Alliance Resource Economics

ST GEORGE WATER SUPPLY SCHEME, NETWORK SERVICE PLAN, 2012-2016

An interim submission to QCA

By

St George Irrigators

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EXECUTIVE SUMMARY

Background: This submission has been compiled by St George irrigators in response to a Queensland Government 'referral notice' currently with the Queensland Competition Authority. QAC is to review and recommend irrigation water delivery prices for the five year period commencing 1 October 2011. Section 1.6 of the Government's referral notice says "…in recommending prices the Authority must have regard for the legitimate commercial interests of SunWater and the requirements for SunWater to operate as a commercial entity". Because it speaks for the customer, this submission questions the legitimacy of SunWater's commercial status and its capacity to operate like a normal commercial entity[1]. Since the prices QCA recommends must have regard for the legitimacy of SunWater's commercial status, our analysis questions the appropriateness and social acceptability of the prevailing SunWater model.

The St George Water Supply Scheme: The main features of the St George WSS are Jack Taylor Weir (completed 1958) and Beardmore Dam plus Moolabah and Buckinbah weirs (all completed about 1967) and the irrigation 'distribution' area (commenced in 1956 and now about 10,000 hectares). In addition to agriculture the scheme supplies water to the township of St George. The scheme has 156 customers using 386 metered outlets. The headworks currently supply 3,000 ML of high priority allocation and 81,575 ML of medium priority allocation. Only about one quarter of the total allocation is used directly from the river with the balance distributed and used via the channel system. The main crop is cotton with small areas of horticulture, melons, peanuts and tree crops.

Basis of this analysis and reporting: The quantitative analysis used in this report is confined to medium priority water supplied at an average annual rate of 85% (of the total entitlement) to the St George distribution system. It is assumed that SunWater's published NSP for St George is a proposal for 'consideration by stakeholders'. In practice, SunWater's NSP might or might not be accepted by QCA and the Government as a reasonable basis for establishing the new price path. This submission draws upon our integral knowledge of irrigated agriculture, sound economic and political principles and careful scrutiny of the relevant issues to arrive at conclusions and recommendations regarding appropriate water delivery charges.

Derivation of cost/prices: Operating and renewal costs are apportioned between medium and high priority users according to assessed demands on the system and headworks. In the case of medium priority supply at St George, the apportionments of operating and renewal costs are 96% and 94% respectively. Costs are apportioned in a similar way between bulk (river) and distribution (channel) systems with the latter suffering costed distribution losses. In addition, assessed fixed costs are charged independently of water supplied while variable costs are charged on a per ML basis. These charges are referred to as Part A and Part B respectively and in the case of St George the split is about 75:25. While the actual apportionment factors might not be accurate, we have no in-principle problem with such pricing methods; our primary concern lies with the quantum of charges and implicitly, SunWater's particular capacity and inclination to inflict such charges.

[1] If SunWater was not a government owned monopoly it would be investigated by ACCC for evidence of market domination. Australian firms found guilty of market domination are normally fined and required to re-structure so that 'competitive conditions' are restored to the market place in which they operate.

Results of price projections: Our calculations, based on the NSP data provided by SunWater, indicate that water costs/prices for the St George distribution system would rise by more than 50% if SunWater's proposal is accepted. This rise would be even higher if certain risks nominated by SunWater turn out badly. Leaving aside the issue of risks, we believe there should be no increase in real prices over the life of the new price path or any other contiguous period. As the aim of 'user payers' has already been achieved, SunWater has no legitimate grounds for raising its charges in real terms. We are saying that SunWater should not be allowed to use its monopoly powers to exploit users of the St George WSS.

Our take on water prices: Over the past decade, Australia has pursued an aggressive program of water pricing reform. The reform has been enabled by corporatisation of government owned water selling enterprises and guided by recovery from users of the full cost of supplying water delivery services. St George irrigators have no problem with the principle of 'user pays'; we are proud of the fact we pay our own way. What we do have a problem with is having no choice but to purchase water supply services from a monopoly. It is apparent to us that SunWater can set its rates at levels sufficient to meet whatever its costs turn out to be. Among these costs are executive perks that did not exist before SunWater was corporatised. There is nothing in the St George NSP or the Issue Papers to suggest that SunWater's costs derive from competitive market forces or anything similar. No-one expected that something as harmless and wholesome as 'water reform' would morph into a conspiracy against users. Ultimately we are disappointed that government policy has relied on unrestrained market domination to achieve the aims prescribed for water reform. We believe this situation is unsustainable; in the fullness of time all tiers of government must introduce structural reforms that will deliver more cost effective and price competitive utilities.

