

**Submission To  
The Review Of The Water Services  
Coordination Act**

**November 2002**



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**CHAMBER OF COMMERCE AND INDUSTRY  
WESTERN AUSTRALIA**

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## Processes and Objectives of Regulation

### Overview

Before identifying how the water industry should be regulated, it is important to establish whether, and why, it should be regulated.

The Issues Paper does a good job of outlining the key reasons why regulation is important and necessary in some industries<sup>1</sup>.

The most important of these in the context of the WA water industry are:

- "market failures"<sup>2</sup> (market power<sup>3</sup>, externalities<sup>4</sup>, public goods<sup>5</sup>, and information asymmetry and deficiency<sup>6</sup>),
- equity and other social objectives<sup>7</sup>, public health, and environmental considerations, and
- the risk of "provider failures" (failure to meet contracted or reasonably expected standards of service quality, maintenance of capital stock, accessibility and price).

Furthermore, WA's unpredictable and variable rainfall make resource availability uncertain, and this combined with the expensive and lumpy nature of investment to significantly boost supply means that a more active and interventionist approach to demand management may, be more appropriate in the water industry than other sectors, under some circumstances.

A range of other issues is also identified in the paper, but these tend to be either administrative and technical, or are subsets of the reasons outlined above.

The WA water industry has many of these characteristics that establish an *a priori* case for regulation.

Other things being equal, the best solution to market failures is to remove their causes – breaking up monopolies and eliminating legislative sources of monopoly power, for example, or imposing charges or subsidies which "internalise" the costs or benefits of pollution or similar activities that generate externalities.

In the case of the WA water industry, the scope for such "first best" solutions is in many cases limited.

Much of the water supply industry is a

"natural" monopoly<sup>8</sup>, and while there may be a case for removing some artificial barriers to market participation, and encouraging competition by breaking down vertical integration, some of these solutions would generate new problems, and it is certain that areas of natural monopoly would remain.

Other factors also guarantee a role for regulation in this sector. Water supply is genuinely an essential service, and both water quality and sewerage services are vital to community health.

The critical ecological importance of environmental flows and other environmental and implications of water and wastewater management demands a regulatory framework.

The expensive, long-lived, large-scale nature of the industry's necessary infrastructure also mean that the consequences of mismanagement for the WA community would be too severe for investment and maintenance decisions to be left entirely unscrutinised.

For all of these reasons, the underlying causes of the need for government intervention in the water industry either cannot or should not be removed, and regulation is therefore appropriate.

Having established a case for regulation in principle, the question arises as to what constitutes good regulation, what are its characteristics and how do we get it.

According to the Productivity Commission Chairman Gary Banks<sup>9</sup>:

*"At the broadest level, the answer is almost tautological: good regulation is regulation which, in achieving its goal, brings the greatest net benefit to the community. But the little word 'net' is important. It signifies that regulation must be judged not only by its beneficial effects, but also by the costs that arise in achieving them.*

*"For this overall net benefit requirement to be satisfied, regulation needs to meet three other tests:*

- *"regulation must be the most effective way of addressing an identified problem;*

- *"it must impose the minimum burden on those regulated; and*
- *"cause the minimum amount of collateral damage to others."*

In order to achieve these objectives, regulation should encompass key design features:

- *"Regulation should not be unduly prescriptive. Where possible, it should be specified in terms of performance goals or outcomes. It should be flexible enough to accommodate different or changing circumstances, and to enable businesses and households to choose the most cost effective ways of complying.*
- *"Regulation should be clear and concise. It should also be communicated effectively and be readily accessible to those affected by it. Not only should people be able to find out what regulations apply to them, the regulations themselves must be capable of being readily understood.*
- *"Regulation should be consistent with other laws, agreements and international obligations. Inconsistency can create division, confusion and waste.*
- *"Regulation must be enforceable. But it should embody incentives or disciplines no greater than are needed for reasonable enforcement and involve adequate resources for the purpose.*
- *"Finally, regulation needs to be administered by accountable bodies in a fair and consistent manner, and it should be monitored and periodically reviewed to ensure that it continues to achieve its aims." <sup>10</sup>*

Mr Banks concluded that most regulation that the Productivity Commission looks at fails at least some of these tests, and some regulation fails most of them.

Part of the reason for complexity, inconsistency and vagueness in regulation is that the response to each newly perceived problem or issue in a sector is often to introduce additional regulation.

Conversely, existing regulation is less often simplified, and even less frequently repealed.

