SUBMISSION

TO

QUEENSLAND COMPETITION AUTHORITY

ON

ASSESSMENT OF PRICING MATTERS

FOR

BURDEKIN HAUGHTON WATER SUPPLY SCHEME

Queensland Government
Natural Resources and Mines

MARCH 2002

Purpose

The purpose of this submission by the Department of Natural Resources and Mines is to:

- clarify the roles of the Queensland Government and the Department of Natural Resources and Mines in respect to the development of the Burdekin Haughton Water Supply Scheme and the current price path for rural water supplies provided by SunWater;
- provide background to the water industry and some of the significant changes implemented by Government;
- outline the bases for the establishment of the Burdekin Haughton Water Supply Scheme by Government and for the direction by Government to SunWater on the current price path; and
- provide comment on the matters under consideration by the Queensland Competition Authority.

Roles

In April 1980, the Queensland Parliament approved the establishment of the Burdekin River Project. Its primary objective was to provide adequate water supplies for the irrigation of sugar-cane and rice to be developed in the Lower Burdekin.

Design, construction and operation of the project was managed by the then Queensland Water Resources Commission, and until recently by State Water Projects, a commercialised unit of the Department of Natural Resources. In October 2000, this unit was corporatised, with its assets and bulk water services business now managed separately from the Department, by the government owned corporation SunWater.

The Department of Natural Resources and Mines now has stewardship of the State's land, water, mineral and petroleum resources. Principal activities of the Department in respect to water include water resource planning and management, and the regulation of water service providers.

The Water Reform Unit, a separate unit with the Department, has had a substantial role developing a new framework for the water industry in Queensland, culminating in the new Water Act 2000, as well as implementing a number of reform initiatives. The unit has undertaken significant work, assisting Queensland Treasury with the corporatisation of SunWater, and with the development of the current price path for rural water in schemes managed by SunWater.

In November 2000, when an Interim Resource Operations Licence was granted to SunWater for the management of the scheme, the project was titled the Burdekin Haughton Water Supply Scheme.

Background

The 1970s and 1980s represented a period of significant water resource development for Queensland. A number of large water supply schemes were developed to promote regional development. Some of these schemes include the Bundaberg Irrigation Area, Emerald Irrigation Area and the Burdekin Irrigation Area.

The Queensland Government undertook the roles of developer and operator of the State owned schemes, which in some cases attracted funds from the Federal government, in addition to the State's funds.

In general prices for rural water supplies to the irrigation sector have been subsidised, with little or no return to government, on the capital outlaid.

In the late 1980s, Queensland's first water auction was held at St George, marking a milestone in the industry where allocations had previously been granted by government. Across the 1990s, the Queensland Government introduced charges for the purchase of nominal allocation in schemes that were not fully allocated, and held water auctions in Goondiwindi, Emerald, and Mareeba.

In the early 1990s, the Government released a discussion paper "What Price Water?" in response to concerns that the current level of water charges to the irrigation sector fell short of allowing for the full costs of operation and, importantly, refurbishment of assets. Around that time, the benefits of economic reform were promoted by the Federal government, culminating in the Council of Australian Governments (CoAG) Agreement. This set in train a major change in water policy for all States, including a requirement for "cost recovery" in respect to water pricing, and institutional arrangements that allow for separation of roles of water service providers, resource manager and industry regulator.

Major changes in Queensland for the water industry include legislative review and the new Water Act 2000. Water resource plans are now being developed for all major basins in Queensland. Water Service providers have been commercialised or corporatised and are required to comply with the provisions of the Water Act. In the area of pricing for rural irrigation water supplies, the Queensland Government has undertaken an extensive assessment of the schemes managed by SunWater, and established a price path aimed to recover as a minimum the essential costs of operation and maintenance, administration and refurbishment.

Basis

The basis for the establishment of Burdekin Project, as adopted by the Queensland Government, is documented in the report to Parliament, "Report on Establishment of Burdekin River Project Undertaking (March 1980)".

A recent report, "Parliamentary Public Works Committee Inquiry on The Burdekin River Project Departmental Submission (November 2001)" provides details for the project, some twenty years after commencement.

A summary of the work undertaken by the Queensland Government in establishing the current price path for rural water prices in schemes operated by SunWater is provided in the Green, Edwell Consulting Pty Ltd report, "Determination of Recommended Price Paths for Rural Irrigation Schemes Operated by State Water Projects (June 2000)". The recommendations in this report were essentially adopted by Government in respect to the price path for rural water prices for existing irrigation schemes managed by Sunwater.

Comments

Funds for the Burdekin River project were provided by the Queensland Government and a grant to the State from the Australian Government under an Agreement linked to the construction of Burdekin Falls Dam.

Table 7-3 on page 112 of the original report to Parliament sets out the proposed charges and estimated revenue from water charges, sugar mill charges, drainage charges and land rents for the Burdekin Project.

The estimated surplus of direct revenue over expenditure is $3.18 million. This surplus is equivalent to 2.05 percent of the service charges of 9.5 percent (9 percent interest and 0.5 percent sinking fund) on $33.5 million of the total capital cost of the proposed works.

Water charges adopted at the time reflected the same level of charge in place for the older Burdekin irrigation areas.

