NATIONAL COMPETITION COUNCIL

SUPPLEMENTARY SECOND TRANCHE ASSESSMENT

30 JUNE 2000

Table of Contents

ABBREVIATIONS

ACCC	Australian Competition and Consumer Commission
ACT	Australian Capital Territory
ANZECC	Australian and New Zealand Environment and Conservation Council
APPEA	Australian Petroleum Production and Exploration Association
ARMCANZ	Agriculture and Resource Management Council of Australia and New Zealand
ATC	Australian Transport Council
CN	Competitive Neutrality
COAG	Council of Australian Governments
CPA	Competition Principles Agreement
CSO	Community Service Obligation
CTP	Compulsory Third Party Motor Vehicle Insurance
DNR	Department of Natural Resources (Queensland)
DPIWE	Department of Primary Industries, Water and the Environment (Tasmania)
DTF	Department of Treasury and Finance (Tasmania)
EGP	Eastern Gas Pipeline
EM	Explanatory Memorandum
FCP	Full Cost Pricing Policy
FIRS	Federal Interstate Registration Scheme
GBE	Government Business Enterprise
GOC	Government Owned Corporation
GSO	Government Service Obligation
GST	Goods and Services Tax

kL	Kilolitre (1000 L)
LRMC	Long Run Marginal Cost
ML	Megalitre (1000 kL)
NCC	National Competition Council
NCP	National Competition Policy
NT	Northern Territory
OGOC	Office of Government Owned Corporations (Queensland)
PPL	Petroleum Production Licence
QCA	Queensland Competition Authority
QR	Queensland Rail
ROL	Resource Operations Licence
ROP	Resource Operations Plan
RWSC	Rivers and Water Supply Commission (Tasmania)
RCL	New South Wales Rice Cooperative Limited
REA	Rice Export Authority
SBA	Significant Business Activity
SCI	Statement of Corporate Intent
SWP	State Water Projects
TER	Tax Equivalent Regime
TPA	Trade Practices Act 1974
UIWG	Upstream Issues Working Group
USO	Universal Service Obligation
WACC	Weighted Average Cost of Capital
WMP	Water Management Plan
WRP	Water Resource Plan

SUMMARY AND RECOMMENDATIONS

National Competition Policy (NCP) is a comprehensive mix of economic policy and measures to provide for social needs. Agreed by all governments in 1995, the NCP program builds on the pro-competitive reform process which commenced with the Trade Practices Act of 1974.

Governments established the National Competition Council to assess, among other things, their progress against the agreed NCP reform program. There are three tranches of assessments: prior to July 1997, July 1999 and July 2001. The Council also undertakes supplementary assessments where jurisdictions achieve progress against reform objectives but have not achieved full implementation at the time of the tranche assessment.

Under the NCP Agreements, the Commonwealth makes funding available to the States and Territories on the basis that they make satisfactory progress against NCP reform objectives.

A maximum of $1.106 billion in NCP payments is available for the second tranche period (1999-2000 and 2000-01), with the payments allocated by the Federal Treasurer taking account of the advice of the Council.[1] The recommendations in this report form the basis of advice to the Federal Treasurer on the allocation of NCP payments for 2000-01.

Where the Council's assessments find that governments are continuing to progress all matters consistent with agreed NCP obligations, the Council recommends that relevant governments receive full NCP payments.[2] However, where the Council identifies areas where reform activity has not satisfactorily met obligations, and the breach is non-trivial, the Council considers whether a reduction in NCP payments, or a suspension of payments pending further work by the jurisdiction, is appropriate.

Unless there is work clearly documenting the cost of the breach to the community, the Council expresses its recommendations in terms of a percentage of the NCP payments available to the jurisdiction. In determining the quantum of any reduction or suspension, the Council takes account of the relative importance of the reform, the extent of progress the jurisdiction has achieved, the complexity of the matter and the time which has been available for implementation. The Council also takes into account the need for the recommended reduction or suspension

---

[1] See Attachment 1 for a disaggregation of second tranche NCP payments by jurisdiction.

[2] The Council also assesses progress by the Commonwealth, which is a party to the NCP Agreements. However, NCP payments are not relevant to the Commonwealth.

to provide a sufficient incentive for the jurisdiction to rectify the identified breach. The Council's objective in expressing the quantum of any reduction or suspension as a percentage of NCP payments is to ensure equivalent treatment of jurisdictions in respect of breaches which the Council considers to be of the same order of magnitude.

The June 1999 second tranche assessment showed that in general, governments were continuing to progress their NCP reform programs.

However, the Council identified several areas where governments' activity had not sufficiently met obligations. Given that jurisdictions had reform action proposed or underway in many of these areas, rather than propose reductions in second tranche NCP payments, the Council recommended three supplementary assessments, in December 1999, March 2000 and June 2000, to give jurisdictions more time to advance their programs.[3] The Council also deferred the second tranche assessment of Queensland's progress with implementing competitive neutrality principles because a matter relevant to the assessment was then before the Supreme Court of Queensland.

The Council's supplementary assessments show that actions taken by Victoria, Tasmania and the ACT to deal with concerns identified in June 1999 demonstrate sound progress against those governments' second tranche NCP commitments.

However, the Council finds remaining questions relating to the regulation of domestic rice marketing (New South Wales), the water industry (New South Wales, Queensland, Western Australia, South Australia and the Northern Territory), competitive neutrality (Queensland) and road transport (Northern Territory). These matters have implications for the Council's recommendations on NCP payments to these jurisdictions.

New South Wales has not yet agreed to a Commonwealth proposal to reform rice marketing, or to repeal the State domestic rice marketing arrangements consistent with the findings of its 1995 Rice Review. Therefore, the Council is not satisfied that New South Wales has met its obligations for this supplementary assessment and recommends that, unless these commitments are met by 31 July 2000, a $10 million per annum reduction in NCP payments otherwise payable to New South Wales be imposed.

All States and Territories are implementing reforms to their dairy marketing arrangements. Issues arose in the second tranche in relation to New South Wales, Queensland, Western Australia and the ACT and,

[3] The first two supplementary assessments have been previously reported by the Council, and the outcomes are presented here in summary only. (See NCC 2000 and NCC 1999b)

therefore, actions by these jurisdictions are directly relevant to this supplementary assessment. All States and Territories have now passed legislation repealing milk marketing regulations, thereby meeting their obligations for this supplementary assessment. The Commonwealth dairy assistance package is due to commence in October 2000. At that time, the Council will confirm that dairy reform legislation is operational in all jurisdictions.

Changes aimed at improving the efficiency with which Australia uses water are a key component of the NCP program. New South Wales, Queensland and Western Australia have not satisfied the Council that they have put in place a water allocation framework consistent with the water resources policy set by COAG. Queensland is also yet to put in place institutional arrangements removing regulatory functions from water service providers. The Council recommends that there be no reduction or suspension in payments at this stage as relevant legislation is before all Parliaments. However, a failure to have in place appropriate arrangements by December 2000 will result in a recommendation for a reduction and ongoing suspension of NCP payments for these States.

South Australia and Queensland have not made sufficient progress on urban pricing reform for the Council to be satisfied that reform commitments have been met. For South Australia, the Council recommends a suspension of 5 per cent of NCP payments for the financial year 2000-2001 until September 2000. For Queensland, the Council recommends a 5 per cent suspension of NCP payments for the financial year until December 2000. If there is satisfactory progress by then, the Council recommends that payments be reinstated.

The Northern Territory has not fully committed to the establishment of institutional arrangements consistent with the water resources policy. In regard to this, the Council recommends suspension of a small part of the Northern Territory's payments for 2000-01. If the Northern Territory satisfactory progresses this matter within the next four months, the Council recommends that the suspended payments be reinstated.

The Council recommends suspension of 10 per cent of Queensland's NCP payments for 2000-01, pending the development by Queensland of a framework defining and costing the Community Service Obligations (CSOs) placed on Queensland Rail in respect of passenger rail services in South East Queensland. The Council proposes to conduct a supplementary assessment of Queensland's progress with developing the framework prior to 31 December 2000. The Council will recommend that the suspended payment be reimbursed if an appropriate framework is finalised but will consider recommending that the suspended penalty become a permanent reduction if Queensland has not finalised the framework by 31 December 2000.

In the area of road transport, the Council recommends an ongoing annual reduction for the Northern Territory, to commence in 2000-01, equivalent to 5 per cent of the Territory's NCP payments for 2000-01. The reduction is recommended because of the failure of the Northern Territory to either implement a driver demerit points arrangement sufficiently in line with the COAG road reform package or obtain an exemption from COAG for this aspect of the road reform program.

The Council also found that both the Commonwealth and Western Australia had not completed their second tranche road transport programs at 30 June 2000. However, reform programs in both jurisdictions are now significantly advanced. Western Australia has devoted considerable recent effort to progressing its legislation delivering the national vehicle registration and driver licensing program and, in the interim, is using administrative mechanisms to meet its obligations. As a result, the Council does not recommend any reduction in NCP payments for Western Australia.

In several cases, mainly relating to legislation review and reform obligations, governments addressed identified concerns by instituting new review processes or undertaking to revisit their previous policy approach. Where governments committed to such actions, the Council assessed them as meeting second tranche NCP obligations. However, the relevant matter remains under consideration, with the outcomes to be considered under the third tranche process in 2001.

The following table summarises the Council's findings and recommendations arising from the three supplementary second tranche assessments.

FINDINGS AND RECOMMENDATIONS: SECOND TRANCHE SUPPLEMENTARY ASSESSMENTS: 31 DECEMBER 1999, 31 MARCH 2000 AND 30 JUNE 2000	
Supplementary Second Tranche Assessment 31 December 1999	
NCP Reform and Relevant Jurisdiction(s)	**NCC Findings and Recommendations**
Electricity: implement regulatory arrangements recommended by structural review under clause 4 of CPA (South Australia)	Implemented through South Australian Independent Pricing Regulator.

Water: Various elements of the second tranche reform package (Queensland, South Australia, Tasmania, Northern Territory)	Suspension of NCP payments to Queensland lifted following resolution of concerns regarding new rural schemes. Supplementary assessment of guidelines prior to 30 June 2000. Progress of pricing reforms in Queensland, Tasmania and Northern Territory. Further supplementary assessment for Queensland, South Australia, Tasmania and Northern Territory prior to 30 June 2000. Commitment to devolve irrigation management met by Tasmania. Further supplementary assessment for Queensland prior to 30 June 2000. Further supplementary assessment regarding institutional arrangements for Queensland and Northern Territory prior to 30 June 2000. Further supplementary assessment regarding legislative framework for water allocation and trade for Northern Territory prior to 30 June 2000.
National gas: implement recommendations of the review of the Cooper Basin (Ratification) Act 1975 (South Australia)	Some progress at 31 December 1999. Further supplementary assessment prior to 30 June 2000.
Supplementary Second Tranche Assessment 31 March 2000	
NCP Reform	**Findings and Recommendations**
Various elements of the NCP second tranche road reform package (Commonwealth, Queensland, Western Australia, South Australia, Tasmania, ACT, Northern Territory)	South Australia, Tasmania and ACT have met second tranche NCP obligations. Western Australia and Queensland progressed reforms consistent with a likely implementation date of 30 June 2000. Further supplementary assessment prior to 30 June 2000. The Commonwealth progressed reforms but is unlikely to implement in full by 30 June 2000. Further supplementary assessment prior to 30 June 2000. The Northern Territory had not implemented a demerit points arrangement consistent with COAG framework. Further supplementary assessment prior to 30 June 2000.
Supplementary Second Tranche Assessment 30 June 2000	
NCP Reform	**Findings and Recommendations**
National gas: application of the National Gas Access Code (Queensland)	Legislation commenced on 19 May 2000.

National gas: remaining recommendations of the review of the Cooper Basin (Ratification) Act 1975 (South Australia)	South Australia has met second tranche NCP obligations.
Water: remaining elements of the second tranche water reform package <u>New South Wales</u> Legislation to establish appropriate water allocation framework <u>Queensland</u> Legislation to establish appropriate water allocation framework, implement institutional separation and provide for devolution of irrigation management Urban water pricing reform <u>Western Australia</u> Legislation to establish appropriate water allocation framework <u>South Australia</u> Further implementation of	<u>New South Wales</u> No suspension or reduction in NCP payments. Supplementary assessment in December 2000 to ensure legislation consistent with the water framework is substantially in force, otherwise a reduction in 2000-2001 NCP payments of 5% (for the period July to December 2000, approx $7.5m) will be recommended. In addition, a suspension of 5% (for period January to June 2001) will be recommended; total of 10% of NCP payments affected. <u>Queensland</u> No suspension or reduction in NCP payments. Supplementary assessment in December 2000 to ensure legislation consistent with the water framework is substantially in force, otherwise reduction in 2000-2001 NCP payments of 7.5% (for the period July to December 2000, approx $6.5m) will be recommended. In addition, a suspension of 7.5% (for period January to June 2001) will be recommended; total of 15% of NCP payments affected. Suspension of 5% of 2000-2001 NCP payments (approx $4.3m) until 31 December 2000 for insufficient progress with implementation of two-part tariffs where cost effective by Townsville City Council although slow progress in Johnstone and Cooloola is also of concern. Further assessment at this time and if progress remains unsatisfactory reduction in payments. <u>Western Australia</u> No suspension or reduction in NCP payments. Supplementary assessment in December 2000 to ensure legislation consistent with the water framework is substantially in force, otherwise reduction in 2000-2001 NCP payments of 5% (for the period July to December 2000 approx $2.3m) recommended. In addition, a suspension of 5% (for period January to June 2001) will also be recommended; total of 10% of NCP payments affected. <u>South Australia</u> Suspension of 5% of 2000-2001 NCP payments (approx

urban water and sewerage pricing reform: • trade waste charges • sewerage charges • free water allowances • commercial charges	$1.8m) until 30 September 2000 for insufficient progress with urban water pricing reforms. Further assessment at this time and if progress remains unsatisfactory reduction in payments.
Bulk water	Reform commitments met.
<u>Tasmania</u>	<u>Tasmania</u>
Legislation to establish appropriate water allocation framework	Reform commitments met.
Urban water pricing reform	Sound progress with implementation of two-part tariffs achieved, revisit in third assessment.
Progress with pricing reform and CSOs provided by local government	Reform commitments met.
<u>Northern Territory</u>	<u>Northern Territory</u>
Bulk water charging	Second tranche commitments met, revisit in third tranche assessment.
Legislation to provide for Institutional separation	Suspension of 2½ % of 2000-2001 NCP payments (approx $120 000) until 31 October 2000. Further assessment at this time. If legislation not before Parliament, reduction of this amount. Supplementary assessment in December 2000 to ensure legislation consistent with the water framework is substantially in force. If still not before Parliament, further reduction of 2½ %. If before Parliament and not commenced a reduction of 2½ % (if applicable, where legislation was before Parliament by 31 October 2000) and a suspension of a further 2½ % (for period January to June 2001) will be recommended; total of 5% of NCP payments affected.
Legislation to establish appropriate water allocation framework	Reform commitments met.
Road: reforms not implemented at 31 March 2000 (Commonwealth, Queensland, Western Australia, Northern Territory)	Queensland will have introduced fee-free licence conversions by 30 June. Both the Commonwealth and Western Australia have progressed their road reform programs but will not have implemented the full second tranche COAG framework at 30 June. Nonetheless, given that relevant Bills are before the Western Australian Parliament, the NCC recommends there be no reduction from the NCP payments otherwise due to Western Australia in respect of road reform.

	The Northern Territory has not agreed to implement a driver demerit points arrangement consistent with the COAG framework nor sought an exemption from COAG. The NCC recommends that annual NCP payments otherwise payable to the Northern Territory from 2000-01 be reduced by 5% of the Territory's payments for 2000-01 (approximately $235 000) until an appropriate demerit points arrangement is agreed or exemption for this reform obtained from COAG.
Legislation review: dairy industry (New South Wales, Queensland, Western Australia, ACT)	New South Wales, Queensland, Western Australia and the ACT have passed legislation repealing market milk regulations and have met their obligations for this supplementary assessment.
Legislation review: domestic rice marketing arrangements (New South Wales)	New South Wales has not agreed to a Commonwealth proposal to reform rice marketing arrangements or repealed its domestic rice vesting legislation in accordance with a review finding and, therefore, has failed to meet its obligations for this supplementary assessment. The NCC recommends that NCP payments otherwise payable to New South Wales be reduced by $10 million per annum from 31 July 2000 until such time as agreement is reached on a Commonwealth reform model or repeal of domestic rice vesting is achieved.
Legislation review: compulsory third party insurance for motor vehicles (Victoria, Tasmania)	Victoria committed to a new NCP review. Tasmania committed to re-assess policy approach on the basis of the findings of the Victorian review. These commitments meet second tranche NCP obligations.
Legislation review: workers' compensation arrangements (Victoria)	Victoria committed to a new NCP review. This meets second tranche NCP obligations.
Legislation review: professional indemnity insurance for solicitors (Victoria)	Victoria has undertaken to finalise its approach after releasing review reports and the Government's draft policy approach for public discussion. This meets second tranche NCP obligations.
Legislation review: Australian Postal Corporation Act (Commonwealth)	Progress to date is consistent with second tranche NCP obligations.
Implementation of competitive neutrality principles (Queensland)	Queensland stated that it is progressing the implementation of a framework defining and costing the CSO requirements placed on Queensland Rail, but is still to finalise the passenger transport CSO framework for South East Queensland. The Council recommends suspension of 10% of Queensland's NCP payments for 2000-01 (about $8.6 million), pending a supplementary assessment of progress in December 2000. The Council will recommend that the suspended NCP payments be reinstated if an appropriate framework is finalised. However, the Council

	will recommend that the suspension become a permanent reduction if Queensland has not developed an appropriate passenger transport CSO framework for South East Queensland by 31 December 2000.

1 ABOUT THE SUPPLEMENTARY NCP SECOND TRANCHE ASSESSMENTS

Governments introduced Australia's National Competition Policy (NCP) in 1995, with the objective of developing a more dynamic, competitive and innovative economy. The program is a balanced mix of economic policy and measures to deliver social needs, including protection of the environment.

The NCP reforms, which are delivered through three inter-governmental agreements, focus on:

- infrastructure monopolies such as electricity transmission grids and rail networks, many of which have been, or are, government monopolies, where competition concerns are addressed through the infrastructure access regime under Part IIIA of the Trade Practices Act 1974 (TPA);

- monopolistic activities addressed through extension of the reach of the TPA under the Conduct Code Agreement; and

- legislated restrictions, where pro-competitive reforms are considered under clause 5 of the Competition Principles Agreement (CPA).

NCP has two other key elements. It:

- addresses concerns about the performance of government businesses through the obligation on governments to apply competitive neutrality principles to significant government businesses under clause 3 of the CPA and, to review the structure of public monopolies under clause 4 of the CPA; and

- requires governments to focus broadly on the management of Australia's water industry, to ensure appropriate use of water including for the environment.

Under the Agreement to Implement the National Competition Policy and Related Reforms (Implementation Agreement), the National Competition Council is required to conduct three assessments of the progress achieved by governments against the reform obligations in the NCP Agreements.[4] Governments asked the Council to assess progress recognising that Australia is in essence a national market, and that consistent progress by all jurisdictions rather than a piecemeal approach is the key to maximising the benefits to the community.