The result is a ratchet effect in which the net of regulation spreads more widely, and its effectiveness diminished steadily.

This tendency is evident in the Issues Paper, which opens with the argument that:

*"Legislation reviews provide the opportunity to insert new objectives or aims or to amend existing provisions to better achieve the original objectives."<sup>11</sup>*

More specifically, it argues later<sup>12</sup> that:

*"The aims of the Act, as explained in the Second Reading Speech ... were to protect the interests of consumers in respect to levels of service and prices charged, and to support the Industry Minister through the provision of independent advice.*

*"However, the Review of the WSC Act is not limited to these aims. There are other issues that have assumed increasing importance in government and in public debate since the introduction of the Act that may appropriately be reflected in the aims and objectives of the regulatory system and hence in the provisions of the Act.*

*"For instance, it is noteworthy that in New South Wales, there is currently a strong focus on water conservation, demand management and Environmentally Sustainable Development in terms of reflecting these values and concepts in the regulatory system that is overseen by the Independent Pricing and Regulatory Tribunal (IPART).*

*"Additional aims for the regulatory system in Western Australia could include:*

- *"Encouraging conservation of a limited resource and sustainable environmental outcomes.*
- *"Stability and certainty in relation to regulated service providers, ensuring long-term financial viability.*
- *"Promoting competitive market conduct. The presumption here is that competition generates better*

*outcomes for consumers, in terms of more attractive prices and better standards of service.*

- *"Preventing the misuse of monopoly market power, thereby preventing customers being forced to pay unfair charges or put up with poor quality services.*
- *"Facilitating market entry. More open access to the market is one means of promoting competitive market conduct.*
- *"Facilitating efficiency in regulated industries.*
- *"Ensuring users and consumers benefit from competition and efficiency. In a competitive market, utilities would be forced to be efficient, and to hand a fair share of the benefits of that efficiency on to customers in the form of lower prices and*

*improved services.*

- *"Ensuring customers are informed, involved and consulted in regards to levels of service, price, and rights of redress."*

CCI would argue that these "new" objectives are either adequately covered by the existing regulatory framework (environmental constraints), are in fact several ways of saying the same thing (the dot points dealing with aspects of monopoly power), or are not, in fact, appropriate objectives of regulators ("Stability and certainty in relation to regulated service providers, ensuring long-term financial viability" sounds rather like a rationalisation of regulatory capture of the regulator by the service provider/s).

The following sections discuss some of the issues arising from the regulation of water in the context of some of the principles discussed above.

## Prescription

The Productivity Commission argues that regulation should not be unduly prescriptive, and where possible, it should be specified in terms of performance goals or outcomes.

In some respects, a prescriptive approach to water regulation is appropriate and desirable – in mandating minimum standards of water quality, for example.

However, in other respects, CCI is concerned that the regulatory process is unnecessarily and detrimentally restrictive, and that it over-emphasises processes at the expense of outcomes.

Perhaps a greater concern is the growing tension between the views of those who would seek to constrain demand for water by regulating and prescribing who can use it, how, and when; and a more flexible, market-driven approach which allows proper pricing and the operation of the market to ensure that this scarce and valuable resource is used as effectively as possible.

This does not feature much in the Issues Paper, but was a strong theme of the debate at the recent Water Symposium, for example.

## Demand Management

CCI is a firm advocate of taking a market-based approach, where possible. In particular, we argue:

- If prices truly reflect costs, then any attempt to force the community to consume less than it would prefer at the market price diminishes community welfare, except in the case of identifiable market failure.
- In those cases where (non-price) market failures are identified, the best regulatory response is targeted narrowly at redressing the particular problem, not blanket regulation.
- Markets are generally better than regulators at inducing efficient water use. For example, a genuine system of secure, predictable tradeable water rights in the agricultural sector and extending to other intensive business users will encourage inefficient producers to withdraw from the market in favour of efficient ones.
- This demands symmetry and equity between different water users. For example, water users who self-supply (both domestically and in business) should be incorporated into the same water resource management framework as users of scheme water and should, where appropriate<sup>13</sup>, pay for both the cost of resource planning and management and rent for the

- resource used.
- Where a market-based approach is not appropriate or adequate – for example, in maintaining adequate environmental flows - regulation should focus on outcomes not processes. This is true both for suppliers - eg regulating minimum environmental flows, not how they are to be achieved - and consumers – for example, mandating efficiency standards for domestic appliances, not prohibiting the sale of top-loading washing machines. Furthermore, residual user issues can still be determined in the marketplace (for example, who gets to use the water resource not earmarked for environmental flows).