The role of QCA: QCA sits between government owned monopolies (GOMs) and customers; its role is to recommend prices and trading standards that will make GOMs behave like firms facing normal competition. For the purpose of ensuring SunWater's new delivery prices are demonstratively efficient (thereby emulating what they would be if determined by competitive forces) QCA has interrogated numerous aspects of SunWater's costing procedures. But none of the background papers have determined whether SunWater's prices are indeed efficient or whether some alternative delivery model would result in more socially optimal outcomes. Most of the consultant's reports commissioned by QCA come across as meek and mild validation of the *status quo* rather than critical testing of SunWater's commercial legitimacy. These deficiencies and their associated implications are explored throughout this report.

Additional comments: Fundamental reform will be needed to make the pricing of water delivery services demonstratively competitive and therefore efficient. While such reforms might not be delivered in the next price path, the Government should direct QCA to commence background work with a view to presenting stakeholders with some tangible proposals well before 2016. In the meantime, we have several second-tier recommendations that should be incorporated into the upcoming price path. If adopted, these recommendations will help SunWater to eliminate any real increase in charges and go some way to compensating water users for having to suffer monopoly prices and tactics.

- The price paths proposed for the St George bulk and channel systems must be adjusted down so that there is negligible real increase in rates over the life of the new price path. Thus we do not accept as reasonable or legitimate any real increase in rates over the life of the new price path. It is suggested that this adjustment be affected in two ways: a) by SunWater absorbing a large proportion of the cost of the 2010-11 Intersafe Project, currently being inflicted on the St George distribution system; and b) by SunWater absorbing the full cost of distribution losses from the St George WSS.

- For the purposes of upholding the user-pays philosophy, SunWater should invoice the appropriate government department for all the costs associated with constructing and maintaining recreational facilities at their various water storages. Imposing 'recreation costs' on irrigators violates the spirit of user-pays and is a blatant abuse of monopoly power in government hands; in a competitive market it would not be possible to arbitrarily pass-off charges (created by some third party) to the primary customer.

- The prices imposed on St George water users should explicitly recognise any reductions in the total allocation due to intervention by government or any external body with statutory powers. If intervention results in any reduction in the historical WAE, then the apportionment available to local users will be less than 100%. In this event SunWater should recover the gap from the agency that intervened. Along similar lines, SunWater should not be used as tax collector for infrastructure that bestows benefits on the whole community. Thus bridges etc that service the St George WSS but remain accessible to the public should not be the exclusive responsibility of irrigators. Well established cost-sharing formulas should be employed to uphold the user pays principle.

- All demands placed on SunWater for OH&S expenditure should be critically reviewed by a standing committee that includes representatives of St George water users. This committee would have the power to recommend material changes to OH&S proposals, resulting in more cost effective solutions for irrigators.

- The Minister's Referral Notice asks QCA to "…review drainage and channel water harvesting charges". In 2000, SunWater took control of the water harvesting license previously owned and operated by St George irrigators. SunWater has no natural rights to water harvesting (during high flow events) and before the license was taken from them, irrigators oversighted equitable and efficient distribution of this water. Irrigators should have direct *pro rata* ownership of the channel water harvesting license so they can use or trade this water for maximum benefit. Accordingly we request that the channel water harvesting license at St George be returned to the irrigators immediately.

- Water users must have direct representation on the SunWater Board. This representation should take the form of one or several irrigators positioned to protect the diverse interests of water users against the commercial instincts of a monopoly.

1 CURRENT AND PROJECTED PRICE PATHS

1.1 PROJECTED COSTS

The current cost of MP water for channel users at St George is $44.66 per ML before any drainage charges. This figure can be used as a basis for assessing the reasonableness of the charges being proposed by SunWater for the new price path.