[4] The three NCP Agreements are reproduced in NCC 1998.

The Commonwealth makes payments to the States and Territories for implementing the NCP reform package. Satisfactory progress against the obligations in the NCP Agreements is a pre-requisite for States and Territories to receive these payments.

The Council assesses progress in three tranches (prior to July 1997, July 1999 and July 2001) and makes recommendations on payments to the Federal Treasurer. Approximately $1.106 billion in NCP payments are available in the second tranche period (1999-2000 and 2000-01). The Council also assesses the Commonwealth Government's progress (the Commonwealth is a party to the NCP Agreements), although there are no implications for NCP payments.

In addition to the three tranches of assessments, the Council also conducts supplementary assessments. Supplementary assessments are undertaken where governments had achieved progress against reform objectives but had not implemented the objectives in full at the time of the tranche assessments. Because NCP is a comprehensive program often demanding on resources of governments, the Council prefers to use the supplementary assessment process to allow additional time where a reform is progressing but not complete at the time of the tranche assessment rather than to recommend a reduction in NCP payments. Where the Council considers a supplementary assessment is warranted, it defers recommendations for reduced NCP payments pending the supplementary assessment.

The Council recommended several matters for supplementary second tranche assessment, to occur at different times during the 12-month period following the 30 June 1999 second tranche assessment. The Council determined the timing for the supplementary assessments after considering progress at the time of the second tranche assessment and the extent of the remaining reform task.[5] The matters identified for supplementary second tranche assessment are summarised in Table 1.1 below.

In addition, the Council deferred the second tranche assessment of Queensland's progress with implementing competitive neutrality principles. The assessment was deferred because an application for judicial review relevant to the assessment was then before the Supreme Court of Queensland. The deferral allowed time for the Supreme Court to determine the matter and for the Queensland Government to finalise its policy response. The Supreme Court rejected the application in September 1999.

The Council's December 1999 supplementary assessment of progress with water and electricity reform and its March 2000 report of progress with

[5] For a full statement of the reform obligations, see: NCC 1998.

road transport reform have been released by the Federal Treasurer and are public documents (NCC 1999b and NCC 2000).

This report covers those matters identified for supplementary assessment in June 1999 which have not yet been the subject of a supplementary assessment or, were considered in the earlier supplementary assessments and found not to be implemented in full. It also covers the deferred assessment of Queensland's progress with implementing competitive neutrality principles. Further, it includes a summary of the Council's earlier supplementary assessments covering matters relevant to the electricity, gas and water industries. Satisfactory progress, addressing concerns with NCP compliance identified in the June 1999 assessment, is a pre-requisite for the Council recommending to the Federal Treasurer that jurisdictions receive full NCP dividends for 2000-01.

There were also three legislation matters identified in the second tranche scheduled for progress assessment in the third tranche. These were the regulation of liquor licensing in Victoria and South Australia and shop trading hours in South Australia. This report summarises progress on these matters since the second tranche assessment but does not report on NCP compliance. The Council will assess progress in these areas in the third tranche, consistent with the legislation review obligation to remove restrictions by the end of 2000 which are not shown to provide a net community benefit or are not the only way of achieving the objective of the legislation.

Table 1.1: Schedule of Supplementary Second Tranche Assessments

NCP Reform	Relevant Jurisdictions	Date of Assessment
Electricity: implement regulatory arrangements recommended by structural review	South Australia	31 December 1999
Various elements of the second tranche water reform package	Queensland, South Australia, Tasmania, Northern Territory	31 December 1999
Other remaining elements of the second tranche water reform package	New South Wales, Queensland, Western Australia, South Australia, Tasmania	30 June 2000
National gas reform: implement recommendations of the review of the Cooper Basin (Ratification) Act 1975	South Australia	31 December 1999 with a further supplementary assessment 30 June 2000
National gas reform: application of the National Gas Access Code	Queensland	30 June 2000
Remaining elements of the NCP second tranche road reform package	Commonwealth, Queensland, Western Australia, South Australia,	31 March 2000

	Tasmania, ACT, Northern Territory	
Road reforms not completed at 31 March 2000	Commonwealth, Queensland, Western Australia, Northern Territory	30 June 2000
Legislation review: dairy industry	New South Wales, Queensland, Western Australia, ACT	30 June 2000
Legislation review: domestic rice marketing arrangements	New South Wales	30 June 2000
Legislation review: compulsory third party insurance for motor vehicles	Victoria, Tasmania	30 June 2000
Legislation review: workers' compensation arrangements	Victoria	30 June 2000
Legislation review: professional indemnity insurance for solicitors	Victoria	30 June 2000
Legislation review: Australian Postal Corporation Act 1989	Commonwealth	30 June 2000

2 SUMMARY OF OUTCOMES OF EARLIER SECOND TRANCHE SUPPLEMENTARY ASSESSMENTS

Electricity Industry Regulation: South Australia

In its June 1999 second tranche assessment, the Council identified the establishment of independent electricity industry regulatory bodies as recommended by a South Australian review under clause 4 of the CPA as an outstanding NCP matter. The Council proposed to consider South Australia's progress with this matter before 31 December 1999.

The South Australian Independent Pricing Regulator was established on 11 October 1999 following enactment of the *Independent Industry Regulator Act 1999* and the *Electricity (Miscellaneous) Amendment Act 1999.*

The Council advised the Commonwealth Treasurer in December 1999 that South Australia had met its second tranche electricity reform commitments as the regulatory framework required under the NCP agreements had been satisfied.

Road Transport: Commonwealth, Queensland, Western Australia, South Australia, Tasmania, ACT and the Northern Territory

The Council's second tranche assessment in June 1999 found that there had been significant progress against the Council of Australian Governments (COAG) road reform program, with over 80 per cent of the second tranche program then in place. However, only New South Wales and Victoria had implemented all elements at the time of the assessment.

The Council's March 2000 supplementary assessment considered progress with implementing the remaining reform elements in the seven jurisdictions which had not implemented the full second tranche program at June 1999. The supplementary assessment found that all jurisdictions except the Northern Territory had implemented, or were in the process of implementing the full second tranche program.

South Australia, Tasmania and the ACT had passed legislation and drafted associated regulations to introduce the national vehicle registration and driver licensing reforms. Parliamentary schedules in Queensland and Western Australia suggested that the necessary legislation and regulations would be in place by 30 June 2000. Despite earlier assurances that its legislation would be in place by 30 June 2000,

the Commonwealth is now expecting to introduce the required legislation in the Spring sitting (beginning mid August) 2000.

The Council said it would conduct a further assessment for Queensland and Western Australia in June 2000 to ensure the legislation is in place. The Council indicated it would consider recommending a reduction in the NCP dividend for 2000-01 if Queensland and Western Australia had not completed their legislative commitments by 30 June 2000. The Council also stated it would review the status of the Commonwealth's legislation, when it would assess whether the Commonwealth is in breach of its obligations.

The Northern Territory had implemented 15 of the 16 road reforms relevant to it at June 1999. At that time, it was still to take a decision on a demerit points system for licensed drivers. In the course of the March 2000 supplementary assessment, the Northern Territory announced it would introduce a demerit points system, but only in respect to drivers of heavy commercial vehicles, from February 2002.

In March 2000, the Council advised the Federal Treasurer that it considered the Northern Territory proposal to be at odds with the demerit points element of the COAG framework. The Council undertook to conduct a further assessment for the Northern Territory in June 2000. The Council stated that it would consider recommending a reduction in the NCP payment to the Northern Territory, to apply from 2000-01, until the Territory either agrees to implement a demerit points arrangement consistent with the COAG framework and timetable or demonstrates that it has an exemption from COAG for this aspect of the road reform program.

The Water Industry: Queensland, South Australia, Tasmania and Northern Territory

The Council's June 1999 second tranche assessment against the COAG water reform framework[6] found that, while there was strong progress across all jurisdictions, only Victoria and the ACT had met required commitments. The second tranche assessment flagged the following matters for supplementary assessment in December 1999.

- Queensland's progress on reform commitments in relation to urban cost recovery, pricing and institutional arrangements. During this time, the Council also noted its further assessment of issues concerning the assessment of economic viability and ecological sustainability of rural schemes. The Council had recommended a suspension of 25 per

[6] COAG 1994.

cent of Queensland's 1999-2000 NCP payments in respect of this matter.

- South Australia's commercial water pricing following announcement of the State's retail water pricing policy.

- Tasmania's progress on the implementation of two-part tariffs for urban water supply and devolution of irrigation management.

- The Northern Territory's reform progress in relation to urban cost recovery, bulk water pricing, cross-subsidies, water allocations and trading and institutional reform. The Council also noted that it would assess the timetable on action to be taken in relation to priority river and ground water systems.

Assessment in December 1999

Queensland

The Council's supplementary assessment reported the ongoing progress of Queensland in addressing reform commitments. The Council, however, remained of the view that many reform commitments were not met. In particular, the following second tranche commitments were still outstanding:

- for urban cost reform and pricing, the failure of reform progress in smaller local governments; and

- institutional separation of the roles of water service provision and resource management, standard setting and regulatory enforcement.

The Council recommended that both these matters be the subject of a further supplementary assessment in June 2000.

Queensland also provided information on investment in new rural schemes and undertook to further develop guidelines for analysis of economic viability and ecological sustainability of new projects. These guidelines were to be assessed in June 2000. In summary, the Council was satisfied that relevant rural schemes had proceeded in a manner consistent with reform commitments, had not proceeded or, if they had proceeded, should not result in a reduction in NCP payments. The Council recommended that the suspension of 25 per cent of Queensland NCP payments for 1999-2000 be lifted and the suspended payment be reimbursed.

South Australia

South Australia released a discussion paper in December 1999 as part of a public consultation process targeting the future direction of water pricing,

including commercial water pricing. However, at this time, South Australia stated that it would not finalise its approach to commercial water pricing without a period of public consultation. Acknowledging the importance of public consultation, the Council recommended a further assessment of South Australia's progress with commercial water pricing reform in June 2000.

Tasmania

The Council was generally satisfied that the process adopted by Tasmania to assess and implement two-part tariff reforms demonstrated genuine commitment to urban pricing reform. The Council recommended that actual implementation of tariffs be the subject of a further assessment in June 2000.

The Council was also satisfied that devolution of irrigation management in relevant schemes was consistent with second tranche reform commitments.

Northern Territory

The Council was satisfied that second tranche commitments were met by the Northern Territory in relation to the following aspects of urban price reform: full cost recovery, rates of return, and cross-subsidies. The Council recommended a further assessment of progress on the implementation of internal bulk water charges by the Power and Water Authority in June 2000.

The Council assessed the implementation program for allocations in priority water resources and processes for assessing the economic viability of new rural investment as being consistent with second tranche reform commitments.

The Northern Territory, while demonstrating progress in establishing arrangements for water allocations and trading arrangements and institutional separation, had not completed this process by December 1999. The Council recommended that a further assessment be conducted in June 2000 to confirm that appropriate legislation has been passed by the Legislative Assembly.

3 LEGISLATION REVIEW AND REFORM

Under NCP, all governments committed themselves to reviewing, and where appropriate, reforming legislation that restricts competition by December 2000.

The guiding review principle, contained in clause 5 of the Competition Principles Agreement (CPA), is that legislation should not restrict competition unless it can be demonstrated that the benefits of the restriction to the community as a whole, outweigh the costs or, the objectives of the legislation cannot be achieved in another way.

The NCP program is extensive, involving review of almost 1700 separate pieces of legislation between June 1996 and December 2000. All new legislation restricting competition must also meet the competition tests in the CPA. All jurisdictions now have in place a process for examining the potential impacts of new anti-competitive legislation and the costs and benefits of alternative approaches.

Restrictions on competition can be retained under NCP, but this requires governments to undertake an objective assessment of the costs and benefits of those restrictions. The matters which should be taken into account in assessing costs and benefits include those in clause 1(3) of the CPA. This is commonly known as the 'public interest test.'

The Council's tranche assessments investigate significant restrictions retained by governments and whether there is a rigorous justification for those restrictions. In the second tranche assessment, the Council found several areas where it considered governments' review and reform activity did not sufficiently meet NCP principles, generally because there was not a convincing net community benefit argument to support retained restrictions.

In most cases, governments undertook to reconsider their policy approaches to these areas of regulation. In response, the Council scheduled these matters for supplementary assessment in June 2000, providing jurisdictions with time to establish new processes for examining remaining questions against the agreed objective of removing, by the end of 2000, all restrictions not shown to provide a net community benefit.

The Council will consider the outcomes of these processes in the third tranche assessment. Consistent with the CPA, where a jurisdiction retains restrictions in legislation after 2000, the Council will assess jurisdictions as complying with NCP obligations only where the jurisdiction can provide:

- a rigorous net community benefit case supporting the restriction; and

- evidence that it is necessary to restrict competition to achieve the objectives of the legislation.

The Dairy Industry: New South Wales, Queensland, Western Australia and ACT

The raw milk produced by Australia's dairy farmers tends to be classified as either "market milk" (that is, fresh drinking milk) or "manufacturing milk", which is used in the production of milk powder, cheese and butter.

Historically, the market milk sector has been tightly regulated through state-based dairy corporations, while the more export-focused manufacturing sector is relatively lightly regulated. This has resulted in the prices for market milk paid to producers being approximately twice that of manufacturing milk (the price of which approximates the world price).

The Council's second tranche assessment in June 1999 outlined the existing regulatory framework (NCC 1999a, pp.97-8).

Compliance with the NCP Principles at June 1999

In its June 1999 assessment, the Council considered the dairy industry reviews conducted by the New South Wales, Queensland, Western Australia and ACT Governments. At that time, the Council expressed a range of concerns about the conduct of those reviews.

In the case of New South Wales, the split in the recommendations of the Review Group highlighted the Council's concern that reviews clearly demonstrate a net community benefit in support of the retention of restrictions, in this case those relating to market milk. The Council's concern in this case was exacerbated by the links between the Review Group and the dairy industry, which was represented directly on the panel. To ensure that reviews have the interests of the community as a whole as the paramount consideration, it is important that review panels, particularly in sensitive areas, be independent from the relevant industry. While industry participation is critical, it should occur through submissions and other consultative mechanisms, rather than direct representation on review panels.

In the case of Queensland, the Review Group determined that *"the overall impact on the economy is of less concern than the potentially important regional effects"* (Queensland Dairy Legislation Review Committee 1998, p. 163). This approach suggested that the Review Group believed that the highly concentrated benefits to a few from the existing arrangements should be protected at the expense of the more diffuse costs to the majority. This approach is inconsistent with the principle underpinning

legislation review, that arrangements should be reformed unless it can be shown that they deliver a net benefit to the community as a whole.

Similarly, the Council was concerned about the robustness of the cost-benefit analysis undertaken in reviews. For example, many of the costs and benefits listed in the ACT review report appeared to have been included directly from submissions without analysis of their merit. The Council recognised that the ACT's analysis was predominantly qualitative: however, the review did not appear to weigh up the many costs and benefits listed and thereby provide an overall sense of where the balance of the public interest lies.

However, each of the reviews expressed the view that deregulation is inevitable, with market arrangements becoming increasingly difficult to sustain due to domestic and external commercial pressures. All reviews also expressed concern that reform be introduced in a manner sensitive to expected social and economic impacts on producers and rural communities.

In its second tranche assessment, the Council recognised that the size and structure of the Victorian dairy industry has a significant influence on the rest of the Australian dairy industry. It noted that, if Victoria deregulated its industry, it would be increasingly difficult for other jurisdictions to sustain any remaining price and market restrictions, due to the competitiveness of Victorian producers, processors and manufacturers, the operation of the *Mutual Recognition Act* and inter-state trade.

The Council concluded that, in view of the proposed national dairy industry reform and the adjustment package that was under consideration at the time, and the significance of the outcome of the Victorian review, it would consider the New South Wales, Queensland, Western Australia and ACT reviews through a supplementary assessment before July 2000.

Activity since the June 1999 second tranche assessment

The Victorian dairy industry review was completed in July 1999. It recommended the removal of remaining supply management and farm-gate pricing arrangements for market milk in Victoria by mid-2000.

A new government was elected in Victoria in September 1999. In December 1999, and in keeping with an election commitment, the new Victorian Minister for Agriculture conducted a plebiscite of all Victorian dairy producers on whether to deregulate market milk arrangements. Victorian producers overwhelmingly supported reform in conjunction with the proposed industry adjustment assistance package.

In March 2000, all Australian Agriculture and Primary Industries Ministers signed a communique setting out governments' commitments to

reform market milk regulation prior to 30 June 2000 and the provision of an industry adjustment assistance package. The key features of the dairy industry adjustment program are:

- structural adjustment payments in the order of $1.63 billion will be made to dairy producers who choose to stay in farming. The payments will commence in October 2000 with payments to be made to producers quarterly over eight years (the Dairy Structural Adjustment Program);
- producers who decide to leave the industry will be assisted with an exit payment of up to $45 000 per producer, (the Dairy Exit Program - totalling $30 million);
- assistance to dairy-based communities in the order of $45 million (the Dairy Rural Adjustment Program);
- the adjustment package will be funded by a retail/consumer levy of 11 cents/litre imposed by the Commonwealth on liquid milk products (including fresh milk, UHT milk and flavoured milks); and
- the package will be administered by the Dairy Adjustment Authority.

The Commonwealth legislation required to give effect to the reform program was passed on 8 April 2000.

All States and Territories have passed legislation to repeal market milk regulations in accordance with the March communique (see Table 3.1). Several States have announced additional State-based adjustment programs and/or funding to assist their industries.

Table 3.1: Progress with legislation to implement dairy industry reform at 30 June 2000

Jurisdiction	Summary of legislative action at 30 June 2000
Commonwealth	Dairy Industry Adjustment legislation was passed on 8 April.
NSW	Legislation was passed on 29 June.
Victoria	Legislation was passed on 1 June and proclaimed on 27 June.
Queensland	Legislation was passed on 22 June.
Western Australia	Legislation was passed on 27 June.
South Australia	Legislation was passed on 1 June and proclaimed on 22 June.
Tasmania	Legislation was passed on 24 May and proclaimed on 16 June.
ACT	Legislation was passed on 23 May.
NT	na

Over the past twelve months, the Victorian Government (as discussed above), and the dairy industries in New South Wales and Western Australian have conducted ballots of dairy producers in their respective States to gauge support for industry reform and the Commonwealth's adjustment package. In Victoria, 89 per cent of producers who voted supported reform, with 65 per cent support in New South Wales and 56 per cent support in Western Australia. The Tasmanian Government also sought producer views on reform. Most of the comments received by Tasmania supported reform in conjunction with the adjustment package.

Assessment

The Council supports the national approach adopted by governments and the industry to dairy industry reform. To meet commitments for this supplementary assessment, the Council is looking for jurisdictions to have tabled, before their Parliaments, legislation to implement dairy industry reform. As all relevant jurisdictions have now passed dairy reform legislation the Council will not make any payment recommendations as part of this assessment.

The Commonwealth adjustment assistance package is due to commence in October 2000. At this time the Council will also confirm that the legislation is operational in all jurisdictions. Moreover, the Council will continue to monitor the implementation of the national dairy industry reform program and adjustment package over the next year prior to its third tranche assessment.