CCI has some concerns at the extent to which current policy debate – including some of the contributions to the Water Symposium held in October 2002 – emphasise the need to compel the community to change its behaviour to conform to water conservation agendas.

CCI recognises that the government has a legitimate leadership role in public education, encouraging responsible water use and explaining the problems and issues of water supply and conservation to the public.

But in a democracy, it is ultimately the responsibility of government to serve the wishes and welfare of the community, not to impose its will on them against their consent.

The increasingly authoritarian tone and growing emphasis on command and control solutions to water resource management in some recent debate almost presents proscription as a virtue.

At its most absurd, there was almost a sense of disappointment that the Water Corporation's sensible medium-term

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## Clarity

The Productivity Commission argues that regulation should be clear and concise, communicated effectively and be readily accessible to those affected by it.

It also calls for regulation that is consistent across regulators, and enforceable, and "administered by accountable bodies in a fair and consistent manner".

In the current, evolving, regulatory framework, this is impossible for the time being. The precise allocation of

strategy for enhancing infrastructure and water availability made apocalyptic visions of imminent catastrophe seem much less probable.

CCI believes that prohibitions, caps, targets and other proscriptive demand limitation measures are a last resort, appropriate only for overcoming urgent short term problems or where clear evidence of market failure demonstrates that a (suitably educated and informed) community would not choose to use (properly priced) water resources in the manner which maximises its welfare.

The development of water use and wastewater reuse targets for different sectors causes some concern. While CCI recognizes that targets may be useful to encourage improved performance, the capacity of business to make savings – and the extent to which they have already done so – vary greatly.

### *Business Operations*

Demand management is not the only area that CCI fears might be subject to increasingly and inappropriately prescriptive regulation.

Many of the items termed "policy" in the Issues Paper (debt recovery, project prioritisation etc.) are really operational matters. The service provider is best placed to determine these internal, day-to-day management issues.

Where there are operational issues that really warrant regulatory attention, these should be identified by Government as a finite and temporary list and addressed with appropriate representation.

Again, these should be at an industry structure level (such as the need to ensure safe drinking water, licence provision for greenfield sites etc) to provide regulators clear outcomes against which to regulate.

responsibilities between the different existing and proposed agencies with a role in the regulated water industry is still to be determined.

All current changes to the industry's regulatory and policy structures need to be considered and integrated. These include:

- The WA Water Symposium, which came up with a broad range of recommendations including



- regulation, policy structures and accountabilities.
- The ERA Draft Bill to create Economic Regulation Authority from 1 July 2003. Some of the draft legislation (functions etc of ERA for water) differs from the policies discussed and seemingly favoured in the Issues Paper.
- Treasury has canvassed the creation of a Regulatory Policy Steering Committee. It is also considering the need to support this committee.
- Following from the reforms advocated by the Machinery of Government Task Force, the Water and Rivers Commission is being disbanded, and its functions moved to the Department of Environment, Water and Catchment Protection, recommendations.
- There has been some discussion about creation of a water resource council (discussed at WA Water Symposium). Implications for the Water and Rivers Commission's policy and regulatory functions are still unknown.
- The State Sustainability Strategy is being developed as broad government principles including

specific application to water industry and resource management.

The diagram below illustrates the Water Corporation's understanding of the current state of expected and possible regulatory structures. It does not show the functional boundaries between the responsibilities of the different agencies, but it nonetheless highlights the many regulatory and policy-making agencies that are expected to share responsibility for the water industry from 2003.

