



**SUBMISSION TO THE PRODUCTIVITY COMMISSION'S DRAFT
REPORT ON ITS INQUIRY INTO AUSTRALIA'S URBAN WATER
SECTOR**

DATE

May 2011

1. Introduction

The Local Government Association of NSW and Shires Association of NSW (the Associations) are the peak bodies for NSW Local Government.

Together, the Associations represent all the 152 NSW general-purpose councils, the special-purpose county councils and the regions of the NSW Aboriginal Land Council. In this role, they represent the current 106 Local Government water utilities, including 97 council-owned and operated local water utilities, four water supply county councils, and one water supply and sewerage county council. The mission of the Associations is to be credible, professional organisations representing Local Government and facilitating the development of an effective community-based system of Local Government in NSW. In pursuit of this mission, the Associations represent the views of councils to NSW and Australian Governments; provide industrial relations and specialist services to councils and promote Local Government to the community.

The Associations thank the Commission for the opportunity to make a submission on the draft report of its Inquiry into Australia's Urban Water Sector and provide the following comments.

2. Comments on the draft report

General support

The Associations commend the Commission on the comprehensive and constructive draft report. In particular, the Associations agree with the Commission that reform of water supply and sewerage services in regional NSW is a matter for the NSW Government and NSW Local Government to determine and that it should be based on the work undertaken by the *NSW Independent Inquiry into Secure and Sustainable Urban Water Supply and Sewerage Services for Non-Metropolitan NSW*.

The Associations also support the recommendation to introduce mandatory compliance with the health aspects of the *Australian Drinking Water Guidelines* as well as the recommendation to provide continued government funding for regions where it is economically not feasible (due to external circumstances) to provide the desired level of water supply and sewerage services.

Infrastructure Australia/AECOM Report

The Associations are concerned about the widespread use in chapter 13 of the draft report of the report submitted to the inquiry by Infrastructure Australia and prepared by AECOM entitled *Review of Regional Water Quality & Security* (the "AECOM Report").

The AECOM Report has been shown to contain significant shortcomings and serious misrepresentations. In this respect, the Associations refer to their supplementary submission to this inquiry which contains a detailed critique of the AECOM Report as well as to comments on the AECOM Report in submissions by the Water Directorate NSW and NSW Government agencies. The Associations believe the AECOM Report is not credible and should not be used in any research and policy development.

The Commission's draft report contains a number of references to incorrect and/or misleading statements made in the AECOM Report including:

- Page 377 of the draft report: The statement that "less than full cost recovery is common among regional utilities". This statement is not supported by data in the AECOM Report and is certainly incorrect for NSW;
- Page 382 of the draft report: The statement that per capita construction cost of water treatment plants would be higher in small utilities appears overly simplistic as it does not seem to take account of any scalability of treatment plants. No such analysis is undertaken in the AECOM report;
- Pages 386 of the draft report: The statement that water treatment plant operators in regional areas do not receive access to the same level of training provided in larger metropolitan areas is misleading. The NSW Office of Water provides appropriate operator training in regional NSW;

- Page 387 of the draft report: The statement that the AECOM Report documented a range of problems with drinking water quality throughout regional Australia is unsupported. Evidence of water quality problems in the AECOM Report is sketchy to say the least;
- Page 395 of the draft report: The AECOM Report's simple comparison of water bills in Victoria, Queensland and NSW to infer economies of scale in larger regional utilities is inappropriate. The comparison does not seem to take account of different external circumstances that might affect cost (e.g. population density); and
- Page 399 of the draft report: The statement that many small towns were without water treatment is incorrect for NSW. Water supplies in regional NSW receive water treatment at the level required to achieve high quality water supplies.

Cost recovery and rate of return

The Commission requests information on the following questions (page 380 of the draft report):

“Is the economic real rate of return an appropriate measure to assess full cost recovery? Are there any risks in using this measure, especially in considering whether utilities are properly providing for returns on capital invested to date, and on future capital expenditure? Is there merit in adopting a measure, or at least a benchmark, that reflects full economic cost?”

The Associations fully support the current best practice framework in place in NSW as set out in the NSW Office of Water's *Best-Practice Management of Water Supply and Sewerage Guidelines, 2007*. According to this framework, full cost recovery requires the recovery of efficient costs of service provision, including an appropriate return on infrastructure capital.¹ As a minimum, full cost recovery is achieved if either the economic real rate of return or the return on assets equals or is greater than 0.²

As pointed out in previous submissions to this inquiry, Local Government water utilities in regional NSW are well advanced in implementing full cost recovery. Utilities which comply with the NSW best practice framework also comply with the *National Water Initiative Pricing Principles, 2010*.

Conclusion on aggregation

The conclusion on aggregation on page 409 of the draft report does not appear to fully reflect the preceding discussion on costs and benefits of horizontal aggregation. On page 409, the draft report states: “There is considerable scope for (appropriate) aggregation of regional water utilities to give rise to material productive efficiencies for a significant number of local council water utilities in regional New South Wales and Queensland, relative to the current arrangements.”