Table 1 shows forecast (2011) and proposed (2012-2016) operating and renewal costs for SunWater delivery services at St George. The table shows the forecast renewal annuity spend for 2011 and SunWater's estimated renewals program for each year from 2012 to 2016 (all in 2011 rates). Combined with the pre-determined apportionment factors and assignment of distribution losses, the proposed costs provide a basis for estimating the costs/prices that will apply to the new price path.

It will be noted that Table 1 shows service costs for both the river at St George and the distribution system. This was necessary because the 'losses cost' imposed on the distribution system is linked to the costs of supplying water directly from the river. While the cost per ML figures shown in Table 1 might not be a totally accurate reflection of the prices proposed by SunWater, they are considered a useful indicator on the following grounds:

- The operating and renewal figures were taken directly from the NSP
- The methodology follows that prescribed by SunWater
- It is reasonable to assume that SunWater's charges will be closely linked to their cost projections.

The NSP shows a serious anomaly with the rates forecast by SunWater for 2011. The renewal annuity spend in 2011 is forecast to be over $2.6m or 3.66 times higher than the next highest renewal spend. A break-out in the renewals annuity was not projected by the current price path (published in September 2006) and the NSP plan itself provides no explanation of the anomalous (2011) figure or how it might be managed in practice.

A draft report by GHD released on 28 March (page 68) indicated that the 2011 'annuity expenditure' was due to the so-called Intersafe Project – essentially a chain wire fence designed to stop pedestrian access to the main supply channel. We regard SunWater's decision to spend more than $2m on the Intersafe Project in one year and book it up to the irrigator's renewal account as unconscionable.

Based on our calculations, the cost of channel water will increase by more than 50% in real terms, going from about $44.60 per ML currently to an average for the period 2012-2016 of $67.59 per ML. This increase would result mainly from passing on of distribution losses to channels users[2]. But renewal costs are severely inflated by the legacy of expenditure in 2011.

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[2] Distribution losses are a 'fact of life' for many businesses. But rarely do we see customers lumbered with an itemized account that includes a charge for losses arising before the supply chain makes delivery. Customers usually prefer to get what they pay for. It seems SunWater's monopoly is so secure it has no qualms about charging its customers for product they don't get.

To ensure there is no increase in real prices over the life of the new price path, it will be necessary for QCA to negotiate (on our behalf) various adjustments to the 2012-2016 price path. According to the report provided by SAHA on 28 March, SunWater is harbouring substantial scope to cut costs going forward.

1.2 WHY REAL PRICES SHOULD NOT INCREASE?

Quite apart from the anomalous nature of the 2011 forecast rates, there are several reasons why we think there should be no rise in real costs/prices going forward.

1. **Full cost recovery was achieved by the current price path**. With full cost recovery now in place, the structure of water delivery services should be stable and prices need only increase according to the CPI. In other words, the hard work associated with water reform has been done and there should be no need to do it again. This should make some SunWater staff redundant. It is appreciated there will be between-year variation in renewal expenditure, but the budgeting for this outlay should be 'controlled' by various accrual methods. It is also appreciated that electricity costs might, in some years, increase by more than the CPI but SunWater will have to make productivity gains that more than offset cost increases outside its control.

2. **Total cost is dominated by overheads**. The cost recovery processes for the new price path are focused not so much on the cost of activities that have to be recovered but more on the accuracy of cost allocation among users. Perhaps the best example is the allocation of centralised costs. 85% of centralised costs are classified as either overhead or indirect costs and SunWater has come up with elaborate mechanisms for spreading these costs among individual WSSs. We are concerned about: a) the quantum and compilation of centralised costs; b) the practice of allocating centralised costs according to arbitrary rules; and c) the difficulties of quarantining costs that don't properly belong to any WSS. SunWater's total centralised costs have no doubt increased as it's become more involved in 'outside' construction, consulting and contracting.

3. **Obsession with method at the expense of efficiency.** The reports commissioned by QCA are largely focused on mechanical aspects of recovering costs. We are in general agreement with changes that increase the accuracy of cost recovery (according to effort, resources, risks, attribution, etc) but we are disappointed that more attention has not been given to ways and means of increasing SunWater's operational efficiency for the purpose of actually reducing water delivery charges. The scope of work brought to bear on the investigations has been limited by QCA's selective interpretation of the 'referral notice' and apparent reluctance to reform SunWater's service delivery model.