Domestic Rice Marketing: New South Wales

In 1995, the New South Wales Rice Review Group (the Review Group) recommended that the domestic rice marketing monopoly held by the New South Wales Rice Marketing Board (the Board) be deregulated, finding that this would deliver a net community benefit. The Review Group found a case for retaining the Board's export monopoly.

The Review Group proposed that domestic deregulation be implemented by allowing the Board's vesting power over the New South Wales rice crop to expire after 31 January 1999. However, contrary to this recommendation, the New South Wales Government retained the existing vesting arrangements until 31 January 2004, with a further review in the year 2002.

Compliance with the NCP Principles at June 1999

In its first tranche assessment in June 1997, the Council identified the decision by New South Wales not to reform its domestic rice marketing arrangements, consistent with the review finding, as a failure to meet its NCP obligations. The Council's recommendation did not extend to the single desk export monopoly, which the Review found to provide a net

benefit. The Council agreed to reassess New South Wales' progress with implementing domestic deregulation prior to July 1998 following an undertaking by the New South Wales Government to work with the Council towards resolving the matter consistent with the recommendations of the 1995 Review.

The following twelve months saw no progress toward deregulating domestic rice market arrangements. As a result, in June 1998, the Council recommended that the Commonwealth Treasurer reduce New South Wales' NCP payments by $10 million.

The $10 million reduction was ultimately not imposed following an in-principle agreement in April 1999 by the New South Wales Premier to deregulate domestic rice marketing in line with the recommendations of an inter-governmental and industry rice Working Group. The Working Group proposed a model that would allow for the retention of the single export desk while providing for domestic deregulation.

As a result of the in-principle agreement, and an expectation that this agreement would result in satisfactory progress being made, the Council was satisfied that New South Wales had met its second tranche NCP obligations. However, the Council determined to monitor developments and make a supplementary assessment, prior to the third tranche assessment, if evidence emerged of unsatisfactory progress against this in-principle agreement.

Activity since the June 1999 second tranche assessment

Over the past twelve months, the Commonwealth and New South Wales Governments, in consultation with representatives of the New South Wales rice industry, have worked towards achieving the Working Group's proposed model, the key features of which are:

- the establishment, under Commonwealth jurisdiction, of a Rice Export Authority (REA) to manage a Commonwealth export monopoly for rice;
- export rights to reside with the New South Wales Rice Cooperative Limited for an initial 3-5 years;
- during this period the REA could approve third parties to export rice where such action would not diminish benefits arising from the single export desk;
- the regular review of the single desk to ensure it delivers a net benefit to the community;
- the REA to report regularly to the Commonwealth Parliament on the use of the export monopoly; and

- the cost of managing the single desk be recovered from exporters.

While not a party to the discussions between the governments, the Council understands that the Commonwealth has forwarded a proposal, based on the Working Group's preferred model, to New South Wales for its consideration.

Assessment

The Council considers that there has been sufficient time since its second tranche assessment for New South Wales and the Commonwealth to have developed and agreed to a reform model. Therefore, to conclude that satisfactory progress has been made for the current assessment, it is necessary for New South Wales:

- to agree to the Commonwealth model – conditional only on the Commonwealth seeking and obtaining the agreement of all other States to the proposal; or

- to have repealed it's domestic rice vesting arrangements in accordance with the 1995 Review recommendation.

At the time of reporting, the Council understands that New South Wales is still to respond to the Commonwealth's proposal. Consequently, the Council considers that New South Wales has failed to meet its current NCP commitments. However, the Council understands that a response from New South Wales is imminent.

Consequently, the Council recommends a reduction of $10 million per annum from New South Wales' NCP payments for 2000-01 be imposed from 31 July 2000. If, prior to this time, New South Wales accepts the Commonwealth proposal or repeals its domestic rice vesting arrangements in accordance with the 1995 review recommendation, the Council will recommend that the Treasurer not impose the reduction and that the Council re-examine this issue in its third tranche assessment.

Compulsory Third Party Insurance for Motor Vehicles: Victoria and Tasmania

Compulsory third party motor vehicle insurance (CTP) provides for cover against personal injuries arising from motor vehicle accidents. The insurance is purchased in conjunction with the registration of a vehicle and aims to protect the purchaser against liability to a third party. All jurisdictions in Australia have some form of compulsory compensation for transport accidents. The nature of the product supplied differs between jurisdictions with eligibility and benefits defined in legislation.

In all jurisdictions, except New South Wales and Queensland, CTP is provided by monopolies. The ACT allows competitive delivery, however

only one private insurer operates in the Territory. Other jurisdictions operate statutory monopolies.

New South Wales, Victoria and Tasmania were the only jurisdictions that had completed their review processes at the time of the second tranche assessment. Apart from the ACT where there is provision for competitive delivery, legislation review and reform activity in all other jurisdictions will be assessed as part of the Council's third tranche assessment prior to July 2001.

Compliance with NCP Principles at June 1999

The Council second tranche assessment identified restrictions on competition in CTP legislation in both Victoria and Tasmania which did not comply with the tests in the CPA.

Victoria

Victoria reviewed its CTP arrangements in 1997-98. The review found a net benefit in requiring motorists to hold CTP insurance but significant costs associated with the statutory monopoly. These include reduced incentives for suppliers to innovate, reduce costs and prices, and constraints on consumer sovereignty.

Despite the review recommendation, the then Victorian Government announced in October 1998 that it would retain the key features of the monopoly. In essence, the case put by the Government to support retention of the monopoly was that it considered that a competitive model with compulsory coverage, lifetime care and community ratings would involve substantial regulatory costs.

In the light of the Council's concern about the disparity between the recommendations of Victoria's review and the Government's policy response, Victoria undertook to support a national review of the regulation of transport accident insurance looking at, among other things, the appropriate level of competition in the provision of CTP services. The Council considered that Victoria's agreement to participate in a national review would meet second tranche NCP obligations but stated that it would conduct a supplementary assessment by July 2000 if the national review did not proceed.

Tasmania

Tasmania reviewed its *Motor Accidents (Liabilities and Compensation) Act 1973* in 1997. The review found that the statutory monopoly delivered a net community benefit and recommended that it be retained. The Tasmanian Government accepted the review findings. The review raised several arguments in support of the monopoly, including that premiums would be higher under a competitive model and that the small size of the

Tasmanian market is likely to preclude more than two providers, leading to potential oligopoly.

The Council was not convinced by the weight of the review's argument supporting the monopoly in the second tranche assessment. In particular, the Council believed that the findings that premiums would be higher under a competitive model or that requiring monopoly supply is the best way to address problems relating to oligopolistic pricing warranted further consideration.

The Council's concerns about the rigour of the argument supporting the review findings were exacerbated by the lack of independence in the review process. The CTP review was undertaken by a panel including a representative from the Motor Accidents Insurance Board, which is the monopoly provider of insurance in the state.

Although it argued that its review and reform activity relating to CTP fully met NCP obligations, Tasmania undertook to support a national review of the regulation of transport accident insurance. The Council considered that Tasmania's agreement to participate in a national review would meet second tranche NCP obligations but stated that it would conduct a supplementary assessment by July 2000 if the national review did not proceed.

Activity since the June 1999 second tranche assessment

Following the second tranche assessment, a proposal to conduct a national review of the regulation of CTP insurance by the Productivity Commission was considered by all States and Territories. It did not receive support from a majority of jurisdictions, although both Victoria and Tasmania supported the review.

In the absence of the national review, Victoria advised the Council in February 2000 that it intended to conduct a further state-based NCP review of CTP arrangements. Tasmania advised the Council in June 2000 that it intended to consider its policy approach in the light of the outcome of Victoria's review, which is expected to examine other review outcomes and experience in other jurisdictions. While stating that it would not necessarily be bound by the findings of the new Victorian review, Tasmania emphasised that its objective is to implement the most effective policy arrangements for the delivery of CTP services.

Assessment

The Council considers that Victoria's proposal for a further review of the regulation of CTP and Tasmania's undertaking to consider its policy approach in the light of the findings of Victoria's review, to the extent they are relevant, satisfies both jurisdictions' obligations for this

supplementary assessment. The Council will assess progress with CTP review and reform outcomes in both jurisdictions as part of the third tranche NCP assessment.

Workers' Compensation: Victoria

Workers' compensation insurance is a compulsory arrangement, whereby employers purchase insurance policies from authorised insurers on behalf of employees. Public monopoly providers operate in three States and the Commonwealth, with multiple providers in other jurisdictions. There are significant price controls in all jurisdictions.

New South Wales and Victoria were the only jurisdictions that had completed their review processes at the time of the second tranche assessment. Review and reform activity in all other jurisdictions will be assessed as part of the third tranche assessment.

Compliance with NCP Principles at June 1999

Victoria reviewed its workers' compensation arrangements in 1997-98. The review recommended that the Victorian WorkCover Authority monopoly should cease and that competition should be introduced, although it did not put forward a proposal for a competitive scheme.

The Victorian Government rejected this recommendation and decided to retain monopoly provision of workers' compensation. The Government noted the benefits from reform of workplace accident arrangements in the existing scheme, including low and stable premiums and a greater ability to capture the benefits of investment in accident prevention and long term rehabilitation.

The Victorian workers' compensation regulatory arrangements were identified by Council as a supplementary assessment matter in its second tranche assessment in June 1999.

In response to the Council's concerns, Victoria agreed to support a national review of workers' compensation arrangements. The Council stated that it would conduct a supplementary assessment by July 2000 if the national review did not progress sufficiently.

Activity since the June 1999 second tranche assessment

The proposal for a national review of workers' compensation arrangements did not proceed. Because of this, Victoria decided to proceed with its own independent State-based review.

Assessment

Victoria's undertaking to conduct a new NCP review satisfies supplementary second tranche assessment obligations. The Council will consider the outcome of this review and the Victorian Government's policy response in the third tranche assessment.

Professional Indemnity Insurance for Solicitors: Victoria

Professional indemnity insurance is compulsory for all solicitors in Australia. In all jurisdictions, except the ACT, there is a monopoly provider of professional indemnity insurance.[7] The ACT has deregulated its market to allow two approved insurers.

Victoria and the ACT were the only jurisdictions that had completed their NCP review processes at the time of the second tranche assessment. Compliance with NCP principles by all other jurisdictions will be assessed as part of the third tranche prior to July 2001.

Compliance with NCP Principles at June 1999

Following a review in 1996, Victoria introduced legislation to allow lawyers a choice of insurer, with a phased transition period. However, after another review by Victoria's Legal Practice Board in 1998, the Government decided to retain the statutory monopoly in the provision of professional indemnity insurance for solicitors. Subsequently, Victoria confirmed the statutory monopoly through *the Legal Practice (Amendment) Act 1998*.

While acknowledging that determining the best way of delivering professional indemnity insurance involves some complexities, particularly in ensuring adequate affordable cover for sole operators and small firms, the Council's view in the second tranche assessment was that Victoria's approach did not fully address the competition tests in the CPA. The Council concluded that the experience of other countries and the pro-competitive recommendation of the corresponding review in New South Wales suggest that competitive delivery represents a workable alternative to the monopoly. Indeed, Victoria's earlier NCP review had recommended a more competitive arrangement.

In the light of the Council's concerns, the former Victorian Government committed to revisit its policy approach to the delivery of professional indemnity insurance for solicitors. The then Government undertook to

[7] In New South Wales, professional indemnity insurance for barristers is open to the market.

conduct a further review to test whether a change to the existing monopoly arrangement would be appropriate.

Activity since the June 1999 second tranche assessment

Subsequently, the new Victorian Government has confirmed that it intends to assess its approach to the regulation of professional indemnity insurance for solicitors following a period of public consultation. However, rather than conduct a further review, the Government has stated that it will release all review reports and its draft response for public discussion, prior to finalising its approach.

Assessment

The Council considers Victoria's undertaking to determine its approach to the regulation of professional indemnity insurance, following a period of public discussion based on previous review material, satisfies supplementary second tranche NCP obligations. The Council will consider the outcome of this process and the Victorian Government's policy response in the third tranche.

Australian Postal Corporation Act 1989: Commonwealth

On 19 May 1997, the Commonwealth requested the NCC to review the *Australian Postal Corporation Act 1989*. Following a nine-month public review, the Council recommended a package of reforms for consideration by the Government. The recommended reforms included:

- retaining the obligation on Australia Post to provide an Australia-wide letter service, with unprofitable parts of the universal service obligation (USO) subjected to community service obligation (CSO) funding from a mix of sources;
- household letter services remaining reserved to Australia Post, with a mandated uniform rate of postage;
- open competition in business letter services, with Australia Post free to discount against a maximum charge set at the same level as the uniform rate for household letters; and
- open competition in all international mail services.

Compliance with NCP Principles at June 1999

The Commonwealth Government announced its response to the Council's recommendations in July 1998. The main features of the Commonwealth's response were:

- the retention of the universal service obligation and the uniform letter rate;

- the reduction in Australia Post's monopoly on domestic mail, from four times the standard letter rate and 250g, to one times the standard letter rate and 50g; and

- the introduction of an access regime.

While the Commonwealth's proposals differ from those of the Council, both approaches are intended to increase competition in the provision of mail services while maintaining Australia Post's universal service obligation and the uniform letter rate.

Accordingly, in the second tranche NCP assessment, the Council considered that the Commonwealth's proposed package could fulfil the Commonwealth's NCP obligations. It noted, however, that the key to the success of the reform program is the implementation of an effective access regime. The Council concluded that, subject to putting in place an effective access regime, the Commonwealth had fulfilled its NCP obligations.

Activity since the June 1999 second tranche assessment

On 5 April 2000, the Commonwealth tabled a Bill to amend the *Australian Postal Corporation Act 1989*.

The Senate Legislation Committee on Environment, Communications, Information Technology and the Arts completed its inquiry into the provisions of the Bill on 5 June 2000. The Committee recommended that the Commonwealth's reforms proceed, with minor changes including widening the scope of the community service obligation (CSO) to include distance education materials, monitoring whether small parcels should be included, and reviewing the effects of competition so that, if necessary, a mechanism for competitors to share the cost of the CSO can be introduced.

The Committee made a number of other recommendations, including that:

- rural and remote postal outlets be considered for inclusion in the Rural Transactions Centres' Scheme;

- Licensed Post Offices should continue to receive top-up payments where this is necessary for their viability;

- the proposed legislation be changed to remove any doubt that the Government is intent on discouraging remail (that is, the assembling and mailing of local mail overseas for delivery back into Australia); and

- that the role of the Australian Competition and Consumer Commission (ACCC) in regulating access be limited to those instances where Australia Post fails to reach a negotiated agreement with a competitor on fair access.

Assessment

The Bill introducing an access regime for Australia Post is currently before the Commonwealth Parliament. In view of this, the Council considers that the Commonwealth's progress with implementing reforms arising from the review of the Australian Postal Corporation Act has satisfactorily met second tranche NCP obligations.

The Council will continue to monitor implementation of the Australia Post access regime as part of the third tranche assessment.

Matters Identified in the Second Tranche for Assessment in the Third Tranche: Progress Update

In the second tranche assessment, the Council identified three legislation review matters as raising questions about NCP compliance. The Council asked relevant jurisdictions to progress these matters by end 2000 in accordance with the NCP principles.

Regulation of Liquor Licensing: Victoria's '8 per cent rule'

Following the NCP review of its *Liquor Control Act 1987*, Victoria undertook considerable pro-competitive reform of its liquor licensing arrangements. However, it retained a provision that restricts the number of off-licences held by the same or related persons to 8 per cent of the total number of licences.

Victoria's decision to retain the 8 per cent rule for off-licences was contrary to the recommendation of its review panel, which found, among other things, that the restriction did not achieve the objective of minimising underage consumption, was not necessary to achieve diversity in liquor retailing, and was not the way to deal with concerns about market concentration. No other State or Territory has an explicit restriction on the number of licences that a single entity may hold.

In the June 1999 second tranche assessment, the Council considered that the review recommendation to abolish the 8 per cent rule had not been satisfactorily addressed by public interest arguments subsequently raised by the then Victorian Government. The Council called on Victoria to remove the 8 per cent rule in accordance with the CPA obligation to remove unjustified restrictions on competition by the end of 2000.

Victoria has now commenced a new review of the 8 per cent rule against NCP principles. This review is expected to report to the Government by 30 June 2000. The Council welcomes the commitment demonstrated by Victoria to date to resolving this matter consistent with NCP principles. The Council will consider the outcome of the new review and Victoria's policy response as part of the third tranche NCP assessment.

Regulation of Liquor Licensing: South Australia's proof of need requirement

Following an NCP review of its *Liquor Licensing Act 1985* in 1996, South Australia removed several restrictions on the sale of alcohol. However, the State retained the 'proof of need' requirement, whereby applicants for liquor licences must demonstrate that the licence is necessary to meet the needs of consumers in the locality, and prohibitions on the sale of packaged liquor by outlets other than those totally devoted to selling liquor.

The Government's decisions on these matters were consistent with the recommendations of its NCP review. However, noting that the review also proposed a further examination of licensing arrangements in three to four years when the community impacts of less regulated approaches in other jurisdictions are clearer, the Government undertook to review the case for the proof of need requirement around the end of 2000 or early 2001. The Council will take into account South Australia's progress towards the further review of the proof of need requirement as part of the third tranche NCP assessment.

Regulation of Shop Trading Hours: South Australia

South Australia reviewed its *Shop Trading Hours Act 1977* in 1998. The Government announced new trading hours arrangements in response to the review, which took effect from 8 June 1999. The Government's response retained significant restrictions on trading hours, discriminating between different shops on the basis of location, size or product sold.

The public interest case supporting the new trading hours arrangements provided by South Australia as part of the June 1999 second tranche process did not, in the view of the Council, clearly demonstrate that the remaining restrictions provide a net benefit to the whole community or are the best way of achieving the objectives of the State's trading hours legislation. South Australia did not release the report of its trading hours review or provide a detailed comparison of the review recommendations and the Government's response.

In the June 1999 second tranche assessment, the Council recommended that, to comply with NCP obligations, South Australia will need to remove all unjustified restrictions on shop trading arrangements by 31 December 2000 or demonstrate that the restrictions retained beyond that date

provide a net benefit to the whole community. South Australia has undertaken to report further on this matter in its 2001 NCP annual report. The Council will consider whether South Australia has achieved the objective of removing all unjustified restrictions on trading hours by the end of 2000 as part of the third tranche NCP assessment.

4 COMPETITIVE NEUTRALITY PRINCIPLES: QUEENSLAND

Background

The Council's second tranche consideration of Queensland's compliance with competitive neutrality principles took account of the implications for competitive neutrality of the Queensland Government's response to the recommendations of its competitive neutrality complaints body, the Queensland Competition Authority (QCA) on the Coachtrans matter. The Coachtrans matter was a complaint by a passenger bus operator, Sita Queensland (trading as Coachtrans), that Queensland Rail's (QR) passenger transport service from Brisbane to Helensvale (Gold Coast) was, among other things, not applying appropriate competitive neutrality principles in respect to fares on the route and that QR enjoyed procedural and regulatory advantages.