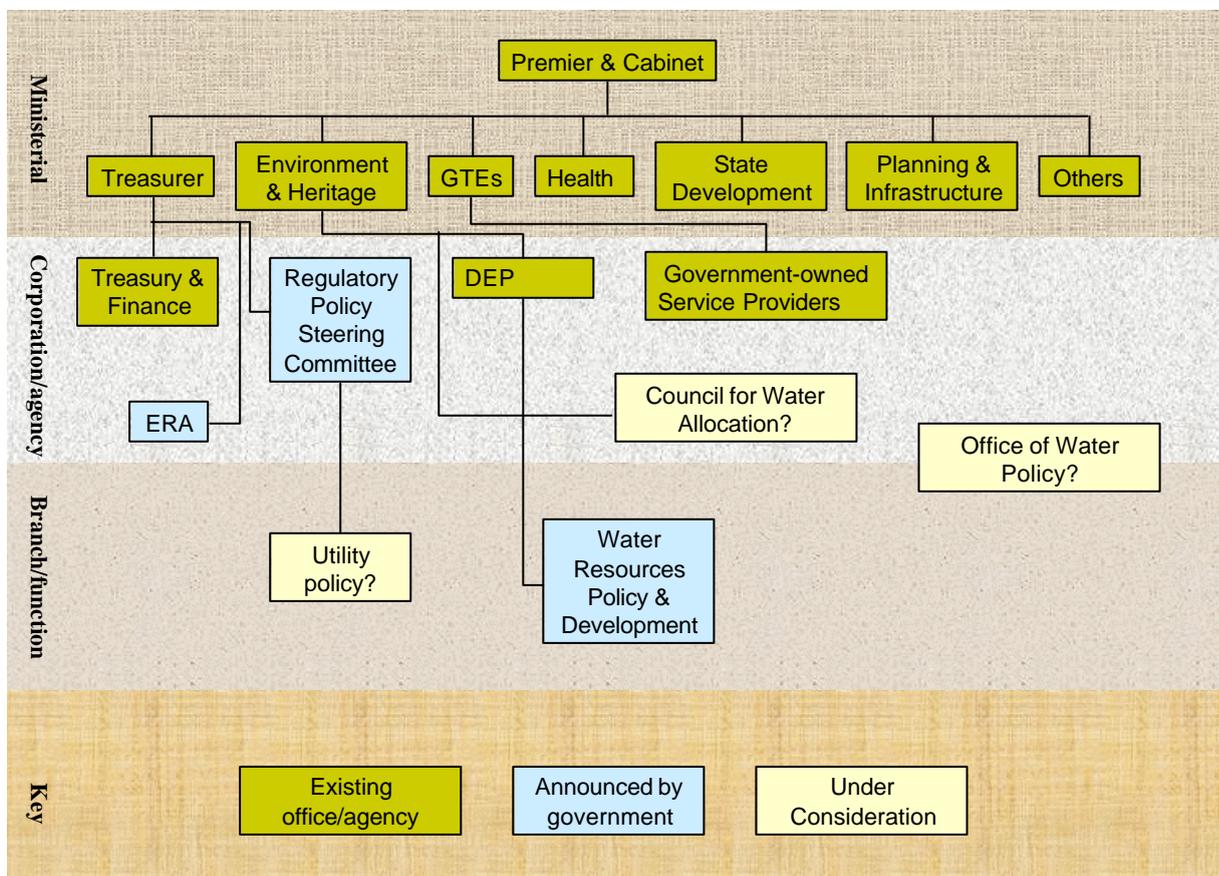
There is a clear potential for overlap, duplication, ambiguity, and inefficiency in any regulatory structure to emerge from these reviews.

This is perhaps inevitable, as the water industry is important in so many disparate ways that demand regulation – economic, social, environmental and public health concerns being the most obvious.

But policy should seek to minimise such inefficiencies.

Where possible, scarce regulatory and industry expertise in Government should be concentrated to optimise cost

**Current and Possible Regulatory Framework of the Water Industry**



efficiencies and outcomes.

In particular, care must be taken that accountabilities (including policy roles) are not duplicated – especially through legislation.

For this reason, CCI has long been a strong supporter of the need for a generic across-industry regulator responsible for regulating access to utility infrastructure, and broadly supports (with some reservations) the model proposed by the ERIC.

The advantages of a regulator of this type include:

- It is administratively efficient and avoids duplicating expertise and experience across agencies;
- It reduces the risk of ‘capture’ of the regulatory agency and its officers by the businesses it is supposed to regulate; and
- It allows consistency and intellectual rigour in the application of policy

across industries and activities.

Similarly, CCI argues that policy advice should be developed at arm’s length from the service provider.

This is not to say that policy should develop in isolation from the service providers. The expertise and experience of service providers has an important contribution to make in determining both broad-brush policy directions and the feasibility of effectiveness of specific proposals.

As a general rule, including all relevant players and views is the preferred approach to good policy development. Where there is a potential commercial advantage in access to policy and regulatory forums - for example, the case of the Infrastructure Planning Committee discussed in the Issues Paper<sup>14</sup> - the solution is, where possible, to extend this privilege and access to information to others, not to prohibit input from the industry’s key player.

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## **Economic Regulation**

The issues of economic regulation are primarily to be addressed through the proposed Economic Regulatory Agency. Nonetheless the Issues Paper addresses some of these, and their importance to the regulation of the water sector – particularly from a business perspective - is such that it will be addressed briefly here. Furthermore, economic regulations impinge on other aspects of the industry more directly covered by this review, for example, symmetry and equity of treatment between water service providers (including self-suppliers).