4. **Economies of size**. SunWater likes to boast about how big it is. In economic terms this should translate into economies of size and low long term average costs of production. SunWater should be able to use the entrepreneurial freedom it enjoys to find the very lowest point on its long term cost curve and then pass on the associated benefits to water uses. The issue of whether SunWater is a natural monopoly (or one preserved by government fiat) remains an open question that should be explored in due course. Some SunWater assets might perform better from a social perspective if transferred into an environment that is demonstratively competitive.

5. **Doubts about the efficiency of the costs**. The network service plans issued by SunWater are very light on detail – they do not, for example, tell us how particular cost items were arrived at. Moreover, consultations since publication of the plans have failed to bring forth much in the way of supplementary information. We are not surprised by SunWater's reticence; it's simply naïve to expect a monopoly, confident about its status, to give up information that might threaten its profitability. But not cooperating has a downside; it leads us and others to assume that the crude cost projections shown in the NSPs are masking the possibility of inflated and inefficient water prices. If QCA feels the same way, it is likely to recommend to the Government that SunWater's proposed NSP be materially modified.

6. **Monopoly pricing is a threat to efficiency.** To the extent that SunWater's charges are artificially high, they will have a negative impact on efficient resource allocation. This distortion could be corrected or offset by compensating water users. Thus the various offsets sought by St George irrigators should not be viewed negatively from a social perspective – if granted they will result in more optimal water application rates and substantial productivity dividends for irrigators, and by implication, the state.

1.3 MAINTENANCE OF THE THURAGGI WATERCOURSE

The Thuraggi Watercourse is effectively part of the St George WSS headworks. The problem local irrigators have is that neither DERM nor SunWater are maintaining this 'infrastructure'. It is apparent to us that neither party sees Thuraggi Watercourse as their responsibility. Given the importance of Thuraggi to our WSS, the impasse must be broken. Both parties can rationalise why they are 'not the responsible entity', but it will assist if we take the bold step of making a nomination. Culturally, DERM is more likely to acknowledge and deliver on a social obligation than SunWater; on these grounds we call upon DERM to take responsibility for the ongoing maintenance of Thuraggi Watercourse.

Table 1: Forecast and proposed price paths[3] for MP irrigation water delivered via the bulk and distribution systems at St George based on getting 85% of WDE

	2011	2012	2013	2014	2015	2016
Bulk system	**Forecast**	**NSP Price path**				
Medium priority WAE factor	0.96	0.96	0.96	0.96	0.96	0.96
High priority WAE factor	0.04	0.04	0.04	0.04	0.04	0.04
Operating costs	$881,000	$933,000	$982,000	$1,007,000	$992,000	$970,000
Medium priority HUF factor	0.94	0.94	0.94	0.94	0.94	0.94
High priority HUF factor	0.06	0.06	0.06	0.06	0.06	0.06
Renewal spend or annuity reserve	$1,001,000	$760,000	$750,000	$745,000	$738,000	$732,000
100% of av. MP WAE (ML/a)	81,575	81,575	81,575	81,575	81,575	81,575
100% of av. HP WAE (ML/a)	3,000	3,000	3,000	3,000	3,000	3,000
Cost of 85% MP water ($/ML)*	$25.77	$23.22	$23.76	$24.04	$23.74	$23.35
Cost of 85% HP water ($/ML)	$37.37	$32.52	$33.05	$33.33	$32.93	$32.44
Distribution system	**Forecast**	**NSP price path**				
Operating costs	$1,228,000	$1,216,000	$1,269,000	$1,284,000	$1,291,000	$1,277,000
Renewal spend or annuity	$2,616,000	$405,000	$398,000	$396,000	$391,000	$397,000
MP Distribution losses	5,696 ML	5,696 ML	5,696 ML	5,696 ML	5,696 ML	5,696 ML
HP Distribution losses (ML)	3,000	3,000	3,000	3,000	3,000	3,000
Distribution cost ($/a)	$258,890	$229,817	$234,509	$236,918	$233,994	$230,337
85% of WDE (ML)	43,170	43,170	43,170	43,170	43,170	43,170
Cost of 85% MP water ($/ML)	$95.04	$42.87	$44.05	$44.40	$44.38	$44.11
Plus bulk charge ($/ML)		$23.22	$23.76	$24.04	$23.74	$23.35
Total cost ($/ML)**	$95.04	$66.09	$67.81	$68.45	$68.12	$67.47