Coachtrans' concern was that its viability was diminished and its parent company was underwriting losses because the competing QR rail service, introduced in February 1996, was setting fares which Coachtrans considered were subsidised by the Government in breach of NCP competitive neutrality obligations. Coachtrans submitted that, if it were forced to discontinue its services, almost 450 000 passengers a year would be without public transport. (QCA 1998, p. 2)

The QCA reported on the Coachtrans complaint in June 1998, finding that QR's fares on the Brisbane to Gold Coast route breached competitive neutrality principles but that QR did not enjoy any procedural or regulatory advantages. In August 1998, the Queensland Government rejected the QCA decision that there had been a breach of the principle of competitive neutrality in relation to the fares charged by QR. At the time, however, the Treasurer and Premier requested the Minister for Transport to develop, as a matter of priority, a comprehensive Community Service Obligation (CSO) framework for passenger transport in South East Queensland, taking account of the principle of competitive neutrality.[8]

The Council deferred the June 1999 second tranche assessment of Queensland's competitive neutrality compliance to a supplementary process, advising in June 1999 that the CSO framework promised by Queensland would be a key to considering compliance. The Council deferred the assessment because there was an application by Sita Queensland for judicial review of the decision of the Queensland Premier

[8] Community Service Obligations are goods and/or services which a business would not provide if it considered its commercial interests only, and which the Government considers are necessary to deliver particular social objectives.

and Treasurer to reject the QCA decision on QR's fares then before the Supreme Court of Queensland.

The Supreme Court denied the application in September 1999. The Court could not be satisfied there was any error of law, in that the Premier and the Treasurer had applied some incorrect test, or that they had taken into account irrelevant considerations, in arriving at their decision. The Court stated, in relation to the decision of the Premier, that it is understandable that he took account of broader policy considerations than government policy on competition. The Court also found that no action by the QCA infringed natural justice afforded to any party.

What is competitive neutrality?

The objective of competitive neutrality policy is the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities (CPA clause 3.1). In summary, competitive neutrality policy involves:

- adoption of a corporatisation model for significant Government business enterprises;
- payment of all relevant Commonwealth, State and local government direct and indirect taxes and charges or equivalents;
- payment of debt neutrality charges or commercial interest rates;
- achievement of a commercial rate of return on assets to ensure competitive neutrality components are not accommodated through a reduction in profit margin;
- compliance with regulations to which private sector companies are normally subject; and
- pricing of goods and services provided in contestable markets to take account of all direct costs attributable to the activity and the applicable competitive neutrality components.

Queensland's 1996 policy statement, *A Statement on the Application of Competitive Neutrality to Queensland Government Business Activities* sets out three reform approaches to achieving competitive neutrality, through either:

- (preferably) corporatisation of significant business activities; or
- (alternatively) some other kind of structural reform (commercialisation); or

- (at the very least) full cost pricing, ie prices should reflect the actual cost of providing the good or service (Queensland Treasury 1996. pp.9-10).

Under NCP, governments must also have a facility for investigating complaints that publicly-owned businesses are not applying appropriate competitive neutrality principles. They must also report annually on allegations of non-compliance with competitive neutrality policy.

What about social objectives?

The NCP Agreements do not impose any directions on governments in relation to their commitments to broader social policies. That is, the Agreements, while seeking to achieve benefits through competition, also provide for governments to establish and deliver broader social objectives including through CSOs. Nevertheless, the Agreements are premised on careful and systematic identification and implementation of CSOs. This is to ensure the community gains the maximum possible benefits from appropriate implementation of competitive neutrality principles, including in relation to pricing.

Queensland's 1996 policy statement emphasises the importance of effective delivery of social objectives. It states that 'structural reform resulting from competitive neutrality strengthens the delivery of … Community Service Obligations (CSOs) by clearly identifying them and imposing specific performance targets and standards which must be met by the SBA (Significant Business Activity) charged with their delivery.'

Further, the policy notes that the Government provides CSOs for Citytrain (the Brisbane to Gold Coast service). It states that 'these CSOs will be conditional upon agreed levels of service (including, for example, a minimum level of on-time running) and based on efficient costs.' (Queensland Treasury 1996, p. 36)

The three approaches to implementing competitive neutrality set out in Queensland's 1996 policy statement all recognise CSOs.

- The *Government Owned Corporations Act 1993* imposes strong accountability requirements on Government Owned Corporations (GOCs), including that CSOs be negotiated with shareholding Ministers at the time of corporatisation and be transparently defined, costed and funded (in statements of corporate intent).

- Queensland's approach to commercialisation requires annual performance contracts which include 'competitive neutrality measures such as the objectives, nature and scope of the main activities of the business unit, including commercial and non-commercial activities.' (Queensland Treasury 1996, p. 14)

- Queensland's Full Cost Pricing Policy (FCP), applies to significant business activities that are not either a GOC or a fully commercialised business unit, and aims to achieve competitive neutrality between these businesses and private businesses by ensuring prices charged by the government business reflect a similar cost structure to that faced by a private sector competitor. FCP requires that full details and any agreed CSO and GSO (Government Service Obligations) activities, including the description, arrangements for measuring the effectiveness of their delivery, funding levels, and costing and payment arrangements will be agreed between the relevant business, the head of the portfolio department, the Portfolio Minister and the Treasurer prior to the commencement of each financial year. (Queensland Treasury, pp. 2 and 14)

What does the Council look for in assessing progress with competitive neutrality?

The Council's NCP progress assessments look to see that, in line with the CPA, full competitive neutrality measures are applied to significant government business activities, including local government businesses, where appropriate.

The Council also looks for effective processes to investigate complaints that significant government businesses are not applying appropriate competitive neutrality arrangements, and for governments' responses to complaints to reflect the recommendations of their complaints mechanisms. In this regard, the Council expects complaints mechanisms to investigate complaints rigorously and expeditiously, and for governments to implement recommendations of their complaints mechanism or provide a robust public interest justification if they do not.

The QCA's considerations on the Coachtrans matter

Queensland has declared all of QR's business activities as significant business activities for competitive neutrality purposes. This means that the Government has decided that all QR businesses must comply with the principle of competitive neutrality.

In accordance with the QCA Act, in relation to the Coachtrans matter, the QCA considered:

- whether QR and Coachtrans are in competition in a market;
- whether QR enjoys a competitive advantage over Coachtrans in that market; and
- whether the competitive advantage is the result of government ownership or control of QR.

In summary, the QCA's findings were as follows.

- QR and Coachtrans are in competition in the public transport passenger market from Brisbane to the Gold Coast. In particular, the QCA noted that following the introduction of services by QR, Coachtrans suffered a significant loss of passengers and that internal documentation of QR, Queensland Transport and Coachtrans accepted that there is competition between QR and Coachtrans and that each party acted accordingly.

- QR is in receipt of substantial subsidies from the Queensland Government and, as a result, is able to set prices which are below its operating costs and which make no return on capital.

- QR makes no contribution to the cost of track whereas bus operators in general fully recover the capital cost of road infrastructure.

- The subsidy arrangement which enables QR to enjoy a competitive advantage over Coachtrans is directly based on the fact that QR is owned or controlled by government. (The QCA did not argue that the Government might not have provided a subsidy to a commercial rail operator if it had been operating the service, but considered that the arrangements would be less generous and require greater accountability than the current external subsidy arrangement with QR.)

The QCA also considered whether there were reasons which justified the breach of competitive neutrality it had found. It looked at whether there are economic, social and environmental factors (such as reduced air pollution, increased safety, reduced road congestion, and reduced expenditure on road capacity) which might justify the price differential for the QR and Coachtrans services. The QCA considered whether the relative contribution of rail over bus to alleviating the economic, environmental and social costs caused by private vehicle usage was sufficiently large enough to justify non-compliance with competitive neutrality principles. The QCA found that available quantifiable estimates of these factors did not significantly alter the relative total costs associated with the QR and Coachtrans services. The Authority found no objective information available on the relative contribution of the modes to broader social goals. (QCA 1998, p. 5)

Subject to a caveat that its conclusions were based on available material not specific to Brisbane-Gold Coast, the QCA concluded that:

- the current price relativities between rail and bus operators do not promote the long term efficient allocation of resources in the public transport market or promote ecologically sustainable development;

- the current arrangements do not promote competition;

- there are no government guidelines, directions or laws which would obviate that the principle of competitive neutrality should apply to QR; and

- there are no social welfare, equity, occupational health and safety, industrial relations, economic or regional development matters, or matters related the interests of consumers or any class of consumers which justify the breach of competitive neutrality. (QCA 1998, p. 5)

The QCA then considered how QR's failure to comply with competitive neutrality might be overcome. It looked at either removing the source of the advantage (to restore competitive neutrality to bus/rail competition) or at conferring an equivalent benefit on QR's competitors. It noted that, if the advantage were removed, in the absence of compensating cost savings by QR, or requiring road users to meet the full economic cost of their usage (including congestion) private vehicle usage of the corridor would increase, to the detriment of the community.

The QCA concluded that a CSO framework should be established which reflects the relative contribution of the various modes to the community's broader economic, environmental and social goals, regardless of whether the services are in public or private ownership (so that it is competitively neutral). It recommended that the framework provide for competition between service providers to ensure the costs of providing transport services are minimised and to encourage innovation and improvement in quality. The QCA did not make specific recommendations on the CSO framework, recognising that there is significant work required by the Government to define and quantify the relevant elements.

The Queensland Premier and Treasurer rejected the QCA decision that there was a breach of competitive neutrality by QR relating to fares on the Brisbane to Gold Coast route in August 1998. However, at that time, they undertook to ask the Minister for Transport to develop, as a matter of priority, a CSO framework for South East Queensland passenger transport, which takes account of competitive neutrality principles.

Developments since June 1999

The Council wrote to Queensland in November 1999, reiterating advice in its second tranche report to the Federal Treasurer that its assessment would consider the Government's reasons for rejecting the QCA advice and would look for progress with development of the passenger transport CSO framework.

The Queensland Treasurer wrote to the Council in May 2000, noting that the Government had been unable to respond until the appeal period relating to the judicial review action by Sita Queensland had expired. In this letter, the Treasurer outlined his views that:

- the Coachtrans matter had been concluded by the Supreme Court decision to reject the application for judicial review by Sita Queensland (Coachtrans) and, as a result, is not relevant to the deferred assessment of Queensland's progress in implementing competitive neutrality;

- he is not convinced that the QCA had established that QR and Coachtrans are in competition in the relevant passenger transport market;

- in any case, whether or not they are in competition is immaterial as the QCA should have asked 'whether the competitive advantage accruing to QR, because of the receipt from Government of CSOs/subsidies, was due solely to Government ownership or control';

- it is the responsibility of elected Governments to make decisions about the appropriateness of CSOs/subsidies and about whether CSO/subsidies should be made contestable;

- the CSO framework is not related to Queensland's obligations under the NCP Agreements (and so not relevant to the June 2000 assessment); and

- Queensland's whole of government CSO policy requires that CSOs are clearly defined and transparent and the Government 'is proceeding with the implementation of a comprehensive CSO framework for passenger transport in South East Queensland.'

Subsequently (June 2000), the Treasurer advised the Council that the Government is developing purchase contracts with QR, which will provide total CSO funding in the order of $700 million per year for rail transport services. Queensland also indicated that it expects to have completed a passenger transport CSO framework for South East Queensland by the end of 2000.

Competition between QR and Coachtrans passenger services

Under trade practices law in Australia, the term 'market' is held to mean a market in Australia and, when used in relation to goods or services, includes a market for those goods or services and other goods or services that are able to be substituted for, or otherwise competitive with, the first-mentioned goods or services.

The QCA concluded that QR and Coachtrans are in competition, noting among other things, the loss of passengers by Coachtrans following the introduction of the QR service and internal QR documentation. It considered that differences in the characteristics of the two modes mean the two are not perfect substitutes, but that the differences do not preclude the existence of competition.

The QCA noted that national and international studies supported its conclusion that rail and bus services are substitutable and that demand for the services is sensitive to each other's price. However, the QCA noted that such data are not available specifically for the Brisbane-Gold Coast and considered such information necessary to determining the most appropriate means of overcoming the failure of QR to comply with competitive neutrality.

In the context of current Australian trade practices law, the occurrence of a single product market is rare. While the Courts have found there is no a priori reason why a single product market cannot be established at law, it can only be done so after having proper regard to both the supply and demand side substitution possibilities (*Regents Pty Ltd v Subaru Pty Ltd* (1998) ATPR 41-647).

Apart from the conclusions reached by the QCA, QR has expressed some views relating to the freight forwarding market which suggest it is likely that rail and bus services are competitors in the (more homogeneous) passenger transport market. In submissions on an application by Carpentaria Transport seeking declaration of certain QR rail freight services, QR stated that the freight forwarding market in which QR operates is highly contestable. It noted evidence of movement of business between road and rail, including significant business lost by rail to road. (QR 1997a and QR 1997b)

While these views about the freight forwarding market contradict the argument that the passenger transport market(s) is not contestable, the Council acknowledges that the Queensland Government's major concern regarding the QCA recommendation on the Coachtrans matter centres on whether there are reasons beyond QR's government ownership for the Government's decision to subsidise rail passenger services.

The 'solely due to government ownership' argument

The QCA found that some of the advantage available to QR arises because of QR's government ownership and some is justifiably available as a result of (as yet undefined and unquantified) social, economic and environmental factors. It considered that the extent of the actual advantage which is solely due to government ownership requires further empirical work. This was a key recommendation of its investigation of the Coachtrans matter.

The Queensland Treasurer rejected the QCA finding on the basis that the QCA did not show that all elements of the identified advantage are due to government ownership. As the Council understands it, the Treasurer is saying that the whole of the advantage must be due to government ownership for the matter to be a competitive neutrality question. In this regard, the Treasurer stated that the Government has strong policy reasons for paying a CSO to QR in order to encourage train travel and, in doing so, remove congestion on the Brisbane to Gold Coast road corridor.

Defined and budget funded CSOs

For some time now, all Australian governments have been reviewing their approach to delivering CSOs as a component of their efforts to improve the performance of their business enterprises. Their concerns in respect of CSOs are that in the past:

- poorly specified CSOs have resulted in confusion of the commercial and non-commercial objectives of government businesses;
- the cost of implementing CSOs was often hidden or not measured appropriately;
- in many cases, CSOs were funded internally through cross-subsidies imposing higher costs on some users;
- CSOs were not always delivered to the intended target groups; and
- different approaches to defining, costing and funding CSOs were making it difficult to measure accurately the performance of businesses.

An important element of the approach under NCP is improved transparency and reporting arrangements.

Underpinning CPA clause 3 is an (implicit) obligation to clarify objectives and specify the non-commercial obligations of government businesses to help achieve competitive neutrality. Access to clear information about what is, and what is not, required for the delivery of social obligations is an essential element of resolving debates about what is relevant to the delivery of governments' social programs and what is the result of government ownership of businesses. Funding arrangements are an important part of this, with direct funding of CSOs – rather than funding through cross-subsidies – providing a basis for transparency and for introducing greater competition.

Queensland Transport's annual report contains a summary of QR's statement of corporate intent (SCI). The summary indicates that funding is provided by the Government for the following service outputs:

- Citytrain;
- Traveltrain (including interstate passenger);
- Regional Freight and Q-Link;
- Network Infrastructure;
- Gladstone Power Station subsidy; and
- Workshops.

The Queensland Transport annual report also states that the SCI outlines principles for developing clear and transparent contracts for the QR service outputs and for separation of funding for these outputs from subsidies for non-transport objectives (such as employment of regional amenity). The Council was unable to obtain further detail of these objectives or the associated funding arrangements. Advice from QR is that the SCI is not a public document.[9]

CSO payments to QR for passenger services are listed in QR's annual financial statement as an aggregate figure ($329.6m for 1998-99). The CSO does not appear to be defined (other than as to fund metropolitan and regional passenger services) and is not disaggregated across the various elements of QR passenger transport activity.

Queensland's Budget papers for 1998-99 (including the Ministerial Portfolio Statement for Transport) do not separately identify the funding for QR's CSOs. They provided a figure of $390m as the State contribution to all public transport services and they note that the increase in Queensland Transport's budget ($352m) from the previous year is mainly to enable full funding of QR's CSOs. Queensland Transport's annual report for 1998-99 includes a line item of $540 million for 'rail services purchased by the Queensland Government for Citytrain and aspects of the Freight and Travel trains'.

The available documents do not appear to clearly define the Government's social objectives in regard to QR, or to indicate funding provided to particular objectives. The QCA, in its report on the Coachtrans matter, stated that it is 'not aware of any directions issued to QR by the Queensland Government which would remove the need for QR's price from complying with the principle of competitive neutrality'. (QCA 1998, p. 41)

Amendments to the QCA Act

The Queensland Government has recently amended the definition of competitive neutrality in the QCA Act. The QCA Amendment Bill (Third Reading May 2000) amends the Act as set out below, such that 'competitive neutrality', for the purposes of the QCA's jurisdiction, comprises only the three competitive neutrality elements listed in clause 4(b) of the CPA.

The principle of competitive neutrality is that a government agency carrying on a significant business activity should not enjoy a competitive advantage over competitor or potential competitors in a particular market solely because the agency's activities are not subject to 1 or more of the following –

---

9 Personal communication between NCC and QR, June 2000.

- *Full Commonwealth or State taxes or tax equivalent systems;*

- *Debt guarantee fees directed towards offsetting the competitive advantage of government guarantees;*

- *Procedural or regulatory requirements of the Commonwealth, the State or a local government on conditions to which a competitor or potential competitor may be subject, including, for example, requirements about the protection of the environment and about planning and approval processes.*

The Council's interest in this matter relates to potential consequences for the delivery of Queensland's obligations under CPA clause 3, including investigations of allegations of non-compliance with competitive neutrality principles.

In this regard, the Queensland Treasurer advised the Council that complaints about pricing matters will initially be investigated by Queensland Treasury in conjunction with the relevant portfolio department, with provision for referral by the Premier or Treasurer to the QCA. The Government considers that investigation of underpricing by government businesses requires the monitoring of the financial performance of government businesses over time. The Treasurer advised that the recently established Office of Government Owned Corporations (OGOC), which is initially concentrating on preparation of annual statements of corporate intent and performance monitoring issues, will focus on financial performance monitoring.

The obligation on governments under the CPA in relation to competitive neutrality complaints is to investigate allegations of non-compliance with competitive neutrality policy and to report annually on allegations of non-compliance. To date, allegations of non-compliance in Queensland have been investigated by the QCA. The allegation, QCA recommendation and Government decision on the recommendation are then reported in Queensland's annual NCP reports. However, under the CPA, governments are free to determine their own arrangements for investigating and reporting on complaints, and it is open to Queensland to restructure its processes.

The Council notes that the QCA will retain independent jurisdiction concerning allegations of non-compliance with competitive neutrality relating to taxes or tax equivalents, debt guarantee fees and private sector equivalent regulation. With this in mind, the Council considers that Queensland's new arrangements would meet NCP obligations provided that complaints that significant government businesses are not applying competitive neutrality principles (including in relation to full cost pricing) are transparently investigated and reported. The Government's responses must also have due regard to recommendations. The Council will consider compliance in relation to complaints in the third tranche assessment

through scrutiny of complaints activity by the QCA and the Queensland Treasury/OGOC and reporting of all complaints by Queensland in its NCP report for 2001.

Coverage of Significant Business Activities

As part of assessing progress with applying competitive neutrality principles, the Council looks to see that relevant government business activities fall within the scope of competitive neutrality policy. In this regard, the Council sought information from Queensland on the status for competitive neutrality purposes of the business activities of TAFEs, Energex and QBUILD.