Through the 1980s and 1990s, the Queensland Government had a general policy to limit price increases for irrigation water supplies to CPI. This applied to the Burdekin scheme where water users normally paid a minimum charge equivalent to 75% of their nominal allocation volume plus a further charge for each megalitre in excess of the minimum charge volume.

In 1996, subsequent to the CoAG Agreement and development of National Competition Policy, the Queensland Government outlined its policy in respect to water pricing in its document, "Rural Water Pricing and Management". For existing water supply schemes (page 7):

The Queensland Government aims to make ongoing improvements in the financial position of water supply schemes to enable a sound, long term financial position for each scheme to be established………

…… medium term objective is to ensure water revenues for each sector, in all existing water supply schemes cover, as a minimum, the operating and refurbishment costs of providing the supply.

In schemes where sectors were already covering their share of operating and refurbishment costs (page 8):

Government would seek, as a minimum, to maintain this situation .. by

- *continuing to annually adjust water prices in line with cost increases for providing services; and*
- *working with users to reduce costs or increase revenue by selling more water…*

As one of the policy measures, the Government introduced two part tariffs for water supplied in State owned irrigation schemes in 1997/98. The new tariff structure provided a fixed charge component based on the nominal allocation, and a usage charge for each megalitre used.

In July 1997, State Water Projects became a commercialised unit within the Department of Natural Resources. In early 1999, a special Water Reform Unit was established within the Department of Natural Resources to drive a number of key reforms in the water industry including assisting Treasury with the corporatisation of State Water Projects, which became effective on 1 October 2000.

Under the CoAG framework, Queensland Government had endorsed the principles of consumption-based pricing, full-cost recovery, where practical, and the removal of cross-subsidies. For rural water supply, CoAG agreed that where charges do not fully cover the costs of supply, the charges and costs would be progressively reviewed so that no later than 2001, they complied with the principle of full cost recovery, with any subsidies being transparent.

To assist the States implement water reforms, the Standing Committee on Agriculture and Resource Management (SCARM) developed a minimum cost recovery target for all water users. The cost recovery requirements are expressed as lower and upper bounds, within which prices for water services must lie. The lower bound requires prices to cover, as a minimum, operation, maintenance, administration, taxes or tax equivalents, provision for asset refurbishment, interest on debt and externalities. Externalities are to be approximated by a natural resource management charge to cover the costs attributable to water businesses of managing the water resources. The upper bound for cost recovery includes all those lower bound costs and a commercial return on capital.

As the Queensland Government considered the 2001 deadline under CoAG for cost recovery to be too onerous and inflexible, it initiated a Tripartite meeting of States, the Commonwealth and the National Competition Council in January 1999 which resulted in a more pragmatic approach. Specifically, the approach allowed rural water pricing reforms to be implemented over six years to 2004 for those projects that are unable to meet lower bound cost recovery by 2001. It also provides for on-going assistance to continue in some projects where lower bound cost recovery is impractical. In this respect, the Queensland Government won a major concession for water users.

Acknowledging the concessions gained, the Queensland Government approved an initial price increase in most irrigation schemes across the State, averaging 10%, to apply from 1 July 1999 and Cabinet approved the development of a five year price path for 2000/2001 to 2004/2005 inclusive.

On 25 September 2000, the Queensland Cabinet approved a rural water price path for schemes managed by SunWater. The rural water price paths, as documented in the Edwell, Green Consulting report, were based on a rigorous approach that included

- extensive financial modelling;
- an audit of State Water Projects assets by Arthur Anderson;
- an efficient benchmark cost review by Ernst and Young and GHD;
- an assessment of likely water demands over the price path period;
- an assessment of economic impacts on the industries; and
- extensive consultation with peak industry bodies and user groups over an 18 month period.

In regard to the Burdekin Haughton Water Supply Scheme, the existing level of revenue was deemed to be covering operation, administration and refurbishment costs (lower bound costs) when compared to efficient costs. A small return on the asset base was being achieved. In line with its stated policy, and the CoAG framework, the Queensland Government established a price path for the Burdekin that maintained the existing revenue level, while at the same time, SunWater was required to reduce costs.

It is noted that full cost pricing, in accordance with the CoAG framework, has not been presented for the Burdekin Haughton Scheme in the consultant report. Full cost pricing requires the determination of the "regulatory asset base" and application of a suitable weighted average cost of capital. The difference between full cost for water supplied for irrigation in the Burdekin Haughton scheme and the revenue received is the subsidy provided by Government for the scheme, under the CoAG framework.

It is noted that the Queensland Government in the past has set charges for purchase of allocation and has received monies from auction of land in the Burdekin scheme. These revenues are not viewed by the Department as "capital contributions" which might be regarded as equity in the scheme. Rather, they are viewed as payments made for assets which indeed have value and can be sold by the purchaser.

It is the Department's view that water service providers, including SunWater, need to operate under a commercial framework. Under normal circumstances, this would involve setting water charges that provide a commercial return on the "regulatory asset base".

It is noted that Government foregoes a component of return on capital for the Burdekin Haughton scheme.

The price path implemented for the Burdekin Haughton scheme reflects a decision by Government to continue to provide a subsidy to rural water users under the CoAG framework, by capping water prices charged by SunWater at a level that maintains the previous revenue base. Prices for water reduce over the 5 year period, in recognition of revenue to be earned from additional water forecast to be supplied.