***** $/ML of MP @ 85% WAE = [(operating costs x 0.96) + (renewal annuity x 0.94)] / MP WAE x 0.85

****** $/ML of MP @ 85% WDE = {[(operating cost + renewal annuity +distribution loss)] / [(WDE x 0.85)]} + bulk charge

[3] The figures shown are not literally 'price paths' but cost estimates, being proposed by SunWater as a basis for pricing. We can only presume that these costs include a profit margin deemed by SunWater to be acceptable.

2 CRITICAL ANALYSIS OF THE SUNWATER SERVICE MODEL

2.1 INTRODUCTION

As shown in the previous section, SunWater's proposed price path would result in St George channel irrigators paying substantially higher rates in real terms. On these grounds we are justified in questioning whether SunWater, QCA and the Government are doing all they can to ensure that the charges being imposed on irrigators are indeed 'efficient' and as such pose no barrier to optimal water application rates and efficient crop production. In this section we look at a few specific issues relevant to government owned monopolises (GOMs) and most particularly, SunWater. This is done by posing a series of rhetorical questions, which we attempt to answer with maximum candour. To do this we take a multi-disciplinary approach, invoking insights derived from established economic principles, the workings of the political economy and financial accounting. Hopefully our particular approach will prove useful for QCA in arriving at guidelines for taking SunWater into the next pricing phase and beyond.

2.2 CAN QCA MAKE GOMS CHARGE EFFICIENT PRICES?

The prices being inflicted on Queensland's water users stem from a coalition between the Government, QCA and various utilities including SunWater. This coalition has the potential to extract super normal profits from water users, depending on how the review of price setting practices is approached and delivered. As such it is important for us to look at the work commissioned by QCA in support of the current review. The overwhelming emphasis on operational and costing forensics[4] – as distinct from structural change – suggests a preference to "keep things as they are". QCA is apparently confident that SunWater can be made to deliver efficient prices provided it can acquire a good enough understanding of how the SunWater business operates. Clearly a comprehensive knowledge of SunWater's inner workings would be useful to any review but we have doubts of the following nature.

- *Is it really possible to make monopolies charge efficient prices by relying on the artificial techniques employed by QCA*? Unless this question can be answered in the affirmative, the integrity of 'competition management' will remain in doubt. If QCA can't make SunWater apply demonstratively efficient prices, other mechanisms and models will be needed to bring about optimal resource allocation.

- *Is it realistic to require a GOM to 'recover all reasonable costs' but at the same time apply efficient prices – at rates that would apply if the business faced normal competition?* It appears the 'water reforms' of the past decade have been much more intent on recovering all costs (which translate into prices and profits for the seller) than on keeping charges low (for the purpose of maximising consumer surplus and making Australian agriculture more productive and profitable). We suspect that the social gains due to recovering all costs have been eliminated by the social losses implicit in monopoly pricing.

[4] This impression stems from the titles commissioned by QCA to inform the review. None of the titles question SunWater's monopoly status. The titles suggest a stoic belief in the state's ability to control pricing outcomes once enough data is extracted and analysed.

- *What ongoing scrutiny can be applied to SunWater to make sure that its charges remain efficient through time and across different markets and under the full range of circumstances that might arise within five years*? This seems an impossible task relative to reliance on the 'invisible hand' of normal competition.

- *Isn't it in the best interests of QCA and all the consultants involved in the current investigations to keep GOMs such as SunWater firmly in place*? While the referral notice could conceivably embrace some investigation of structural reform (see note 1.6) QCA has not seen it this way; no investigations dealing with either the flaws of monopoly pricing or the benefits of structural reform were commissioned. It seems to us the only stakeholder with a genuine interest in demonstratively efficient water prices is water users.

