities**

Once the roles and responsibilities of the DoW have been clearly defined, then going forward:

- i. The DoW should assume complete responsibility for undertaking and completing its defined roles and responsibilities; or
- ii. Licence holders can perform duties of the DoW in certain instances, provided the cost of this effort is recognised in the DoW’s charges.

Ultimately, the organisation that can effectively perform the duties at the least cost, while ensuring and maintaining quality of service, should be the organisation performing the duties.

Under option ii above, an appropriate charging mechanism should recognise the activities carried out by licence holders on behalf of the DoW that benefit (or will benefit) the general public and/or other licence holders. Under these specific conditions an adjustment would be required, presumably in the form of a reduction to the charges.

In recognising the efforts of a licence holder, the adjustment to the charges would need to ensure that:

- only the proportion of the costs associated with the benefits provided to the general public and/or other licence holders are recognised; and
- only the efficient costs of performing the DoW’s duties are captured, so that there is no incentive for licence holders to “gold plate” activities associated with these duties.

If no adjustment is made, then customers of the licence holder performing activities on behalf of the DoW will bear a disproportionate percentage of the costs. This cross-

subsidy (of other beneficiaries of the resource) has the potential to result in an under-investment in the development of the resource and an inequitable sharing of the costs.

Had the DoW performed these activities and incurred the costs itself, then the costs would have been appropriately recovered by the DoW from either the tax payer or from the relevant licence holders.

The following example can be used to highlight this issue:

*Example 2 – Perth Regional Aquifer Modelling System (PRAMS)*

The ERA's Discussion Paper specifically highlights the general, large-scale modelling of water resources through PRAMS as an example of a public good provided by the DoW. Under the ERA's proposed economic principles, the costs associated with this activity are most appropriately funded through general taxation.

Historically, PRAMS was jointly developed by the DoW and the Corporation through a memorandum of understanding. The Corporation spent approximately \$2 million in the development of PRAMS and has spent a further \$2 million in investigations to update and improve its accuracy. A proportion of these costs have essentially been recovered from the Corporation's customers for the provision of a public good. This historical expenditure would be regarded as a sunk cost under the economic principles raised in the ERA Discussion Paper.

However, both the DoW and the Corporation continue to use, update and improve PRAMS on an ongoing basis. Once potential charges are introduced, any future DoW expenditure on PRAMS would be recovered through general taxation, while any future Corporation expenditure on PRAMS would be recovered from the Corporation's customers.

Other examples typically relate to research (such as hydro-geological investigations, monitoring etc) that the licence holder has carried out and made freely available to the DoW.

However, with this issue it is important to clarify that if a licence holder performs the DoW's recognised duties for the sole benefit of its own customers then no adjustment to the charges is required. In this instance there would be no cross-subsidisation.