### **Pricing**

As a general rule of thumb, prices should reflect the cost of supply. In particular, in an efficient and competitive market, price will be set at the marginal cost of supply, where cost is adjusted to include any externality and spill-over costs and benefits of water supply and use, as well as the direct financial costs incurred by the service provider.

There are several key issues in this respect:

- In an industry like water, with large capital and relatively small operating costs, setting price equal to marginal cost may lead to a pricing regime in which revenue never matches cost. In this event, what pricing model

should be followed?

- While business, environmentalists and others may agree on the broad principle that costs (including environmental costs) should be brought to account in pricing arrangements, they differ widely in their expectations of the magnitude of those costs. Is it possible to establish an authoritative and objective process for estimating those costs which will be acceptable to key stakeholders?
- As an essential service, social policy demands that households have ready, affordable access to safe drinking water and sewerage services. How are these social and community objectives to be achieved and financed?

### **Corporate Operation and Efficiency**

The operation of the water supply business is an essential factor influencing the efficiency of the industry. Issues include:

- As a natural monopoly, it is unlikely that large parts of the provisions of water and sewerage services will ever be effectively opened to competition. In this context, how are efficiency, innovation and cost minimisation to be delivered?

- Much, but not all, of the supply of water and sewerage services comprises a natural monopoly. How can competition be fostered in those parts that are not natural monopolies?
  - o competitive neutrality
  - o tendering
  - o financing of CSOs
  - o Headwork/ 'user pays'
- The lumpy nature and large costs associated with major incremental additions to water supply infrastructure make the choice and timing of investments extremely problematic.
- Environmental constraints need to be balanced against social and economic objectives in decisions about the nature of additional capital expenditures.
- Decisions on the timing, scale and nature of additions to capacity should be made according to strict principles of cost-benefit analysis and opportunity cost. Visionary but expensive plans such as the Kimberly pipeline should be dismissed if they do not meet these standards.

### **Investment**

Grand schemes for piping water from the Kimberley, turning around rivers and drought proofing Australia would yield questionable benefit for huge cost.

As in all other areas, investment decisions should be guided by principles such as cost-benefit analysis and opportunity cost, ensuring that needs are met in the most efficient way possible.

### **Neutrality**

Efficiency demands that the scarce resources we have at our disposal are put to their most productive possible uses. Where resources become more scarce or there are other reasons for using them less intensively, mechanisms must be put in place to displace the least valuable uses first.

This is the reason for CCI's preference for market-based solutions to demand management issues, where these can be found. For example, tradeable water use permits could work well to cap exploitation of a limited resource and simultaneously ensure that it is used only by the most efficient producers.

Providing clear, tradeable property rights ensures that industry participants with higher costs and lower efficiency willingly cede the right to operate in a market to

those whose lower costs and greater efficiency is reflected in the higher price they are prepared to pay for a licence to operate.

For this reason, too, CCI is opposed to any measures to earmark water resources for favoured clients (whether householders<sup>15</sup> or particular industries), to impose more stringent reuse or other regulations on some clients than others, or to treat some service providers (including self-providers) less favourably than others. All users must participate in paying for the costs of the services they use.

This means that the Water Corporation should not be the sole or major carrier of costs associated with researching, managing and rationing the state's water resources.

It also means that regulators should not seek to palm off inappropriate demand management costs into industry.

For example, during consultations in preparing this report, the Executive Officer of the Kwinana Industries Council commented that there appears to be a belief within certain parts of the Department of Environment, Water and Catchment Protection that industry in Kwinana should use all the flow in the Cape Perron Outfall, regardless of the price. The aim is to free up groundwater which could then be used for market gardens, playing fields, etc. This is inequitable and inefficient, because industry is being asked to pay for dealing with wastewater it did not create, and to give up current resources to a lower value use.

### **Community Service Obligations**

CCI recognises that the governments have a legitimate concern to protect the interests of potentially disadvantaged consumers in the markets for some essential goods and service.

Governments' involvement generally entails ensuring that all members of the community have the opportunity to access essential goods and services (even in remote areas where it might otherwise be uneconomic to supply them), and in many cases also ensuring that they can afford to access them by targeting subsidies at low income groups.

The nature and extent of the consumer interests to be guaranteed through community service obligations are a matter for community determination to

be implemented through the political process.