- *Who is paying for QCA's investigations*? There was speculation about this question in one of the Issue Paper responses but it was not answered. We can only imagine the Queensland Government is funding all investigations falling under the QCA remit. If the charges were to somehow find their way to SunWater and thence to water users, the impartiality of the whole investigation process would be sorely compromised.

- *How will we (St George irrigators) conclude whether QCA is effective or not*? If, following the scrutiny of SunWater's draft NSP, QCA recommends reductions in the charges to be applied in practice we will judge QCA to be at least partially effective; otherwise we will conclude it is ineffective. All the biases surrounding the review process stop us from accepting its recommendations at face value; we can only be satisfied by results that give us relief from monopoly pricing.

- *Is it reasonable to surmise that GOMs come under relatively greater pressure to acquiesce to 'rules and regulations' with questionable logic and absolutely no economic rationale*? Over the past few years the St George channel distribution systems has been burdened with the cost of the so-called 'intersafe project'. This project bestows no benefits on irrigators but has left us with a massive debt that will take years to pay off. It seems SunWater can acquiesce to spurious demands safe in the knowledge it can pass the associated cost off to water users.

2.3 CAN GOVERNMENT TRADING ENTERPRISES DELIVER EFFICIENT PRICES?

SunWater was corporatised to facilitate water pricing reform. According to the 'theory'**, if** all costs associated with water storage and delivery etc can be quarantined and the new 'owner' required by government statute to recover all its costs, then the reform process will proceed with minimal political and administrative difficulties. To make GOMs politically acceptable and legal, it was necessary to impose a competition monitor between the GOMs and their customers. In theory, scrutiny by QCA would effectively substitute for 'real market forces'. This scrutiny would make GOMs behave like firms confronting unfettered competition. Thus the prices charged by GOMs would be judged 'efficient' if the enterprise behaved like a firm confronting real competition. The question is: how do we know SunWater is behaving like a firm facing normal market competition? Evidence of pseudo competitive (or correct) behaviour might include the following:

- A strong customer focus evidenced by high service standards, good working relations and effective and meaningful communication

- Fear of scrutiny by QCA, resulting in cost-control measures and systems etc that might ‘prove’ the organisation is keeping prices down – as would be the case if there was normal competition

- Empirical data that shows charges imposed on customers stay within the bounds of CPI movements through time and otherwise reflect productivity gains. It is accepted that historical prices had to increase to meet the demands imposed by pricing reform and user pays etc

- In the absence of real and present competition, a GOM could invent systems and mechanisms that have the effect of exerting competitive pressure. It could, for example, aim to reduce the ‘indirect and overhead’ costs passed off to a WSS from 60% of total expenditure at present to (say) 40% within a three year period.

- Ongoing investigation of how key elements of the business can be handed over to the customer or exposed to real market forces.

Determining the appropriate level of operational efficiency that should apply within SunWater is no doubt difficult. Nevertheless, it is the responsibility of QCA to make such a determination and prescribe actions and adjustments that will result in socially desirable outcomes. While the effectiveness of QCA scrutiny will depend on the organisation’s resources and dedication to the job, we will judge the efficacy of the process in terms of outcomes. We require QCA to critically assess both the upcoming price path (to apply at St George) based on SunWater’s NSP and our analysis in Table 1 and longer term we want QCA to recommend fundamental reforms that will result in demonstratively efficient prices for water delivery services throughout the St George WSS.

If, after all the diagnostics, doubt remains about the efficiency of SunWater’s charges, QCA should recommend various forms of compensation. Only after the distortionary effects of monopoly prices have been properly offset will it be possible for irrigators to sense the ‘correct’ relationship between inputs and outputs and apply optimal water rates.