The Government stated that it:

- is currently conducting a public benefit test on whether TAFE businesses should be declared;
- has legal advice to the effect that the Energex (the former AUSTA Energy Corporation) is subject to competitive neutrality requirements; and
- is considering declaring QBUILD as a significant business following a review of business units within the Department of Public Works and Housing.

The Council considers that these actions being taken by Queensland in relation to identifying significant government businesses for the application of competitive neutrality principles, including reviews to establish whether application is appropriate, meet NCP obligations.

Recommendations on NCP compliance

The argument that CSOs pertain to a government's broader social prerogatives (so ruling out their relevance to competitive neutrality) does not deal appropriately with the efficient resource allocation objective of clause 3 of the CPA. Unless governments agree that CSOs (including the associated objectives) are to be clearly defined, costed and funded from budget as part of their NCP competitive neutrality obligations, there is a likelihood that 'social objectives' will become the justification, in effect the balancing item, for any question about pricing by government businesses. It will not be possible to satisfactorily resolve debates about what are CSOs and what is the result of government ownership.

The Queensland Government appears to have recognised these issues in relation to the QR pricing, through its August 1998 undertaking to develop a passenger transport CSO framework for South East Queensland taking account of competitive neutrality principles.

The Council considers that the approach recommended by the QCA (and supported by the Premier and Treasurer in August 1998) – the development of a comprehensive CSO framework for passenger transport in South East Queensland – is the key to resolving competitive neutrality concerns about QR fares on the Gold Coast route. At the time of this assessment, however, Queensland had not finalised the framework, although it indicated that it expects to have done so by the end of this year.

While it is now almost two years since the Premier and Treasurer undertook to ask the Minister for Transport to develop the framework, the Council acknowledges that development of the framework is a complex matter, requiring work to establish the 'efficient' price of the rail service and to define and cost the Government's social objectives for passenger transport. The Council also notes that Queensland is currently developing and entering formal contracts with QR for the rail services that QR is required to provide on behalf of the Government. These contracts should improve the transparency of CSO arrangements between the Government and QR.

The Council recommends a further supplementary assessment for Queensland in respect of competitive neutrality issues relating to passenger transport in South East Queensland prior to 31 December 2000. Further, the Council recommends that an amount equivalent to 10 per cent of Queensland's NCP payments for 2000-01 (approximately $8.6 million) be suspended pending finalisation of an appropriate framework, whereupon the suspended payment would be reinstated. The Council proposes to recommend that the suspension become a permanent reduction in Queensland's NCP payments for 2000-01 if Queensland has not appropriately resolved competitive neutrality issues, for example through the Government's proposed CSO framework, by 31 December 2000.

5 FREE AND FAIR TRADE IN GAS

Application of the National Gas Access Code: Queensland

Under the April 1995 *Agreement to Implement the National Competition Policy and Related Reforms*, the first tranche NCP obligation in gas was that (relevant) States and Territories implement any arrangements agreed between the parties as necessary to introduce free and fair trading in gas, between and within the States, by 1 July 1996 – or such other date as agreed between the parties, in keeping with the 1994 COAG gas reform agreement.

The central plank of the 1994 COAG gas reform program was the application of a uniform national framework for third party access to natural gas transmission pipelines.

In June 1996, COAG broadened the scope of reform and extended the timeframe, deciding that the national access framework should apply to distribution systems as well as transmission pipelines, and that the reforms should be in place by 30 September 1996.

When this timeframe was not met, the Prime Minister in December 1996 proposed a new timeframe for introducing the national gas pipelines access code. Subsequently, all Heads of Government signed the *Natural Gas Pipelines Access Agreement* (1997 Gas Agreement) on 7 November 1997. The Agreement incorporates a National Gas Pipelines Access Code (National Code), a legislative framework under which each jurisdiction would implement the Code, and a revised implementation deadline of 30 June 1998.

Queensland introduced the *Gas Pipelines Access (Qld) Bill* into Parliament on 21 April 1998. It was passed on 13 May and assented to on 18 May 1998. The legislation had not been proclaimed as at 30 June 1999, and was therefore not operational. Queensland informed the Council that it had chosen to delay making the National Code operational in the State until the Council has determined whether the Queensland Gas Pipelines Access Regime (incorporating the National Code) should be certified as an effective access regime under Part IIIA of the TPA. In its second tranche assessment, the Council reported that it would consider whether Queensland had satisfied its obligations with respect to the National Code in the context of the supplementary assessment in June 2000.

Assessment

The *Gas Pipelines Access (Qld) Act 1998* commenced on 19 May 2000. The Council is satisfied that Queensland has now met all its second tranche obligations with respect to free and fair trade in gas.

The Cooper Basin (Ratification) Act 1975: South Australia

Jurisdictions agreed under COAG 1994 to remove all legislative and regulatory barriers to free and fair trade in gas, between and within their boundaries, by 1 July 1996. The Council regards this an ongoing commitment.

South Australia's *Cooper Basin (Ratification) Act 1975* provides concessions to the Cooper Basin producers and exempts certain agreements from the operation of the Trade Practices Act. The ACCC previously identified the Cooper Basin (Ratification) Act as a significant legislative barrier to free and fair trade in gas.

South Australia reviewed the Act during 1998, releasing its review report on 28 May. The review identified a number of restrictions on competition where the costs outweighed public benefits. It noted that some of the restrictions arose because of the lack of a third party access regime to the Cooper Basin facilities, and because separate marketing by the Cooper Basin producers was effectively precluded. The review recommended that these restrictions be removed.

At the time of the Council's second tranche assessment, South Australia had not made an official response to the review and it was not possible for the Council to be satisfied that the Government had met its commitments in regards to removal of regulatory barriers to free and fair trade in gas. The Council reported that it would make a supplementary assessment on this matter in December 1999.

South Australia provided its official response to the Council in December 1999. After considering this response, the Council had remaining concerns and sought further advice from South Australia. Because the Council required further information, it was not possible for the Council to finalise its assessment on South Australia's progress before 31 December 1999. The Council therefore determined to report on this matter in its supplementary assessment in June 2000.

The Review Recommendations and South Australian Government's Response

Recommendation One

Clause 16 of the Ratification Act be replaced with a new clause which for the purposes of the Trade Practices Act authorises and approves:

i. The provisions of the Unit Agreement as those provisions are amended with the consent of the Minister (subject to recommendation 2);

ii. The provisions of the Letter of Agreement (subject to recommendation 3); and

iii. Such contracts acts or things which give effect to the rights and obligations of the parties pursuant to the Unit Agreement or the Letter of Agreement.

This recommendation's objective is to clarify what the Ratification Act applied to and to make it more transparent. There was some doubt about the effect of the Act on later agreements. The South Australian Government has agreed that:

- Section 16 will be brought up to date and made more transparent. The new section will exempt the Unit Agreement, the AGL Letter of Agreement, and the Liquids Contracts, and things done to give effect to those agreements. Redundant references in section 16 will be repealed.

- Clause 10(1)(b) of the Indenture requires the Government to consider exempting agreements when requested by the Producers. Any such consideration will, of course, include a transparent assessment of costs and benefits in line with NCP legislation Review obligations and the Upstream Industry Working Group (UIWG) recommendation in that regard.

- To give simplicity and transparency, all Trade Practices Act exemptions for Liquid Petroleum Contracts, which are presently referred to in both the Ratification Act and the Stony Point (Liquids Project) Ratification Act 1960 (SA), will be placed in the Ratification Act. The exemption will be restricted to joint marketing, pricing, sale and supply. Given the small volumes to which these contracts relate, and the international nature of the market for these products, the Government believes that there will be no difficulty in justifying their exemption.

Recommendation Two

The provisions of the Unit Agreement be exempted provided that:

i. The State implements a third party access regime to the Cooper Basin facilities either by legislation or an Industry Code.

ii. The Unit Agreement be amended to incorporate a mechanism which permits, but does not require, a Cooper Basin Producer to separately market.

This recommendation is for the continued exemption of the unit agreement through the Ratification Act, but for the Government to apply a third party access regime to the Cooper Basin facilities and to amend the unit agreement so that it permits separate marketing by the individual producers. The unit agreement establishes the joint production processes of the joint venture producers.

The unit agreement is currently subject to an interim authorisation by the ACCC.

The South Australian Government considers that there is nothing in the unit agreement that prevents access to the facilities being given by the Joint Venture Producers or that prevents them from separately marketing their product. Further, it argues that clause 5 of the CPA imposes no obligations to introduce pro-competitive regulation, only to remove anti-competitive regulation.

The Government does recognise the potential benefits from establishing a more transparent form of access to the facilities at Moomba, rather than relying on the discretion of the producers/operator. In its letter to the Council, the Government stated that it wishes to encourage the Producers to establish a code of practice and that it is discussing this with Santos currently. This code may be modelled on the one drafted by the Australian Petroleum Production and Exploration Association (APPEA) but with the addition of a right to arbitration and tariffs based on cost reflective pricing. The Government also states that it will continue to monitor the arrangements and may introduce further measures if necessary.

The APPEA code of practice was developed as part of the UIWG examination of reform issues in gas production. UIWG decided that there was no need for national regulation to provide access to gas production facilities. It determined that it was appropriate that access be provided through the less prescriptive industry code of practice and, if necessary, individual jurisdictions could legislate. However, it was not possible to reach agreement on an appropriate industry code of practice. Most jurisdictions and the Council expressed concerns about the effectiveness of the APPEA code. Jurisdictions indicated they would monitor the application of the code and reserved the right to introduce legislation if necessary. The South Australian Government's response to the Council is consistent with this outcome.

Recommendation Three

The AGL Letter of Agreement be exempted provided that clauses 12 and 20 are removed and clause 10 is amended so as to permit delivery into either the Sydney or Adelaide pipelines.

This recommendation's objective is to reduce the anti-competitive effect of the AGL Letter of Agreement by removing or amending the provisions of the Agreement. However, the recommendation was overtaken by the Australian Competition Tribunal's decision in relation to the authorisation of the AGL Letter of Agreement. The South Australian Government's response to the review is that the recommendation that relates to the removal or amendment of provisions covered by the authorisation decision is no longer sustainable. The Government argues that the Ratification Act has no competitive impact as the authorisation provides full protection for those provisions. It further argues that, in accepting the authorisation, the Tribunal has determined the provisions are in the public benefit.

The Council acknowledges that the Tribunal's decision means the removal or amendment of the Ratification Act's protection for the Letter of Agreement has no effect.

Recommendations Four and Five

Section 9 of the Ratification Act or section 27(1a) of the Petroleum Act be amended to ensure that a Petroleum Production Licence shall not be granted to the Producers if the quantity or quality of the petroleum is not sufficient to warrant production.

Section 80L of the Petroleum Act be amended so that the section applies to pipelines between Petroleum Production Licences which are not licensed.

These two recommendations are aimed at ensuring the Joint Venture Producers are regulated similarly to other Cooper Basin Producers subject to the Petroleum Act.

The South Australian Government has decided to amend the Ratification Act to ensure that the Joint Venture Producers will be subject to the criteria in the Petroleum Act when being issued with future Petroleum Production Licenses (PPLs).

However, the Government has said that the costs of the recommendation to apply section 80L of the Petroleum Act to the Cooper Basin pipeline structure outweighs the potential benefits.

Section 80L of the Petroleum Act imposes an access requirement on licensed pipelines that fall outside the National Gas Code. The pipelines covered by section 80L are used to transport raw gas to processing plants. These access requirements do not fall on the Joint Producers' raw gas pipelines because of section 12 of the Ratification Act.

The South Australian Government considers that there would be little competitive gain to be made by removing section 12 of the Ratification Act as it is unlikely that anyone would require access just to the gathering lines subject to that provision. They argue that the exempt pipelines convey unprocessed gas from the field to the Moomba Processing Plant and without some product sharing agreement it would be impossible to separate the streams entering the pipeline at the pipeline exit. Because of this, access to the pipelines would only be effective and commercially useful if access to the processing plant was obtained. As discussed above, access to the processing plant is currently only available through commercial negotiation.

The Government considers that there is potential loss in public benefit resulting from the perceived increase in sovereign risk if the Government was to unilaterally amend the agreement it made with the Cooper Basin Producers. This potential loss warrants the retaining of section 12 because there are no real competitive gains to be made from removing it.

The Council considers that the South Australian Government's assessment of the potential costs and benefits of removing section 12 is appropriate at this time.

However, the Council notes that the South Australian Government is committed to ensuring more effective access arrangements are put in place for the Moomba Processing Plant and that consideration of other relevant upstream facilities such as gathering lines should be included in any such arrangement. Further, it is possible that at some time in the future it may be commercially viable for third parties to use the pipelines and that there would be benefits in subjecting them to the same access arrangements as those pipelines covered by the Petroleum Act.

The Council considers that the South Australian Government would be required to reassess the exemption if, in the future, there was the potential for increased competition through regulating those pipelines under the Petroleum Act.

Recommendation Six

This recommendation is closely related to the subject matter of the review but is strictly outside the terms of reference:

i. A section 51(1) State exemption be granted, if requested, to disaggregated NGASA contracts provided that the terms and conditions of such contracts largely reflect the existing contract;

ii. A section 51(1) State exemption be granted to the Fixed Factor Agreement, if requested, but only on the condition that a third party access regime applies to the Cooper Basin facilities and a mechanism

exists which permits a Cooper Basin Producer to separately market; and

iii. *A Section 51(1) State exemption should not be granted to existing gas sales agreements not currently authorised or future gas sales agreements. Such authorisations should be left to the ACCC.*

This recommendation was made in relation to material that was outside the terms of reference of the review and would only be relevant if the South Australian Government sought to implement new section 51 (1) exemptions. At that time, the South Australian Government would be obliged to take into account clause 5(5) of the CPA and justify the exemptions in terms of the overall public benefit. The Council would then be able to determine whether there were any CPA or gas reform obligations. South Australia stated that no response to this recommendation is required.

Assessment

The Council's underlying concern is with the level of competition at the production level in the Cooper Basin. The Council sees review of the Ratification Act, and acreage management legislation in South Australia, as an opportunity for the competitive pressures in the Cooper Basin to be improved.

However, review of the Ratification Act on its own, and even full implementation of the review recommendations, will have little effect on the level of competition in the Cooper Basin. Changes to acreage management legislation, the release of considerable portions of the Cooper Basin through new exploration licences and the changes being introduced to the gas market in south eastern Australia through the construction of the Victorian/NSW interconnect and the EGP pipeline, are more likely to ensure a more competitive production environment in the Cooper Basin.

This environment would be improved more quickly if there were effective third party access to the Cooper Basin facilities. The recent release of production licences in the Cooper Basin has increased the number of potential producers. However, some of the discoveries may not be economic to exploit if producers cannot get access on reasonable terms to the existing processing facilities. The South Australian Government has recognised that the Cooper Basin is a declining resource as far as deliverable gas is concerned and that South Australia may need to import gas to meet its needs. Efficient utilisation of the Cooper Basin reserves could help meet these needs and it is in South Australia's interests to ensure that appropriate access is provided.

The Council is satisfied that South Australia has now met all its second tranche obligations with respect to free and fair trade in gas.

6 ROAD TRANSPORT

Fee-free Licence Conversions: Queensland

Amongst the COAG agreed reforms for the second tranche is the requirement to simplify the process for drivers to change the jurisdiction in which their licences are issued when they move interstate. Licences must be able to be transferred to other jurisdictions free of charge and without the driver needing to sit another test. At June 1999, Queensland still charged a fee for interstate licence conversions, although the Government stated that it was preparing a new proposal for licence fee restructuring. This was expected to be considered by the Queensland Cabinet in September 1999 for possible implementation in December 1999.

The Queensland Treasurer advised the Council in March 2000 that the Government expected to have arrangements for fee-free interstate licence conversions in place by 1 July 2000, once the State had made the necessary amendments and administrative changes to its Transport Registration and Integrated Licensing System. Queensland had already removed the requirement that people converting interstate licences undergo a further driving test.

Queensland confirmed in June 2000 that it is on track to implement the regulatory changes necessary for fee-free licence conversion by 30 June 2000.

Assessment

Queensland's introduction of fee-free licence conversions means that the significant remaining element of Queensland's second tranche road reform program has been achieved within a reasonable period of the implementation target set by COAG. The Council is satisfied that this approach is consistent with second tranche road transport objectives.

Legislation to implement the national vehicle registration and driver licensing reforms: Commonwealth and Western Australia

Commonwealth

The COAG second tranche framework for roads required, as far as practical, uniform or consistent national procedures and requirements for the registration of heavy vehicles. Finalisation of the reforms required amendments to the *Interstate Road Transport Act 1985*. These were to be implemented as part of the review of the Federal Interstate Registration Scheme (FIRS).

The Commonwealth will complete its second tranche road reform program with the passage of amendments to the *Interstate Road Transport Act 1985*. These will be considered by the Parliament during the Spring sitting or, more likely, early in 2001. The Commonwealth has assured the Council that it is committed to land transport reform, and in particular, to the road reforms. The Commonwealth previously expected the outstanding legislation to be before the Parliament by April 2000. If this had occurred, the Commonwealth would have completed its second tranche reform program by the end of June 2000.

Assessment

The extension of the Parliamentary deadline means that the Commonwealth will not have competed its legislation commitments by the end of June. The Council considers that this breaches second tranche road reform commitments.

Western Australia

Western Australia reported in March 2000 that it had three Bills to amend the *Road Traffic Act 1974* in progress, and that it expected these to be passed by 30 June 2000. These amending Bills were to:

- introduce the national driver's licence classifications and compulsory photographic licences;
- introduce the national heavy vehicle registration scheme; and
- amend regulation-making powers contained in the *Road Traffic Act 1974*.

Western Australia stated in March that it was concurrently drafting supporting regulations so they could be introduced promptly when the amendments to the Act took effect.

On 13 June 2000, Western Australia notified the Council that, while progress is continuing, some of the amending Bills had been delayed. Western Australia stated that Bills reforming Heavy Vehicle Registration, Vehicle Operations and Heavy Vehicle Standards are before the Parliament or should be before the Parliament on or before 29 June. Western Australia now expects passage of these Bills in the Spring sittings. The drafting of the regulatory amendments necessary to implement the Interstate Conversions of Driver Licences is underway. Other reforms depending on amendments to the regulation making powers contained in the *Road Traffic Act 1974* will be achieved in one of the Bills currently before the Parliament.

Because of these delays, Western Australia has drafted a fourth Bill dealing with matters which could not be included in time for the original Bill to go before the Parliament by the end of June 2000. This Bill will

deal with some outstanding driver licensing issues. Western Australia expects it to be introduced in the Spring 2000 sittings.

Western Australia also advised that pending the passage of these Bills and amended regulations, many of the reforms are being implemented by administrative arrangements.

Assessment

As Western Australia has not passed the legislation required to complete its second tranche road reform obligations, it is technically in breach of its second tranche obligations.

However, the Council is satisfied that recent progress with the legislative process, coupled with the use of administrative arrangements to achieve the reform outcomes in the interim, indicates that Western Australia will complete its second tranche reforms within a reasonable period of the target set by COAG.

The Council does not propose to recommend any reduction in Western Australia's NCP payments at this time. The Council will monitor the passage of Western Australia's legislation in the third tranche NCP process and may recommend a reduction in NCP payments if the necessary legislative and regulatory matters have not been finalised.