However, while the detail of community service obligations is not a primary concern to business, the funding of those obligations is. CCI is particularly concerned that the financing of community service obligations should be equitable, be transparent, and be achieved in a way that has the least impact on competition and economic efficiency.

Community service obligations should not be financed through cross subsidies between a supplier's customers. Such arrangements have a number disadvantages:

- They tend to cause inefficiency because customers base consumption decisions on prices that do not reflect costs, resulting in inefficient resource use.
- They often undermine competitiveness because incumbents must be protected from competitors who might "cherry pick" the customers paying prices above cost but offering them cheaper services.
- They are not transparent. Community service obligations are generally imposed by government as a means of fulfilling social objectives. They necessarily entail costs. It is important for the community to understand exactly what costs it is incurring and what benefits it is

receiving when it imposes community service obligations.

- They may not be equitable. There is no correlation between the extent to which a user contributes to or benefits from a subsidy and any usual concepts of "ability to pay".

In general, the most effective way for government to finance community service obligations is through a direct subsidy from general government's consolidated revenue fund. The water industry was one of the first in WA to adopt this model, an initiative welcomed by CCI at the time.

Where the subsidy is provided to an operator in a contestable market, access to subsidies should itself be contestable, with contracts awarded to those operators that can fulfil the government's community service obligations at the lowest cost.

In practice, this tends to be most applicable in the water industry in servicing greenfield sites.

Where subsidies are provided to operators in non-contestable markets (ie to monopoly suppliers), they should be audited carefully and reviewed regularly. CCI would support the regulator being provided with powers to obtain and publish information of licensees' performance (Issue 29).

## Appendix 1: Inquiry Details

### Background

The Hon. Dr J.M. Edwards, Minister for the Environment and Heritage, has commissioned an independent Panel to review the Water Services Coordination Act.

The Review Panel is:

- Dr Thomas G Parry (Chair);
- Mr Chris Pollett;
- Mr Brian Sadler; and
- Mr Harry Ventriss.

Its website, with discussion paper, is <http://www.wsactreview.org/>

### Process

Seven weeks will be allowed for stakeholders to raise additional issues and make comments. Following the submission period, a workshop will be held to support the preparation of a draft Review Panel Report that will outline proposed legislative changes. After the issue of the draft Review Panel Report, four weeks will be allowed for further comments, before the preparation of the final Review Panel Report to Government.

#### Timetable

- Launch of issues paper 9 October 2002
- Close of issues consultation period 29 November 2002
- Workshop 12 December 2002
- Launch of draft Review Panel Report 22 January 2003
- Close of draft Review Panel Report consultation period 21 February 2003
- Issue of final Review Panel Report 21 March 2003

### Terms of Reference

Review the Water Services Coordination Act 1995 in accordance with section 62 of that Act, and with a view to ensuring the improved efficiency and effectiveness of the regulatory framework for the water industry in Western Australia.

The Review is to make recommendations that promote a regulatory regime for the water industry that:

- is sustainable;
- efficient; and
- protects and meets the needs of customers of water service providers.

The Review of the Act is to:

1. Include, but not be limited by, a review of the functions in section 5 of the Act and their appropriateness given the issues facing the water industry in Western Australia and given the emerging regulatory environment;
2. Ensure the improved efficiency and effectiveness of the provisions of the Act in achieving the functions under section 5 of the Act;
3. Consider and make recommendations on any interactions and overlaps with other legislation in the water industry with significant impact on the regulation of the industry;
4. Recognise the subsequent integration of the water industry into the Economic Regulation Authority and make recommendations that enable the best fit of the necessary legislative provisions with the new institutional architecture;
5. With regard to Part 5A of the Act, make recommendations that only address the most appropriate legislative arrangements, given the delegation of responsibility for supporting the regulation of the plumbing industry to the Department of Consumer and Employment Protection; and
6. Consider any other matter that might contribute to a more effective working of the Act.

In undertaking this Review, the Review Panel is to have regard to:

- a) the State's commitments under the National Competition Policy Agreement 1; and
- b) relevant recommendations of the Machinery of Government Task Force Report, especially the formation of the Economic Regulation Authority.

### Issues identified

The paper lists the following issues to be addressed in the inquiry:

1. What are appropriate objectives for regulation of the water industry, noting that the ERA is to become responsible for some aspects of water regulation?