However, the preceding discussion does not seem to indicate that benefits clearly outweigh cost but rather that there are significant costs of aggregation that would need to be weighed up against any potential economies of scale on a case by case basis. Also, whether or not there is “considerable scope for aggregation...for a significant number of local council water utilities in regional NSW” does not follow from the discussion. The draft report does not assess the number of utilities where benefits would outweigh cost.

Cost of aggregation

The significant cost associated with the aggregation of utilities as outlined in section 13.2 (pages 403ff) of the draft report, in particular the cost associated with the loss of economies of scope, should be included in the “key points” section of the relevant chapter of the final report. Many policy makers and other readers will focus on the key points of each chapter and it is therefore important to also highlight there the cost of aggregation.

Economies of scope as benefits of aggregation

¹ NSW Office of Water, *Best-Practice Management of Water Supply and Sewerage Guidelines, 2007*, page 7.

² NSW Office of Water, *2008-09 NSW Water Supply and Sewerage Performance Monitoring Report, 2010*, page 23.

The Associations question the use of the term “economies of scope” to describe efficiency benefits of aggregation on page 402 of the draft report.

Firstly, the situation described on page 402 does not seem to be covered by the Associations' understanding of “economies of scope”, i.e. in economic terms, economies of scope occur if it is cheaper for one entity to provide a range of services together (i.e. water supply and sewerage services and other general purpose services), than for each of the services (e.g. water supply and sewerage services) to be provided by separate entities. Secondly, the use of the term “economies of scope” to describe both benefits and costs of aggregation (see page 405 for loss of economies of scope as costs) is likely to result in confusion and less accurate discussion of this issue.

Revenue restrictions and rate pegging

The Commission requests information on the following question (page 405 of the draft report):

“Do local government financing policies, including restrictions on rate increases, directly or indirectly influence the price setting or investment behaviour of council-owned utilities, and if so how?”

The Associations do not have any evidence that rate pegging would have any influence over the delivery of and cost recovery for councils' water supply and sewerage services. Rate pegging in NSW, i.e. restrictions on the annual increase in general income (mainly income from rates), only applies to councils' tax (rate) income to fund general government activities. Rate pegging does not apply to councils' separate, ring-fenced water and sewerage fund.

Water supply and sewerage services of councils in regional NSW are funded by separate water supply and sewerage charges that are not subject to any revenue restrictions such as rate pegging. Under the best practice framework in place in NSW, councils are required to fully recover the costs of water and sewerage services through these charges. Transfer of funds from the water supply and sewerage fund to the consolidated fund is not allowed pursuant to the *Local Government Act (NSW) 1993* (section 409 (3) and (5)), apart from paying a dividend following comprehensive business plan audit.

Technical efficiency

The Associations are aware of the comparison of technical efficiency of Victorian utilities and utilities in regional NSW by Byrnes, Crase, Dollery and Villano referred to on page 412 of the draft report. However, the Associations question the findings and conclusions of this study as it is unclear whether these efficiency comparisons adequately take account of differences in demographic (e.g. population density), hydrologic (e.g. water sources and quality), geographic (e.g. distances between towns) and climatic (e.g. rainfall variability) attributes that exist in regional Victoria and regional, particularly western NSW. The Associations urge the Commission to critically analyse this study in this regard.

Developer charges

The Commission requests information on the following questions (page 172 of the draft report):

“The Commission is seeking further information on how developer charges are levied in each jurisdiction, for both greenfield and urban infill developments. Do these currently provide adequate signals on the costs of servicing new developments? To what extent should developer charges be set periodically on an ‘across utility’ basis, or be specific to the development in question? Would more development specific charges, especially in high cost areas, encourage greater innovation? Would it be better for developers to build the required infrastructure according to standards set by the utility? If so, what issues would need to be addressed to operationalise this? What are the main impediments to introducing more efficient developer charges?”

The Associations support the concept of developer charges as an economically efficient and equitable financing mechanism for the delivery of public infrastructure required as a result of new development.

Developer charges for water supply and sewerage infrastructure are levied pursuant to section 64 of the *Local Government Act (NSW) 1993* in connection with division 5 of part 2 of chapter 6 of the *Water Management Act (NSW) 2000*. The NSW best practice framework for Local Government water utilities provides comprehensive guidelines on how to levy developer charges.³ These guidelines are reviewed by the NSW Independent Pricing and Regulatory Tribunal.

Under section 306 (2) (b) of the *Water Management Act (NSW) 2000* developers can be required to construct water management works to serve the development and Local Government water utilities have made use of this option. Under the NSW best practice framework, utilities are required to prepare development servicing plans which would include design standards applicable to such in-kind contributions based on available standards such as the Water Services Association of Australia's *National Codes* or AUSSPEC technical specifications and standards and also require satisfaction of certain customer service levels (e.g. minimum water pressure).

3. Closing Remarks

The Associations hope that their comments are of assistance and look forward to participating in the next steps of the inquiry.

³ NSW Office of Water, Best-Practice Management of Water Supply and Sewerage Guidelines, 2007, page 9 and appendix B, section 2.