Demerit Points Scheme: Northern Territory

At June 1999, the Northern Territory had completed 15 of its 16 relevant second tranche road reforms. The only outstanding matter was the demerit points component of the National Driver Licensing Scheme.

This reform requires uniform national requirements for key driver licensing transactions including issue, renewal, suspension and cancellation (excluding learner and novice drivers). At June 1999, the Northern Territory had implemented most elements of this reform package (except for administration guidelines on the use and release of information) but was still to decide whether to introduce a demerit points scheme.

A demerit points system applying to all licensed drivers is a key element of the National Driver Licensing Scheme, which is directed at achieving national uniformity in the key requirements for driver licensing transactions and enhancing road safety. To date, all jurisdictions except the Northern Territory have introduced a full demerit points arrangement.

On 30 March 2000, the Northern Territory advised that it had decided to introduce a demerit points scheme in a form which will apply only to commercial vehicles. The scheme, which is to operate from February

2002, will apply to drivers of all Territory-registered commercial vehicles greater than 12 tonnes (5 tonnes for buses). Interstate drivers of all vehicles who commit offences in the Territory currently accrue demerit points in their own jurisdiction. However, Northern Territory-licensed drivers of smaller commercial vehicles (less than 12 tonnes), buses (less than 5 tonnes) and private vehicles are quarantined from accruing demerit points where they infringe driving laws.

The Government indicated that it intended to introduce the necessary amendments to the Parliament in October 2000, for passage during the November 2000 sittings. The target implementation date of February 2002 is the Territory's estimate of the time it will take to develop a demerit points scheme from the ground up, including drafting new regulations and developing administrative and computer systems to track demerit points. The Government is also proposing a public education process.

Compliance with NCP Principles at 31 March 2000

In the March 2000 supplementary assessment of road transport reform progress, the Council found that the Northern Territory's approach differed considerably from the approach envisaged by the demerit points element of the National Driver Licensing Reform and the approach implemented in other jurisdictions. By providing immunity to categories of drivers in cases where the cumulative effect of driving offences would otherwise result in licence suspension, the Northern Territory's proposal may risk undermining the achievement of road safety objectives.

The Council was also concerned at the time being taken for the Northern Territory to deal with this matter. The Northern Territory is proposing only partial implementation by February 2002. Transport Ministers had voted for the National Driver Licensing Scheme (incorporating core demerit points) in December 1997. The Council had identified the Territory's failure to introduce a demerit points system as an outstanding matter in June 1999.

The Council considered that the Northern Territory's decision to introduce only a partial demerit points arrangement from February 2002 breached the Territory's NCP road reform obligations. As part of the March 2000 supplementary assessment, the Council invited the Northern Territory to reconsider its approach or to obtain an exemption from COAG for the demerit points obligation. The Council undertook to re-assess actions taken by the Northern Territory in the June 2000 supplementary second tranche assessment.

Following the March 2000 supplementary assessment, the Northern Territory wrote to the Council questioning the practicalities and effectiveness of implementing a full demerit scheme due to the Territory's

small population, large geographic area, limited enforcement resources and the lack of conclusive evidence that such schemes deliver any substantial road safety outcomes. The Northern Territory also questioned the justification for reducing NCP payments in relation to this matter, which it believes has no relationship to the principles underpinning NCP.

Assessment

The role of the Council in relation to the road transport component of NCP is to assess jurisdictions' progress against the reform frameworks established by COAG. COAG endorsed the demerit points arrangement as part of the second tranche framework. In the Council's view, this endorsement is clear recognition that, although a consistent national demerit points arrangement is not a 'pure' competition issue, COAG attaches importance to appropriate and consistent regulation of dangerous driving behaviour. In these circumstances, the Council cannot agree that the failure of the Northern Territory to implement a scheme in line with the COAG framework is unrelated to the Territory's receipt of NCP payments.

Moreover, as the Council has made clear in previous assessments, the Council has no authority to change the road transport assessment framework or to determine that it (or any part of it) should not apply to particular jurisdictions. The mechanism for exempting a jurisdiction from any element of the road reform program is for that jurisdiction to seek an exemption from COAG.

The Council acknowledges that the Northern Territory has made good progress against the second tranche road reform framework. Nevertheless, the Northern Territory has not implemented a full driver demerit points scheme. Neither has the Territory sought an exemption from the demerit points requirement, despite having had considerable time to do so. The demerit points obligation has been known for some time. The matter was brought to the Northern Territory's attention in both the June 1999 second tranche assessment and the March 2000 supplementary assessment.

As a result, the Council finds that the Northern Territory is in breach of its second tranche NCP road reform obligations. The Council recommends an annual reduction in the NCP dividend otherwise payable to the Northern Territory of 5 per cent of the Territory's NCP payments for 2000-01 (approximately $235 000), to apply from 2000-01. The Council will review this recommendation if the Territory either agrees to implement a demerit points arrangement consistent with the COAG framework and timetable, or obtains an exemption from COAG for this aspect of the road reform program.

7 WATER INDUSTRY

Introduction

This part of the second tranche supplementary assessment considers the progress of States and Territories, other than Victoria and the ACT[10], in implementing the COAG water reform framework.

The Council's previous consideration of progress against water reform commitments is contained in Volume 2 of the second tranche assessment report (NCC 1999a) and the December 1999 supplementary assessment report (NCC 1999b).

As the June 2000 supplementary assessment is concerned with progress against outstanding water reform commitments, the same assessment framework as was used in conducting the previous assessments has been adopted. The framework is contained as an attachment to this report.

A flexible framework

The Council's assessment demonstrates that the COAG water reform objective of arresting widespread natural degradation is being addressed by each State and Territory in a distinct manner.

The framework is sufficiently flexible for governments to undertake changes in a manner that best meets the economic, environmental and social conditions of their communities.

Each state has approached water resource planning in a distinct manner. While they share common elements of tradeable water rights separated from land title and recognition of the environment's right to water, the precise mechanisms of achieving these differ.

Further, the framework provides for tariff reforms in urban areas only where this is cost effective. This ensures that reforms are implemented only where the relevant community will benefit.

The Council's role is to assess reforms by each government against the water reform framework, not to assess one State or Territory against another. Hence, the Council has been satisfied that reforms have, or may be, met through different means. While the Council may form a view as whether some arrangements are superior to others, this is not the benchmark used in assessing reform.

[10] Victoria and ACT met second tranche reform commitments as at June 1999.

A flexible assessment process

This report demonstrates that the Council's assessment process, which focuses on both timeliness and good reform outcomes, can respond to the circumstances of particular States and Territories while retaining the integrity of the NCP payments as dividends for achieving reform.

While NCP payments may assist in driving timeliness, they should not be used as an excuse for curtailing a full public debate. The recommendations in the supplementary assessment report demonstrate how these competing interests are balanced by the Council.

That said, some commitments are still being implemented well outside the timetable agreed by COAG. This is especially the case for urban pricing reforms and institutional separation. While the Council has recognised ongoing development, this report clearly demonstrates that an ongoing failure to bring in reforms consistent with commitments will result in a recommendation that NCP payments be suspended. Where there is an ongoing failure to implement change at the end of the suspension period, the Council is presently of the view that a reduction in NCP payments will be recommended.

Supplementary assessment issues

Urban pricing reform

The Council notes the ongoing reform of urban water pricing. Pricing is the primary means of allocating scarce resources; water is now clearly recognised by all communities as a scarce resource.

There is now sufficient evidence to say that the COAG reforms are delivering more efficient services and a greater customer focus. They are also giving consumers more control over their water bills: consumers are increasingly making conscious decisions about how much water they use and therefore pay for.

Urban water reforms were an important consideration in the Council's 1999 second tranche assessment. While the Council believes that much has been achieved, some outstanding areas remain. Given the clear benefits to communities and government of implementing the arrangements agreed to under COAG, the Council will continue to closely monitor ongoing achievement of urban water pricing reforms in the period until the third tranche assessment.

Institutional separation

It is the nature of regulation that, as new challenges arise, new responses are required. The Council has seen the debate around appropriate institutional arrangements develop to encompass matters such as the setting of drinking water standards, the need for prices oversight,

especially for large monopoly providers, and detailed consideration of departmental arrangements.

Good institutional arrangements will ensure that the gains made by communities in water management over the past six years are not wound back. Reforms, due in 1998, remain outstanding in some States and Territories. In addition, reports and information released or brought to the Council's attention since June 1999 will mean that that the ongoing implementation of institutional arrangements will continue to be an issue in the third tranche assessment.

Tradeable water allocations

A key reform that is the subject of much of this supplementary assessment is the introduction of tradeable water allocations. The intense debate around defining the environment's water rights, the rights of businesses dependent on water and the rights of downstream users emphasises the importance for all governments and their communities to achieve an equitable and sensitive legislative framework for water allocations.

Tradeable water allocations provide the best mechanism for distributing water for the benefit of the environment and the economy. While reductions in water allocation will harm some businesses, the failure to implement reform would result in degradation such that existing entitlements would decline in value and utility.

The Council notes the achievement of legislative frameworks in Tasmania and the Northern Territory. A further supplementary assessment for New South Wales, Queensland and Western Australia in December 2000 should see new allocations systems implemented across Australia. This significant achievement will provide a sound basis for sustainable management of water into the future.

The importance of community consultation

Complex reforms require detailed community consultation. This is recognised in the 1994 water reform framework itself, wherein COAG agreed:

- to the principle of public consultation by government agencies and service deliverers where change and/or new initiatives are contemplated involving water resources; and

- that where public consultation processes are not already in train in relation to recommendations regarding urban and rural water pricing, water allocations and water trading in particular, such processes will be embarked on.

The Council has recognised this throughout its assessment process. It is again reflected in this assessment, especially for new arrangements for

tradeable water entitlements. In particular, the Council has not recommended reductions in, or suspension of, payments where a clear reform path has been identified by Government, including tabling of relevant legislation before Parliament. That said, the need for new arrangements is urgent. The Council would consider that, should these arrangements not be in place by the end of 2000, this would constitute a clear failure against reform commitments.

The Council has recently contributed to the broader community's understanding of the COAG water reforms through papers explaining, in a clear and concise manner, the reforms themselves and the benefits they offer to metropolitan, regional and rural communities. These papers, covering urban and rural water reform, have been widely distributed.

In addition to meeting with governments, Council Secretariat officers have met with a number of irrigator, environmental and other community groups during the past six months. The discussions have provided valuable information about reform challenges and government responses. The Council will continue these discussions in the period prior to the third tranche assessment.

Assessment of Progress by Jurisdiction

New South Wales

REFORM COMMITMENT: ALLOCATIONS AND TRADING

Outstanding issue, June 1999

At the second tranche assessment the Council found that, while entitlements for regulated rivers and groundwater were sufficient to meet reform commitments, arrangements on unregulated rivers were not consistent with the agreement to provide for a comprehensive system of water entitlements backed by separation of water property rights from land title and clear specification in terms of volume or transferability. Proposed reforms had been developed and consultation undertaken; the Council was of the view that these proposed reforms met the commitments of the water resources policy.

The Council also noted that reforms to provide for the environment were, to some extent, dependent on proposed legislation changes. In addition, while significant trade was taking place in New South Wales, the report by Marsden Jacob *Water Trading Development and Monitoring* (1999) indicated there would be significant further efficiency gains from implementing the reforms proposed by New South Wales.

The Council was therefore not satisfied that reform commitments had been met and recommended that a further supplementary assessment be

undertaken in June 2000 to determine whether water legislation reform had taken place.

Developments since June 1999

White Paper

In December 1999 New South Wales issued a White Paper *A proposal for updated and consolidated water management legislation for New South Wales* (the White Paper). The White Paper outlined proposed water reforms and provided for public comment prior to the Government finalising its position.

The White Paper proposed a new framework which included, amongst other matters, arrangements for:

- environmental water including that the Minister could adjust water entitlements to achieve agreed environmental outcomes;
- water management planning including community involvement and plan implementation;
- an integrated approvals administration system applying to regulated and unregulated surface water and groundwater systems, and clearer water rights including basic water rights, access entitlements (including, where appropriate, a share entitlement and extraction entitlement) and water use approvals;
- trading (including by the government) of the different components of water entitlements; and
- a modern compliance system.

Water Management Bill 2000

The Council has been advised that the *Water Management Bill 2000* was introduced to the New South Wales Parliament on Thursday 22 June 2000. At the time of the assessment the Council has not been provided with a copy of the Bill and has not therefore undertaken an assessment of the Bill.

Other matters

In April 2000 the New South Wales Government wrote to the Council concerning the supplementary assessment. It was noted that, during consultation on the White Paper, stakeholders sought to have the opportunity to provide comment on an exposure draft Bill, and the Government proposed to allow for this.

Apart from the major review of water legislation, New South Wales advised that it has been proceeding with other aspects of its reform commitments. In particular, it was noted that the Farm Dams policy has been legislated, the process of conversion of remaining area-based licences to volumetric licences has commenced and environmental flow rules continue to be implemented and monitored.

The Council has received correspondence from and met with interested persons and groups concerning the proposed arrangements outlined in the White Paper. The Council will consider these and other relevant submissions when assessing whether new arrangements are consistent with reform obligations.

Assessment

The Council was of the view in 1999 that the arrangements in place in New South Wales did not meet reform commitments. Given that those arrangements largely remain, it is inevitable that, for this supplementary assessment, the Council assesses New South Wales as not having met reform commitments. It is noted that comments in the White Paper support the Council's assessment in this respect.

The Council recognises that legislation and other measures to implement new arrangements are complex. They affect a large number of persons and corporations, and are of interest to the entire community, rural, regional and metropolitan. While there is a need to ensure that reforms are timely, it is also important to provide information for community understanding of the reforms and the opportunity for meaningful consultation.

That said, the water allocation reforms are a lynchpin of the COAG reform framework. Tradable water allocations including allocations for the environment will be an instrumental part of arresting widespread natural resource degradation. The allocations framework is also central to addressing the economic, environmental and social implications of the water reforms. The failure to have implemented arrangements consistent with reform commitments is a significant matter.

The Council has previously stated that water reform is an area that extends beyond competition policy matters to embrace social policy issues and recognition of the environment as a legitimate user of water. The Council has said that full implementation of the reform package could do more to benefit the broad community than any other single measure. The Council has indicated its intention to give high priority in the assessments to the timely implementation of agreed water reforms (NCC 1998a).

Implementation of a water allocation and trading regime consistent with commitments:

- provides scope to significantly increase the value of rural produce through movement of water to higher value activities;

- will contribute to healthy and sustainable water ecosystems;

- provides significant opportunities to advance social objectives, especially through water trading;

- will contribute to the development of rural communities; and

- impacts on water users and communities in other states, including Victoria, Queensland, South Australia and the Australian Capital Territory.

However, there is a potential in this case for strict adherence to timeliness to curtail proper public debate, resulting in arrangements that are poorly understood by the community and which fail to address relevant issues in the most appropriate manner.

These are all relevant considerations for the Council when making recommendations to the Treasurer regarding NCP payments.

In this matter, and particularly having regard to the fact that the legislation is before the Parliament, the Council considers that the most appropriate recommendation is that there be no reduction in NCP payments on account of the failure to pass legislation.

The Council will undertake a supplementary assessment in December 2000 to ensure that legislation consistent with the water framework is substantially in force. Between this assessment and that time the Council will review the legislation and consider any submissions it receives concerning the consistency of arrangements with the reform commitments.

Should the legislation not be substantially in force by 31 December 2000, the Council is presently of the view that it will recommend a reduction in NCP payments for failure to meet reform commitments. The Council considers that, having regard to all the competing factors, this failure should have implications for 10 per cent of the State's NCP payments for the year 2000-01.

The Council considers that the appropriate manner to implement this recommendation is as follows:

- that 5 per cent of NCP payments for the year 2000-01 be deducted for the failure to pass legislation between July and December 2000; and

- that 5 per cent of NCP payments for the year 2000-01 be suspended for the period January to June 2001. Following passage of the legislation the Council will make a recommendation as to what part of the suspended payments, if any, should be paid to New South Wales.

The Council notes that should reforms not be substantially in force by the third tranche assessment, it will consider whether a reduction in NCP payments of at least 10 per cent should continue until legislation consistent with COAG water reform commitments is substantially in force.

Queensland

REFORM COMMITMENT: COST REFORM AND PRICING

Queensland has distinguished between large and small local governments in implementing pricing reform. It has chosen to make assessment of pricing reform among its largest 18 local governments (*the big 18*) compulsory.[11] While reform among local governments beyond the *big 18* is encouraged through mechanisms such as the NCP Financial Incentive Program, Queensland's approach has made it voluntary for this group to consider and adopt reform.

The Council accepts that a prioritised approach to reform, focusing initially on the largest service providers, is often consistent with maximising the immediate gains from reform. However, the Council has long held the view that broad application of the water reform framework developed and agreed to by all jurisdictions promises significant gains to communities and the environment. It is the State government's responsibility to ensure broad adoption of reform in its jurisdiction.

Thus, the Council has looked for jurisdictions to consider a broad range of service providers for reform and then implement reform where the benefits of doing so are likely to outweigh the costs. While the Council accepts that different approaches are appropriate in different jurisdictions, it has looked for the approaches adopted to lead to sound reform outcomes within the deadlines set by the framework agreed to by governments in 1994.

The Council has raised with Queensland the importance of ensuring reform beyond the State's largest providers (where appropriate) as far back as 1997. This was publicly stated most recently in the Council's December 1999 supplementary assessment. The December supplementary assessment noted that the Council would look for Queensland to provide a timetable for reform for those local governments outside the *big 18* (then the *big 17*) with more than 5000 connections and identification of a strategy to promote reform across remaining local governments. The Council's position is consistent with a prioritised

[11] The *big 18* local governments are Brisbane, Caboolture, Cairns, Caloundra, Gold Coast, Hervey Bay, Ipswich, Logan, Maroochydore, Mackay, Noosa, Pine Rivers, Redlands, Rockhampton, Thuringowa, Toowoomba, Townsville and Bundaberg City Councils

approach to reform that will promote timely application of pricing reform to all instances where it is likely to lead to a net benefit to the community.

Outstanding issue: extension of full cost recovery to local government water and sewerage service providers beyond the *big 18*

The Council's December 1999 supplementary assessment stated that full cost recovery was still to be implemented, consistent with second tranche commitments, among Queensland's urban and non metropolitan urban water providers. Progress had been achieved (particularly among the *big 18*), and steps were in place to encourage and facilitate further reform. However, much remained to be done before measures contained within the COAG framework were applied in all instances where they would lead to a net gain to the community.

Consequently, the Council agreed to undertake a further supplementary assessment prior to 30 June 2000. The Council also noted that should the assessment in June 2000 indicate little further progress, it would be likely to recommend a reduction in NCP payments.

The December supplementary assessment noted that the following matters would be taken into account in revisiting Queensland's progress prior to 30 June 2000.

1. Finalisation of further guidelines by the Technical Issues Working Group in relation to full cost pricing.

2. Finalisation of the QCA's water pricing principles.

3. The identification of a timetable to progress reform across those local governments outside the *big 18* with more than 5000 connections. This timetable should include specific actions to provide for reform consistent with commitments. The Council would also look for implementation dates prior to 30 June 2001 and the third tranche assessment.