2. Should the water industry licensing function of the WSC Act be transferred upon the establishment of the ERA (proposed for 1 July 2003) or should the incorporation of the relevant functions of the WSC Act into the proposed ERA arrangements follow the development of amendments based on the recommendations of the Review of the WSC Act?
3. How should policy advice, development and setting roles best be catered for in the new regulatory model for the water industry?
4. Should the ERA have a policy advice function (as distinct from a policy setting function)? conflict could then be determined at Ministerial level.
5. Which agency(s) should provide the policy development and advice function in support of the water industry Minister?
6. What would be the most appropriate reporting arrangements to ensure the provision of independent, balanced and effective policy advice to the Industry Minister on strategic initiatives, the business environment within the industry, industry coordination and safety and technical policy in the water industry?
7. What would be most appropriate legislative arrangements for the granting of explicit powers to obtain information for the relevant Industry Minister?
8. Should auditors be engaged by the regulator instead of the licensee?
9. In regards to Water Service Licences:
  - a) do the licences achieve their aim of ensuring customers receive high quality services, and how could they be improved in this regard;
  - b) should licensees have exclusive rights to provide services within their licensed areas; and
  - c) how can regulatory overlaps be better managed?
10. Should there be a single Water Utilities Powers Act setting out the powers of licence holders?
11. In regards to policy development:
  - d) - what role should water service providers play in policy development; and
  - e) - at what level should providers be involved in policy development and what mechanisms should be used to engage providers on such issues?
12. In regards to planning for water services:
  - a) what agency should hold responsibility for the State-wide planning and coordination of the provision of water services;
  - b) is it appropriate that the Water Corporation maintain its present role at this level of decision making; and
  - c) - what form should the Industry Minister's input into over-all planning and coordination of infrastructure provision take?
13. In regards to greenfield sites:
  - a) - Should the Industry Minister (through the relevant agency) be explicitly empowered to conduct competitive licence application processes for greenfield sites and recommend the issue of a licence for the preferred provider to the ERA in accordance with the above model; and
  - b) - What alternative to the above model could best enable the Government to undertake expressions of interest for new water infrastructure investment in greenfield sites?
14. Should the function relating to ways of promoting and achieving open access to water service systems under section 5 (c) ( iii) of the Act be passed to the Industry Minister alongside other policy functions?
15. In regards to water use efficiency:
  - c) who should be responsible for water use efficiency at the following levels: provider/consumer, resource manager/provider, strategic/state and what are the appropriate legislative powers that would support these functions; and
  - a) where responsibility for advising on improved water use efficiency at different levels is assigned to more than one agency or regulatory body, what is the most effective means of coordination and how should responsibility for development of not only general water conservation strategies, but also demand management strategies, be

- determined?
16. Given the proposed role of the ERA in providing advice on tariff levels for water, where should responsibility reside for closely related policy matters such as tariff structures?
  17. What is the appropriate agency to assume responsibility for providing advice on the use of water services policy to achieve other policy objectives of Government?
  18. Has the WSC Act been effective in achieving the goals of ensuring the efficiency of providers and achieving equitable outcomes for customers? What changes would make the WSC Act more effective in this regard?
  19. : Should the Act be amended to remove the section 24 (3) exclusions on licence conditions? Alternatively, should additional powers be inserted into the Act in relation to the Coordinator's regulatory powers with respect to prices and charges?
  20. Given the eventual integration of the water industry into the ERA framework, what is the most effective model for ensuring the efficiency of providers and achieving equitable outcomes for customers through the regulation of prices and charges?
  21. Should the WSC Act include specific provisions to provide for:
    - a) - dispute resolution;
    - b) - dispute determination powers; and
    - c) - the ability to decline the investigation of disputes?
  22. Should a dispute resolution scheme be government run or privately run?
  23. What is the appropriate agency to assume responsibility for dispute resolution?
  24. Should a dispute resolution scheme be funded by industry?
  25. What mechanisms can be put in place to ensure links between dispute conciliation for, and regulation of, service providers?.
  26. Should the WSC Act be amended to include a clear and explicit role for consumers in economic regulation and standard setting?
  27. How can this arrangement work given the incorporation of water regulation functions under the proposed ERA framework?
  28. Should legislative mechanisms be included to safeguard water service consumers?.
  29. Should the Regulator have specific powers to obtain financial and other data from licensees, and publish it?
  30. Should there be strong legislative sanctions available to the Regulator so that failures by water service providers to report data and information of the necessary completeness, quality and timeliness can be effectively overcome?
  31. Given the separation of responsibilities of the Coordinator of Water Services between the ERA and the Industry Minister with the proposed integration of the water industry into the ERA, what is the appropriate agency to assume responsibility for the organisation and promotion of the Water Industry Awards?
  32. Which agency should be responsible for undertaking, sponsoring and coordinating research, development and demonstration of
    - a) - engineering aspects; and
    - b) - economic regulation aspects; of the water industry?
  33. Are there any other, more effective ways of sponsoring and coordinating research, development and demonstration relating to water services under section 5 (e) of the Act?.
  34. In regards to the development of commercial applications of water;
    - a) - should the function be supported by legislative provisions;
    - b) - what agency should be responsible for promoting the development of commercial applications for water; and
    - c) - are there any other, more effective ways of promoting the development of commercial applications of water?.
  35. What legislative arrangements are appropriate, given the delegation of responsibility for supporting the regulation of the plumbing industry to DOCEP?