2.4 IS SUNWATER TOO CENTRALISED?

The headworks that SunWater operates are located throughout regional Queensland as are the company’s customers for the water controlled by the headworks. Moreover, the task of operating and maintaining the headworks is very ‘hands-on’ necessitating local staff. Despite this, SunWater has its head office in central Brisbane and several large regional offices. Ultimately, a significant proportion of SunWater’s total costs are incurred in Brisbane[5]. However, there are good reasons for SunWater having its head office in Brisbane. This location offers superior access

[5] The NSP is not specific about how costs are allocated between St George and Brisbane but the table showing ‘expenditure by type’ indicates that expenditure on ‘indirect and overhead’ will account for 60% of the total over the 10 years 2007-2016. Since ‘indirect and overhead’ expenditure takes in Head Office, there is clearly a large transfer of wealth going from St George to Brisbane.

to appropriately trained staff and to the support services needed to run a 21st century organisation. Moreover, SunWater's senior staff might need to be conveniently located to government departments and authorities with overlapping interests. On the whole, Brisbane is the appropriate place for SunWater's head office but depending on the *final balance*, centralisation in the state capital could be perceived as having the following weaknesses:

- An excessive drag on the budget due to the tendency for the senior staff of GMOs to benchmark their pay and conditions against standards applying in the CBD. In any event, there is something irksome about a GOM providing simple, low risk 'water delivery services' in rural areas, using its corporate status to reward senior staff with executive-style pay and conditions, just because it can. When the same 'water delivery services' were provided by a government department, the 'pay and conditions' of senior staff were subject to comparatively more control and transparency[6].

- Excessive transfer of wealth from the bush to the city. At some critical point the transfer of wealth (via city-based jobs and overhead costs) to head office will be excessive relative to the services provided at SunWater's headworks. If the issue papers were not so focused on the elegance of different pricing mechanisms, there might have been sufficient resources to explore the scope for SunWater apportioning more of the staff budget to operational centres. We note that the report by SAHA (March 2011) identified substantial scope for labour and salary saving and much of this might materialise in SunWater's central and regional offices.

2.5 IS THE DEFINITION OF MAINTENANCE SUFFICIENTLY CLEAR?

The NSP table showing expenditure by activity lists 'preventive maintenance' and 'corrective maintenance' as well as 'renewal annuity spend'. All three of these activities are aimed at keeping the headworks in good working order although a pedantic distinction between preventative and corrective maintenance is attempted. We have difficulty imagining SunWater staff and/or contractors keeping an accurate record of whether they had performed preventative or corrective maintenance on a given day and whether there were any interaction effects with the renewal spend. We would like to see a clear distinction between routine maintenance and renewal expenditure. Thus routine maintenance will keep the headworks working as required until it becomes apparent that some major component must be replaced or a completely new component added. The issue papers suggest that SunWater wants to go to extraordinary lengths to apportion overhead costs accurately but seems less concerned about cost categories that directly affect the operational efficiency of the headworks – such as maintenance.

2.6 WHY IS THE USER-PAYS PRINCIPLE APPLIED SELECTIVELY?

The key driver underpinning the whole water reform agenda is getting users to pay 'the full cost'. The rationale for user pays, whatever the product, has been

[6] The groundswell of customer disquiet about utility prices generally can be traced to corporatization of simple government services; since the corporatization process is often synonymous with monopoly prices, fat salaries and government dividends. If governments don't wish to be in the business of providing utilities they should sell them outright – so that subsequent market performance and outcomes can at least be subject to black letter law.

expounded forever and is fine with us – provided it is applied consistently. The consultant's report on how to deal with the costs of constructing and up-keeping recreational facilities at water storages was sub-standard. For the sake of some imagination it concluded that extracting a charge from the direct users (tourists/locals/others) would be too hard and therefore the associated costs should be loaded onto local irrigators. We agree that extracting a charge from direct users would be hard but there are other entities more responsible and more able (to pay) than local irrigators. The surrogate user is clearly a state or federal government department who might have come up with the idea and has a broad-based budget that would spread the impost relatively evenly across taxpayers. Expecting local irrigators to pay for tourist facilities at storages is demonstrably unjust and dishonours the user-pays principles. QCA should instruct an immediate change to the formulae.

Along similar lines, QAC must make sure St George irrigators are not burdened with the cost of grand visions that reduce local extractions or somehow reduce the value of entitlements. Of course SunWater should not pay for these things either; the user-pays principle should be invoked to identify the responsible party and subsequently the responsible customer. Once identified, the 'real customer' should be invoiced by SunWater.