4. The identification of a strategy to promote reform across remaining local governments. The Council noted that the supplementary assessment would, in particular, focus on those local governments with greater than 1000 connections and would look to specific actions to promote reform across local governments.

Developments since December 1999

Queensland has achieved progress against the milestones set by the December supplementary assessment. For example, the Council has been provided with a draft of *Full Cost Pricing in Queensland Local Government – A Practical Guide* prepared by the Technical Issues

Working Group. The Council has been advised that these Guidelines have now been finalised without major amendment.

Queensland has also forwarded the QCA's *Draft Statement of Regulatory Pricing Principles* and has advised that the QCA will undertake a comprehensive consultation process on the draft. Queensland have assured the Council that the document will be finalised in a timely manner.

Local governments with greater than 5000 connections:

Queensland has provided a timetable to progress reform across those local governments outside the *big 18* with more than 5000 connections, with potential implementation by 1 July 2000. In particular, supplementary information provided by Queensland indicates that:

- Bundaberg will implement full cost pricing from 1 July 2000[12];
- six local government providers will consider full cost pricing over 2000-01 with possible implementation from 1 July 2001; and
- three will consider full cost recovery over 2000-01 for possible implementation from 1 July 2001[13].

Queensland also note that Johnstone Shire Council has decided not to implement full cost pricing but currently earns a rate of return on assets of 5.4 per cent and thus meets the lower bound of the COAG pricing Guidelines.

Local governments with greater than 1000 but less than 5000 connections

Queensland has provided a way forward for local government providers with greater than 1000 but less than 5000 connections as set down by the Council's December 1999 assessment. Of the 42 local governments considered:

- five will implement full cost recovery from 1 July 2000;
- 22 will consider full cost recovery over 2000-01 with possible implementation by 1 July 2001; and

---

[12] Queensland define full cost pricing to include: operational, maintenance and administrative costs, externalities, taxes or TERs, asset consumption (depreciation or other charge) and cost of capital, the latter being calculated using WACC.

[13] Queensland define full cost recovery to include: operational, maintenance and administrative costs, asset consumption (depreciation or other charge) and a rate of return on capital but not competitive neutrality charges such as TERs.

- three will consider full cost recovery over 2000-01 with possible implementation by 1 July 2002.

In addition, Queensland states that six local governments believe that they have net cost recovery. One of these, Broadsound, will move towards full cost recovery from 1 July via a 3 per cent price path.

Finally, no timetable for considering full cost recovery has been provided for six local governments but two currently earn a positive rate of return and two are above the lower bound of the COAG pricing Guidelines.

Assessment

The Council notes completion of the Technical Issues Working Group Guidelines and the imminent release of the QCA Statement of Regulatory Pricing Principles. This is consistent with the first two milestones set down in the December 1999 supplementary assessment.

The Council commends the commitment by Bundaberg to implement pricing reform by 1 July 2000. The Council also notes that in addressing the third and fourth milestones Queensland has provided timetables for local government providers with greater than 5000 connections and between 1000 and 5000 connections. However, the information provided by Queensland suggests that none of the next 10 local governments outside of the *big 18* have yet made a definite decision on whether reform will take place. A strong public benefit justification will need to be provided for any instances where local governments do not decide to proceed with reform, to avoid competition payment implications. Similarly, 1 July is sited as a possible implementation date but the Council suggests that a strong justification would need to be provided for any further delays in implementing a reform commitment that is already 12 months over due.

The omission of competitive neutrality adjustments such as taxes or TERs without a strong public benefit justification is not consistent with the agreed COAG water pricing Guidelines or the competitive neutrality section of the Competition Principles Agreement (clause 3). Thus, these issues will also be looked at by the Council as part of its third tranche assessment of other NCP reforms outside those specified in the water agreements.

While the Council has agreed to a staged extension of reform beyond the *big 18*, it notes that the same issues also apply to the timetable provided for local governments with between 1000 to 5000 connections. Thus the Council will look for progress against the implementation timetable provided. This would include a strong public benefit justification for any situation where reform will not take place.

In regard to advice that Johnstone Shire Council will not implement full cost pricing but currently earns a 5.4 per cent rate of return the Council notes that:

- Queensland has not separately provided information on water and sewerage. On the basis of this the Council cannot rule out the existence of cross-subsidies between these services; and

- failure to apply competitive neutrality principles is not consistent with either the agreed lower bound of the COAG water pricing Guidelines or clause three of the COAG pricing Guidelines.

In summary, Queensland has technically met the milestones set down by the Council's December 1999 supplementary assessment. However, the Council is still not satisfied that second tranche commitments have been met in full. Therefore, the Council will revisit this matter when it next assesses progress, in June 2001.

The Council's consideration of this matter will be significantly assisted by the completion of the QCA's second report on progress in February 2001. Therefore, while the Council does not recommend any reduction or suspension of NCP payments at this stage, substantial progress on this matter will be an important consideration when the Council undertakes its next assessment prior to 30 June 2001.

Outstanding issue: Extension of two-part tariffs to local government water and sewerage service providers

The 1994 COAG water resource policy developed and agreed to by all States and Territories includes a commitment to, firstly, consider whether introducing two-part tariffs for urban water pricing is cost effective and then, secondly, where cost effective to implement reform. Governments agreed to complete this process by 1998.

Two-part tariffs include a connection charge and a variable charge based on the water used. All urban water service providers are required to consider the cost effectiveness of two-part tariffs. This assessment balances such costs as the cost of installing and reading water meters (where they are not already in place) against benefits such as lower operating costs and deferral of investment as a result of reduced consumption due to volumetric pricing.

Queensland has required large local government water service providers to undertake water reform, which begins with an assessment of two-part tariffs. Smaller providers (at present, those providers other than the *big 18* water services providers) are encouraged but not required to undertake even an assessment. To provide an incentive for local governments to undertake reform Queensland is sharing of a portion of its NCP payments following an assessment by the QCA. Other measures include technical

support and the development of guidelines. At its last assessment, the QCA found that most local governments outside the *big 18* had made little progress on water pricing reform.

Queensland was unable to provide significant information on water pricing at the time of the second tranche assessment. However, the available information did lead the Council to express concern regarding the decision by four of the *big 18* not to implement two-part tariffs despite reviews suggesting that reform would lead to a net gain to their communities. However, noting that progress had been achieved and that more information would be available by the end of November the Council agreed not to suspend or reduce NCP payments but rather revisit this issue as part of a December 1999 supplementary assessment. The Council also noted that details of reform outside the *big 18* would be required for the supplementary assessment in December.

The December 1999 supplementary assessment noted the progress achieved by Queensland (particularly among the *big 18* local governments) in relation to introducing two-part tariffs where cost effective. The Council also recognised the systems put in place by Queensland to continue to encourage and facilitate reform and the extenuating circumstances faced by the State (such as the outcome of the *Hume Doors* Supreme Court decision[14]). Therefore, while still not satisfied that second tranche commitments had been met, the Council agreed to review this matter prior to 1 July 2000. However, the Council also noted that should this assessment indicate little further progress, the Council would be likely to recommend a reduction in NCP payments.

The Council's December supplementary assessment noted that when it revisited this issue in the June 2000 it would consider the following matters:

1. in regard to the *big 18*, the Council would consider the response to the AEC Group recommendation that there be a cost effectiveness evaluation on the United Water business encompassing Townsville and Thuringowa City Councils and the Townsville-Thuringowa Water Board.

2. information concerning tariff reforms for other local governments including:

   - identifying those local governments that have undertaken two-part tariff reviews;

   - identifying those local governments that have resolved to implement two-part tariffs following the reviews;

[14] Unreported, Supreme Court of Queensland (Chesterman J) 26 November 1999.

- identifying those local governments that have resolved not to adopt two-part tariff review recommendations where the recommendation was that such tariffs be adopted, including the provision of a copy of the review and relevant reasons and discussions of local governments; and

- providing copies of two-part tariff reviews where the recommendation was that a two-part tariff not be adopted.

3. the identification of a timetable to progress reform across those local governments outside the big 18 with more than 5000 connections. It was expected that this timetable would include specific actions to provide for the implementation of two-part tariffs and removal of base allowances where required by reform commitments. The Council would also look for implementation dates prior to 30 June 2001 and the third tranche assessment.

4. the identification of a strategy to promote reform across remaining local governments. The Council noted that the supplementary assessment would in particular focus on those local governments with greater than 1000 connections and would look to specific actions to promote reform across local governments, including implementation of two-part tariffs and removal of base allowances where required by reform commitments.

Developments since December 1999

Big 18 local governments

Queensland has advised that Thuringowa City Council has resolved to progressively implement two-part tariffs over a three year period commencing 1 July 2000. Queensland has also indicated that Townsville will conduct a further review of two-part tariffs by 30 March 2002 consistent with the requirements of the *Local Government Act 1993*.

Local governments with greater than 5000 outside the big 18

Supplementary information provided by Queensland indicates that:

- Warwick is the only local government among this group with two-part tariffs in place;

- 8 local governments will consider implementation over 2000-2001 with possible 1 July 2001 implementation; and

- 2 (Cooloola and Johnstone) have resolved not to introduce two-part tariffs but will consider reducing base allowances.

Local governments with greater than 1000 but less than 5000 connections

Queensland has advised that:

- 15 already have two-part tariffs in place;
- Nanango will implement two-part tariffs on 1 July 2000;
- 20 will consider over 2000-2001 with possible 1 July 2001 implementation;
- 2 will consider over 2000-2001 with possible 1 July 2002 implementation;
- 5 have resolved not to introduce two-part tariffs but 3 will consider reducing base allowances.

In relation to assisting further reform Queensland notes:

- the recent release of *Full Cost Pricing in Queensland Local Government – A Practical Guide and Technical Appendices* by the Department of Communication and Information, Local Government, Planning and Sport (DCILGPS);
- the imminent release of guidelines for the *Evaluation of Introducing and Improving Two-part Tariffs* which include a cut-down version of earlier guidelines and a spreadsheet to assist smaller local governments to evaluate cost effectiveness *in house*;
- the extension of the time period for local governments to be eligible for Review Pool Payments from the Financial Incentive Payments Scheme (the scheme) for the completion of two-part tariffs reports to 30 December 2000;
- the impending release of urban water pricing principles by the QCA which will form the basis of future assessments for the purposes of the scheme;
- the Queensland Government is funding a full time person for the Local Government Association of Queensland who will provide support and technical assistance on the adoption of water reforms; and
- DCILGPS is planning to hold information sessions for all non type 1 or 2 local governments in 2000 to demonstrate computer packages to assist local governments to structure a two-part tariffs where the decision is taken to implement them.

Assessment

Big 18

The Council commends Thuringowa City Council's decision to introduce two-part tariffs and will review progress with implementation as part of its third tranche assessment.

However, the Council is concerned at lack of commitment to timely reform demonstrated by Townsville City Council.

The Council notes that Townsville City Council's current position means that it will not take a definite decision on whether two-part tariffs will be implemented (let alone achieve actual implementation if appropriate) before 2002. This is significantly beyond the 1998 deadline agreed by Queensland when it endorsed the COAG water reform framework in 1994 and became a signatory to the NCP in 1995. The Townsville City Council's current position also means that it will be the only local government among the *big 18* still to finalise its position in relation to two-part tariffs.

In considering the implications of the time taken by Townsville, the Council noted that a March 1999 review by AEC Group identified that implementation would lead to a net benefit in present value terms of around $23 million.[15] The Council also noted that current arrangements for residential customers include a free water allowance of 776kL beyond which an excess charge of $1.05/kL applies. Information provided by volume II of the QCA's 1999 report on local government progress for the purposes of the Financial Incentive Payments Scheme states that:

- of total residential supply the proportion subject to a volumetric charge varies from 0 to 25% depending on conditions in any individual year; and

- Townsville City Council advise that the level of cross-subsidy is high between commercial customers (who pay volumetric charges on all water) and residential customers.

Local governments with greater than 5000 connections outside the big 18

The Council notes that Queensland has provided a timetable that may see implementation among a significant number of local governments by 1 July 2001.

[15] This figure is based on a 20 year planning horizon, a 6 per cent discount rate and assumed water reductions as a result of consumption based pricing of 20 per cent.

Where reviews of the cost effectiveness of two-part tariffs suggest that implementation should proceed, a strong public benefit justification would need to be provided for any delays in implementation beyond 2001. Further, any decisions by local governments not to proceed with reform where reviews suggest that it is cost effective may have competition payment implications when the Council undertakes its third tranche assessment if this decision is not accompanied by a suitably robust public benefit justification.

The Council notes that Cooloola Shire Council is reducing base allowances that will eventually lead to a two-part tariff. However, the Council notes that this process began in 1997-98 with the largest annual reduction being 20kL. No timetable for reducing the allowance has been provided but even assuming that the largest annual reduction to date is repeated each year, then eliminating the current allowance of 275kL will take another 14 years. This result, combined with the significant size of the allowance, suggests poor incentives to conserve water will continue over a long time, which is not consistent with NCP commitments.

Similarly, Johnstone Shire Council commenced consumption based pricing in 1999-00 but include a 584kL free water allowance. The local government has advised that it has limited information on usage and wanted to keep the base allowance to achieve revenue certainty. Johnstone Shire Council has indicated that it will consider a two-part tariff in the future but has provided no indication of when this will occur. The Council's view is that free water allowances discourage economical water use and create significant potential for non-transparent cross-subsidies which are not consistent with NCP water reform commitments. The Council's concern in relation to the allowance provided by Johnstone is heightened by the fact that the allowance is more than twice the national average and median household water consumption (WSAA 2000). The Council also notes that Johnstone Shire Council's position means that the Council has no indication of when a commitment originally due by the end of 1998 will be implemented.

Local governments with greater than 1000 but less than 5000 connections

The Council has focused on local governments with greater than 5000 connections in this assessment but notes the timetable provided by Queensland and efforts to assist appropriate consideration and implementation of two-part tariffs among smaller local governments. The Council will look for continued progress among these local governments when its undertakes its third tranche assessment.

Payment recommendation

While Queensland has made some progress in relation to two-part tariff commitments, a significant number of large local governments still have

not provided a definite commitment on when two-part tariffs will be introduced or even when a decision will be made on their introduction. In particular, the Council suggests that the position of Townsville City Council does not demonstrate a genuine commitment to considering reform within a timely manner. Similarly the Council views the positions of Johnstone and Cooloola as adding to this substantial breach of COAG commitments.

The Council considers that urban water pricing reform is significant for a number of reasons including:

- it is the principle reform to be implemented in urban areas. Water reform is not only about rural water services such as irrigation services. It includes services to people in cities and towns. These communities are also required to look at the way they use water;

- two-part tariffs provide substantial scope for consumers to choose how they use water, and reward consumers for water conservation. Whole communities should not be prevented from sharing the benefits that cost effective two-part tariffs will deliver;

- tariff reform can encourage improved efficiency and transparency among service providers and therefore offers further significant benefits for the community. This is amply demonstrated by the analysis for Townsville by AEC; and

- reducing water consumption offers benefits to the environment, in the short and long term, especially through delaying increases in water storages such as dams and reducing water usage in stressed rivers, streams and aquifers.

The water resources policy calls for reforms to be in place by 1998. It is now 2000 and the implementation of tariff reform, or even the identification of a path forward within an acceptable time, has not occurred for Townsville, Cooloola and Johnstone.

Recognising that it is appropriate to prioritise reform, the Council's assessment has focused, in the first instance, on the *big 18* local governments. Therefore, the Council is particularly concerned with the lack of progress achieved by Townsville given that:

- this is the third assessment for Townsville where progress has not been acceptable; and

- QCA evidence suggesting that current free water allowances mean that only a relatively small proportion of residential customers face volumetric charges and that current arrangements are resulting in significant cross-subsidies.

In regard to Cooloola and Johnstone, the Council notes that Queensland has made considering two-part tariff reform voluntary for local governments outside the *big 18*. The Council also notes that different approaches to implementing COAG commitments are appropriate in different situations. However, in evaluating progress for the purposes of NCP payments the Council must compare the outcomes delivered by the various processes adopted by jurisdictions against the commitments they made in signing the NCP. The Council acknowledges that initially focusing on the largest providers can maximise the short term gains from reform. However, the Council can find no COAG endorsed record that Queensland should limit reform to the *big 18*.

The Council sees significant benefit from ensuring that timely reform outcomes are achieved among local governments below the threshold used to identify the *big 18*. These local governments represent a significant number of people and generate a large amount of revenue.

The Council position in relation to timely reform beyond the *big 18* is a long-standing one. For example, the Council has raised this point with Queensland as far back as 1997. The above view is also consistent with that taken with other States and Territories.

Therefore, given Council's significant concerns regarding the lack of progress and commitment demonstrated by Townsville, and reservations regarding progress in Johnstone and Cooloola, the Council considers that the appropriate recommendation is that 5 per cent of the NCP payments due to Queensland for the year 2000-2001 should be suspended until 31 December 2000.

A suspension rather than an immediate reduction has been recommended given the progress demonstrated by Queensland overall. However, at 31 December 2000 the Council will undertake a further assessment. In particular, the Council will recommend that the above suspension be lifted at this time if Townsville commits to bring forward its review of two-part tariffs to before 1 July 2001. Commitments by Cooloola and Johnstone to timelier implementation of two-part tariffs will also be an important consideration in the Council's supplementary assessment. Should an acceptable path not be identified in respect of each provider, the Council will recommend that the suspended payments be reduced from Queensland's NCP payments.

Outstanding issue: New infrastructure development

Economic viability

In respect of concerns raised by the Council regarding economic viability assessments of new rural schemes as part of its December 1999 supplementary assessment, the Queensland Government undertook to develop additional economic evaluation guidelines specifically for

evaluation of new rural water projects. Queensland noted that these guidelines would among other things:

- address evaluation of the level of cost recovery for new projects
- address the relationship between economic assessment of new projects and the Queensland Treasury Community Service Obligation Guidelines; and
- require that the results of the economic assessments be reported in a transparent manner.

Other matters

The Council was also concerned that environmental impact assessments (EIA) were completed by water service providers or other parts of the Department of Natural Resources (DNR) and that there was no consistent allocation of responsibility. Queensland advised that new guidelines to streamline completion of EIAs, including arrangements for independent appraisal, would be developed.

The Council also raised concerns regarding the assessment, approval, commencement and completion of schemes while water planning was being undertaken. Queensland advised that it would develop guidelines concerning small rural schemes progressing prior to completion of water planning.

Developments since December 1999

Economic Evaluation

Queensland has provided the Council with a copy of *Guidelines for the Financial and Economic Evaluation of New Water Infrastructure in Queensland*. The purpose of the Guidelines is to outline the rationale and processes for financial and economic analysis of investment in new water infrastructure where a WRP has identified further allocations as being available for development.[16]

Scope

The Guidelines are to apply to statutory bodies, Government Departments and commercialised bodies. However, Queensland also states that commercialised bodies may use their own investment Guidelines where endorsed by the relevant portfolio Minister.

[16] Under the Water Act 2000 Water Resource Plans (WRP) will be developed to establish the demands (including those of the environment) placed on water resources at a catchment level across the state relative to the water currently available.

The Guidelines will only apply to the Government Owned Corporations or private companies where:

- it is proposed that there be some form of Government financial involvement such as the Government taking on some of the project risk;
- the Government is providing a CSO; or
- the Government is issuing a strategically significant water allocation.