## Notes and References

<sup>1</sup> "Review Of The Water Services Coordination Act Issues Paper: A Paper By The Independent Water Services Coordination Act Review Panel", October 2002. P.8

<sup>2</sup> a "market failure" is said to occur when an unregulated market fails to allocate resources efficiently. It typically occurs when prices fail to reflect the true cost of the activities of economic agents.

<sup>3</sup> A firm is said to have some degree of market power where it has the ability to charge higher prices, whether reflecting higher costs or higher profits, than would be possible under fully competitive conditions.

<sup>4</sup> An externality is a cost or benefit arising from a transaction that does not accrue to those agents directly involved in that transaction. Externalities can be positive or negative and can arise from production or consumption. The most commonly cited case of a negative externality is if a firm's activities lead to pollution imposing a cost on the community that is not reflected in the costs of the firm.

<sup>5</sup> "Public goods" are goods that can be enjoyed simultaneously by any number of consumers without the value of the good being diminished for any one of those consumers (they are "non-depletable"). Examples include knowledge, national defence, environmental quality and free-to-air television.

Unless a supplier of public goods is able to isolate the users of the good and charge them for the benefit received (ie they are "excludable"), it is likely that the good will not be supplied or will be under-supplied.

For example, the market for cinema tickets may be efficient because the cinema owner can charge for admission, but the supplier of a television broadcast does not recoup the cost of supply from viewers. In the absence of alternative revenue sources (eg advertising or government subsidies), the private sector would not supply free-to-air television broadcasts.

In reality, the concepts of public goods and positive externalities are closely linked. A non-excludable public good is one for which there are substantial positive externalities.

<sup>6</sup> "Information asymmetry" occurs when there is a disparity between information at the disposal of parties to an economic transaction. It most commonly refers to consumers' lack of information regarding a product relative to suppliers, but can sometimes work the other way (eg medical insurance purchasers' superior knowledge of their medical history). In the context of regulated markets, it also applies to the fact that managers are almost always better informed about a regulated entity's finances and activities than regulators, and may therefore be able to mislead the regulators into imposing overly lax regulations.

Where there are large transaction or search costs, consumers may quite rationally opt not to incur the costs necessary to obtain all possible information about a product or service.

<sup>7</sup> CCI accepts that social and equity considerations are appropriate objective of regulatory policy but, unlike the issues paper, we do not classify them as "market failures", which are more commonly defined as resulting in an inefficient resource outcome.

<sup>8</sup> A "natural" monopoly is a market in which the entire market demand can be met by a single supplier at a lower cost than two or more firms. Such a market will generally not support competition, and if competition does arise, it will diminish efficiency.

<sup>9</sup> Gary Banks, 'Challenges for Australia in Regulatory Reform', Productivity Commission, 10 July 2001, p.2.

<sup>10</sup> Ibid. p. 2-3

<sup>11</sup> Op. Cit., p.1

<sup>12</sup> Ibid. p.14

<sup>13</sup> Charges should be based on demand management, cost of supply and scarcity, not a one-size-fits-all volumetric charge, for example. A case can be made that the reasonable costs that could be demanded of household and small business bore users for their share of resource management and resource rent for water used would be so low that it would be highly inefficient to collect – the cost of administration and compliance would greatly exceed the direct costs to be recouped. This also implies that scarcity and opportunity cost should be taken into account when charges are set, which would in turn mean higher prices in some places than others.

<sup>14</sup> Op. Cit. p.30

<sup>15</sup> This does not necessarily preclude either the social goal of ensuring that all individuals get access to a minimum necessary quantity and quality of water, nor other forms of community service obligations. Rather, it demands that that, as far as possible, these should be compatible with market based



solutions – for example, making subsidies for community service obligations contestable (section #).