2.7 IS WATER DELIVERY BEING USED AS A PLAY-THING BY THE MINDERS?

It appears to us that SunWater has been captured by the agents of OH&S and other lofty causes. It's not fully appreciated that agencies responsible for a particular cause feel their job is never done; they are forever inventing new projects to justify their existence. The St George WSS has been burdened by numerous OH&S projects that add no value whatsoever to water. In our view, some of the new OH&S installations at St George are less safe than those they replaced. The 2010-2011 Inter-safe Project has plunged the St George channel distribution system into serious debt, thereby reducing both farm profitability and asset values. At the very least, community safety is a shared responsibility and should not be lumped onto irrigators just because they are a soft target.

The Inter-safe debacle leads us to make two general points. First, SunWater must not unilaterally commit St George irrigators to CapEx projects that cannot be funded from existing reserves. This directive applies particularly to projects not seen as directly relevant to the operational efficiency of our WSS. Secondly, proposals to spend our money on OH&S must, from now on, be supported by some form of professional analysis designed to convinced local stakeholders of its merits. We reserve the right to veto proposals we find less than convincing.

3 CONCLUSIONS AND RECOMMENDATIONS

The water reform processes of the past decade have achieved their basic aim of getting users to pay all of the costs for which they are responsible[7]. This reform was achieved in part by corporatising government owned water monopolies such as SunWater. While we have no issues with the concept of user pays, we consider the competitive framework in which SunWater currently operates to be socially sub-optimal and ultimately unsustainable. Regardless of the rationale used to justify the creation of GOMs, their political and economic acceptability is eventually undermined by what customers see as the real cause of ongoing prices hikes; namely tolerance of operational inefficiency, cash dividends for the government and bloated salaries for senior staff.

Immediate and longer term adjustments are needed to make the situation more economically, socially and politically acceptable. With respect to the longer term, QCA should be directed to undertake work on 'basic structural reform' that will change how SunWater operates. When the time is right, St George irrigators would be interested in taking over operation of the channel distribution system. This would give us the ability to call for competitive tenders (to operate the distribution system) and in the process give us greater control over our financial destiny.

While we look forward to assuming direct control of St George distribution system, that day is still a little way off. In the meantime, QCA and the Government should look to ways of compensating water users for having to suffer monopoly prices and tactics. The compensation we are looking for would not distort prices or lead to a misallocation of resources. On the contrary, the compensation would correct the influences inherent in monopoly (water delivery) prices and result in more efficient resource allocation overall.

A short list of the compensation measures sought by St George irrigators, for delivery over the course of the 2012-2016 price path, are spelt out below.

1. The price paths proposed by SunWater for the St George river and distribution systems must be adjusted down so that there is negligible real increase in rates over the life of the new price path. Thus we do not accept as reasonable or legitimate any real increase in rates over the life of the new price path. It is suggested that this adjustment be affected in two ways: a) by SunWater absorbing a large proportion of the cost of the 2010-11 Intersafe Project, currently being inflicted on the St George distribution system; and b) by SunWater absorbing the full cost of distribution losses from the WSS.

2. Any charges associated with the cost of constructing and maintaining recreational facilities at St George headworks must not be lumped onto local water users. We are relying on QCA to put right this ridiculous injustice.

[7] To stop any quibbling before it starts, St George irrigators are not liable to pay a return on and of the capital tied up in headworks. As argued in our last submission to QCA, the capital tied up in the headworks at St George (being old) has long since trans-located to the balance sheets of irrigation farmers who use the associated water. So irrigators effectively own the headworks but SunWater has been granted the operating rights. The optimised replacement cost figures published by SunWater are academic.

3. For the period ahead, SunWater must not commit St George irrigators to any CapEx projects that cannot be funded from the asset renewal reserves. While these 'reserves' can be taken to include new funding expected within a year or so following the project's completion, SunWater is not authorised to take our ARR into debt.

4. If the installation of new water meters is thought by DERM to be another plank in the reform process then DERM itself should meet the cost of purchasing, installing and commissioning the meters.

5. Water users must have representation on the SunWater Board. This representation should take the form of one or several irrigators equipped with the time and knowledge to protect the diverse interests of water users against the commercial instincts of a monopoly.