A strategically significant water allocation is one that is significantly large compared to the water available for allocation in the catchment; or where the development of the allocation will have a significant impact on the State or region; or the development of the water allocation will require a significant financial investment on the part of the project developer. The Guidelines will only apply to local government where infrastructure is being developed that has both urban and non urban components and either the government has a financial interest in the non urban component or the Government is issuing a strategically significant water allocation or storage site for the local government development. Queensland notes that an Impact Assessment Statement will still be required for major infrastructure developments and will take account of, amongst other things, environmental, economic, cultural and social impacts.

The Guidelines require both a financial and economic assessment to be completed for water investment projects.

Financial viability involves establishing whether the project has the potential to generate sufficient revenues to cover direct costs associated with the project. These costs include capital, operations, maintenance and administration as well as taxation and regulatory costs. The financial assessment demonstrates whether the financial return is sufficient to make the project commercially viable (profitable). The Guidelines note that financial assessments should be prepared by the proposed project developer.

The Guidelines state that the economic assessment takes account of broader community costs and benefits to establish whether society as a whole will be better off as a result of the development. The economic assessment is based on standard cost benefit analysis. The economic assessments are to be developed by government. Where an assessment suggests that the project is not financially viable but is economically viable a CSO could be considered but the project must at least cover the lower bound of the agreed COAG pricing Guidelines.

Other matters

In correspondence to the Council of 8 June 2000, Queensland advised that *'the responsibility for management and assessment of the impact assessment process for water infrastructure transferred from* [DNR] *to the Environmental Protection Authority* [EPA] *in July 1999. While DNR (Resource Management) still has a number of functions as a concurrence agency under the assessment process, the actual assessment of impacts, including the adequacy any studies, resides with the EPA'.* EPA is required to advise on the level of impacts, environmental acceptability and management/monitoring actions. DNR may be asked for expert advice *but does not participate in the final assessments.*

At a meeting between Council Secretariat officials and Queensland officials in June 2000 Queensland advised small schemes would be assessed in a manner consistent with large schemes, and that the assessment will be conducted by the EPA.

Assessment

Guidelines for economic viability

The Council is satisfied that the Guidelines are consistent with COAG commitments and will be a valuable aid in ensuring that future new rural schemes are consistent with clause 3(d)(iii) of the agreed COAG framework.

Other matters

The advice of Queensland that EPA will undertake all EIAs for new rural schemes removes the concern highlighted in previous assessments that there may be a conflict of interest where the service provider undertakes an EIA. The Council notes that, at this time, the EPA and State Water Projects are both the responsibility of the same Minister. The Council considers this matter further later in this assessment (see Institutional Reform).

Further, the Council is of the view that the extension of this to all schemes is appropriate, and should ensure consistent outcomes.

The Council will review during the period prior to the third tranche assessment that this assessment of any new rural schemes by the EPA does in fact occur. It will also assess the outcomes and implementation of EPA recommendations.

The Council notes that the question of new developments or extractions where a planning process is being undertaken is relevant to the question of whether a moratorium notice should be in place while a plan is developed. The Council considers this matter further later in this assessment (see Allocations and Trading).

The Council is therefore satisfied that, for the second tranche, Queensland has met its reform commitments.

REFORM COMMITMENT: INSTITUTIONAL REFORM

Outstanding issue, December 1999

In the December 1999 supplementary assessment, the Council found that Queensland had not met the water reform commitment to separate institutionally as far as possible the roles of service provision on the one hand, and water resource management, standard setting and regulatory enforcement on the other. Achievement of this commitment was due by 1998. In addition, the Council recorded its concerns regarding the failure to devolve operational management for irrigation schemes.

At this time Queensland provided substantial information demonstrating extensive consideration of reform paths including amendments to legislation and corporatisation of the primary rural water service provider, which would provide for a greater degree of institutional separation. This included consideration of customer councils for irrigation schemes and user management where appropriate. Although discussion papers concerning the proposed reforms had been prepared and consultation was in progress, new arrangements had not been settled.

Given the commitment of Queensland to arrive at arrangements consistent with reform commitments, and having regard to the clear path identified by government, the Council recommended that a further supplementary assessment of institutional reforms be undertaken before 30 June 2000.

Developments since December 1999

Queensland has provided a large amount of information including various stages of draft statutory material to assist the Council in undertaking its assessment against this reform commitment; what follows is a brief summary of that information.

New structure for the Department of Natural Resources

In correspondence to the Council dated 25 May 2000, Queensland provided information concerning new arrangements for the DNR. The information noted that DNR was moving from its traditional role of providing infrastructure (e.g. water development) and advisory services to focussing on policy, planning and broad audit functions.

The proposed structure provided two discrete reporting areas: integrated resource management; and natural resources services (which includes the Regulator, see below).

In meetings with Secretariat officers Queensland also provided the following information:

- the previous Regional Infrastructure Division of DNR has been subsumed into the new structure within DNR, and its development functions have been moved elsewhere in the bureaucracy;

- other than management of some *orphan assets* that do not produce revenue and are not required by State Water Projects (SWP) to provide services and some operational support of providers in small communities, DNR will have no service delivery functions; and

- the proposed structure should be implemented by around mid-July 2000, although DNR will not report against its new structural functions until 2001-02.

Corporatisation of State Water Projects

Queensland has provided the Council with information concerning the proposed corporatisation of SWP, the bulk water provider for irrigated agriculture as well as some industry and electricity generation, and a number of rural and regional local governments.

Information provided includes that SWP has been declared as a candidate Government Owned Corporation (GOC)[17], a draft Corporatisation Charter (endorsed by Cabinet) has been developed and corporatisation will be able to occur on the commencement of the Water Bill.

Shareholder Ministers will be the Treasurer and Minister for Environment and Heritage and Natural Resources. A Board with appropriate expertise will be appointed. Objectives include improving financial performance while maximising long-term business value. A Corporate Plan and Statement of Corporate Intent will be prepared and negotiated with shareholding Ministers.

Queensland has advised that the Office of Government Owned Corporations (OGOC) has been established in Treasury to manage the shareholder relationship with all GOCs on behalf of the Treasurer. OGOC has responsibilities including negotiation of the Corporate Plan and Statement of Corporate Intent. Part of OGOC's responsibility is ensuring the fundamental integrity of the commercial accountability regime established under the GOC Act.

SWP will be required to establish customer councils for all schemes within six months. Customer councils will be given the opportunity to provide

[17] This is the first procedural step in converting a government authority into a Government Owned Corporation.

input to SWP's decision-making processes regarding service contracts, investment and refurbishment of assets and performance standards. Customers will also be given the opportunity to consider local management.

Water Bill 2000

The Queensland Water Reform Unit has advised that the Water Bill 2000 was tabled in the Queensland Legislative Assembly on 22 June 2000. The letter notes that *'it is proposed that the Water Bill 2000 will be debated in the second part of this year'.*

Included in the policy objectives of the draft Water Bill 2000 (the Bill)[18] are the following: to establish a regulatory framework for providing water services covering asset management, customer standards and dam safety; and to establish a governance regime for statutory water authorities.

The draft Explanatory Memorandum (EM) notes that as water service providers begin to commercialise their operations, it is possible that tradeoffs in customer service standards and asset management may occur; a regulatory regime to ensure the maintenance of service standards and asset management is required.

Chapter 3: Water and Sewerage Services

Chapter 3 of the Bill provides for a regulatory framework for the provision of water and sewerage services. Broadly, it provides for:

- the registration of all service providers;
- powers (such as, the power to enter land and protect assets and the power to disconnect unauthorised connections) related to the provision of water and sewerage services;
- service providers to:
  - have an approved strategic asset management plan identifying services and infrastructure, specifying standards for key performance matters and documenting operation, maintenance and renewals strategies;
  - prepare customer service standards; and
  - prepare Annual Reports for consideration by the Regulator.

[18] The Council has not had the opportunity to review the Bill tabled in the Queensland Parliament on 22 June 2000 although it has reviewed a number of earlier drafts.

The Bill also provides for regulation of certain dams[19] and approval of flood mitigation manuals by the regulator; and

- the creation of the Office of Regulator, who is the DNR Chief Executive Officer[20]. The Regulator has functions including keeping a register of service providers, reviewing and making recommendations regarding standards, regulating referable dams and, for some providers, dealing with customer complaints. The regulator prepares Annual Reports about activities.

Chapter 4: Water Authorities

Chapter 4 of the Bill provides for water authorities, established by regulation, to supply services such as the water, drainage and sewerage services.

It distinguishes between Category 1 authorities, being essentially the bulk water service providers (Gladstone Area Water Board and Mt Isa Water Board), that are subject to commercialisation and cannot rate for services provided, and Category 2 authorities that are subject to a less restrictive regulatory regime.

Water authorities are controlled by a Board of Directors, either elected or appointed (in accordance with the establishing regulation) who are required to act in the relevant authority's best interests.

Queensland Competition Authority

The Council has been advised that, following amendment to the Queensland Competition Authority (QCA) Act 1997, consideration will now be given to declaring the larger local governments' water service providers for prices oversight by the QCA.

Queensland officials have also advised that the South East Queensland Water Corporation has been a declared monopoly business activity since the passage of the QCA Act amendments. SWP will be investigated for prices oversight within six months of corporatisation, although five year price paths negotiated with customers to implement full cost pricing will be excluded. Similarly, following passage of the Bill, category 1 authorities will also be investigated for prices oversight.

[19] *Referable dams*, which are defined in the Act.

[20] Hereinafter, where functions are to be assigned to the DNR Chief Executive Officer, this report will refer to these as being assigned to DNR.

The government can refer declared monopoly business activities to the QCA for prices oversight. To date, no water activities (or other monopoly business activities) have been referred to the QCA.

Other information

The Productivity Commission report, *Arrangements for Setting Drinking Water Standards*, noted that while the Minister for Health has extensive powers in the event of a public health emergency, and the Queensland Health Department encourages water service providers to meet Australian Drinking Water Guidelines, responsibility for drinking water quality rests with local governments.

Assessment

Discussion of proposed reforms

The Council appreciates that the nature of institutional reforms to achieve structural separation will differ from jurisdiction to jurisdiction. The strong presence of local government providers in the Queensland water industry and their relatively autonomous status is reflected in the arrangements proposed.

The Council is satisfied that the reforms in their present form will provide for substantially improved water industry structures. In particular they achieve, to a large extent, separation of functions. The arrangements are comprehensive, applying to all but a handful of providers excluded following consideration by the Regulator as to whether compliance costs outweigh benefits. They also provide a very significant potential for increased and more efficient services to customers regulated in an open and transparent manner.

The Council has raised some particular issues with Queensland regarding the arrangements in their present form. These focus on:

- the prolonged transitional arrangements, up to four years in the case of small providers. Queensland have advised that such lengthy periods for transition are needed because of the extensive guidelines and other material that will need to be prepared on the commencement of the Bill and the resource limitations of the Regulator;

- the different treatment of customer service standards for local government and many other government service providers on the one hand and corporatised government and private sector providers on the other. Queensland have undertaken to review the scope of the exemptions from the Regulator's overview of standards and the nature of arrangements between the Regulator and the Parliamentary Commissioner; and

- providers having the power to require persons to connect to services. Queensland have noted this is a significant policy issue requiring consultation between State and local government and may take some time to resolve.

These matters aside, and on the basis of information provided to date, the Council is satisfied that the arrangements proposed meet second tranche reform commitments.

Matters to be monitored for the third tranche assessment

The Council has raised with Queensland a number of matters that it will monitor closely during the period prior to the third tranche assessment. These include:

- Ministerial administrative arrangements given that the SWP shareholding Minister is also the Minister responsible for DNR, the resource management, service standard and enforcement regulator. The Council also notes that, at present, the same Minister is responsible for EPA and the environmental assessor of new schemes, whilst SWP may often be the proponent of such schemes. For these matters the Council will look to procedures and other measures that ensure that potential and actual conflicts of interest are addressed to promote the best outcomes from institutional reform;

- whether the QCA has actually done any work in the oversight of pricing decisions;

- arrangements for the regulation of drinking water quality. The Council's concerns noted in the second tranche assessment are confirmed in the Productivity Commission report. A response that addresses the issues raised by that report would meet COAG obligations; and

- implementation of the arrangements outlined in the reforms that are the subject of this assessment, including increased participation in scheme management by irrigation users.

Assessment of present arrangements

Given that the legislation establishing the arrangements has not as yet been debated by the Parliament or commenced operation, the Council assesses Queensland as not having met second tranche reform commitments for institutional separation and devolution of irrigation management.

However, the Council recognises that the reforms to be implemented by Queensland have significant and far reaching consequences. They involve

two tiers of government and require the restructure of a department and corporatisation of a large service provider.

The reforms have been the subject of considerable consultation with governments, users and other interested persons. This has included consultation on draft legislation.

As noted previously, the Council considers that water reforms, as a package, offer more benefits to the broad community than any other single measure in the NCP program. Institutional arrangements are integral to the COAG water reform policies. For example, proper institutional arrangements:

- provide scope for more efficient and effective water services driven by consumer needs and not provider convenience;
- contribute to the management of significant public investments of the State Government, as well as local government and other metropolitan, regional and rural water service providers;
- ensure integrity and transparency in price setting and regulation of the health and other water service standards;
- promote environmental outcomes both in the short and long term through a strong and focussed natural resource regulator; and
- contribute to fair and efficient water allocation and use.

However, there is a potential in this case for strict adherence to timeliness to prevent proper consideration by all interested persons of the reforms, resulting in arrangements that are poorly understood by governments and their communities and which fail to address relevant issues in the most appropriate manner.

These are all relevant considerations for the Council when making recommendations to the Treasurer regarding NCP payments.

Payment recommendation

Given that similar issues apply to Queensland's progress with institutional reform and allocations and trading commitments the Council has combined its recommendation on payments for both of these issues. This combined recommendation is provided at the end of the next section.

REFORM COMMITMENT: ALLOCATIONS AND TRADING

Outstanding issue, June 1999

In the second tranche assessment the Council found that the existing water allocations system in Queensland failed to clearly separate water

title from land title and recognise the environment's right to water. While substantial policy work had been undertaken, legislation to give effect to reforms proposed had not been drafted. Further, while interim arrangements were in place to provide for water trading, legislation permitted only temporary transfers.

The Council recommended that a supplementary assessment of legislation to provide for water entitlements and trade be undertaken in June 2000 to examine whether legislation consistent with reform commitments was in place in Queensland.

Developments since June 1999

Queensland has provided a large amount of information including various stages of draft statutory material[21] to assist the Council in undertaking its assessment against this reform commitment. What follows is a brief summary of that information.

Water Bill 2000

The draft EM to the Bill notes as a primary objective *'to establish a sustainable management framework for the planning, allocation and use of water and other resources'*. The draft EM notes that the Bill provides for a statutory based water planning process to assess the water required to meet environmental needs and the water available for consumptive use, a process to implement the plans, and water allocations that are separate from land, tradeable and registered.

Chapter 2: Allocation and Sustainable Management

The Bill notes that the purpose of the Chapter is to advance sustainable management and efficient use of water and other resources by establishing a system for planning, allocation and use of water. Sustainable management is defined as management that, for example, facilitates economic development in accordance with principles of ecologically sustainable development (which is also defined), maintains or improves water quality, protects water, watercourses and natural ecosystems from degradation (and if practicable reverses degradation) and encourages community involvement in water planning and allocation. Efficient use is defined as, for example, incorporating demand management measures that achieve a permanent and reliable reduction in the demand for water and promoting water conservation and water recycling.

[21] The Council has not had the opportunity to review the Bill tabled in the Queensland Parliament on 22 June 2000 although it has reviewed a number of earlier drafts.

Water Rights

The Bill vests in Queensland all rights to the use, flow and control of all water. Riparian rights (ie domestic and stock water) and rights to take subartesian and overland flow water are not vested in Queensland as of right. However riparian rights may be restricted during a water shortage. Further, a moratorium notice or water resource plan (WRP) may limit or prohibit the taking of overland flow or subartesian water.

A WRP must regulate the taking of overland flow or subartesian water if the Minister is satisfied of matters including:

- where there is an existing WRP, there is a risk that diversions may significantly impact on the WRP's outcomes; or
- where there is a risk that diversions may significantly affect water availability for existing entitlement holders or water requirements of natural ecosystems.

Water Resource Plan

The Minister may prepare a WRP to advance sustainable management of water. This includes: defining water available for any purpose; providing a framework for sustainably managing water; identifying priorities and mechanisms for dealing with future water use; providing a framework to establish water allocations; and providing a framework for reversing, where practicable, degradation in natural ecosystems.

In very general terms, the WRP process includes:

1. the Minister preparing an information report about water issues and proposed community reference panel and technical assessment arrangements;
2. the Minister publishing a notice of the intention to prepare a draft WRP;
3. the Minister establishing a community reference panel;
4. the Minister publishing a moratorium notice where appropriate;
5. preparation and publication of draft WRP and overview reports;
6. community consultation on the draft WRP;
7. preparation and approval of a final WRP (which is subordinate legislation);
8. preparation of a report on the consultation process including a summary of issues raised and how the issues were dealt with;

9. preparation of reports from time to time as provided for in the WRP with summaries of matters such as research, monitoring, effectiveness, water allocations and non-compliance[22];

10. amendment of the WRP, including that the Minister must amend a WRP where satisfied that the environmental flow or water security objectives are no longer appropriate; and

11. a requirement to prepare a new WRP after 10 years.

A draft WRP must state the purpose of the WRP, a map of the proposed area, the water to which the WRP applies, monitoring requirements, outcomes (including ecological outcomes), reporting requirements and proposed implementation arrangements. A draft WRP may include, amongst other matters, areas where the taking of overland or subartesian water is regulated, criteria for adjusting water entitlements to achieve plan outcomes and criteria for addressing degradation in natural ecosystems. Where the draft WRP provides a framework for water allocations, it must state: environmental flow objectives; water allocation security objectives; performance indicators for these objectives; and priority areas for the conversion to or granting of water allocations.

The Minister must have regard to matters such as:

- the State's water rights;
- national, state and regional objectives and priorities for promoting sustainable development;
- water flows, as assessed by best scientific information, necessary to support natural ecosystems;
- existing and future water requirements;
- cultural and economic values;
- the effects on water not covered;
- sustainable resource management strategies and policies for the catchment;
- submissions and advice; and
- the public interest.

[22] Queensland officials have noted that the monitoring reports would be of a similar type to those prepared by the Independent Audit Group for the Murray Darling Basin Commission in respect of compliance with the Cap on extractions.

Resource Operations Plan and Licence

A resource operations plan (ROP) implements the WRP. The ROP details how objectives of the WRP will be met. Prepared by DNR, the ROP process includes extensive provision for public consultation. DNR must have regard to: the WRP; submissions; proposed infrastructure operating arrangements; and the public interest. The Council notes here the advice of Queensland officials that the WRP will provide for whether a ROP should be prepared and, if so, the timeframe within which it must be prepared.

Matters to be included in a draft ROP include identification of the water infrastructure to which it is intended to apply, and statements as to how water will be sustainably managed, monitoring practices and how WRP outcomes will be addressed. The draft ROP may include environmental management rules, processes for dealing with unallocated water, changes to water entitlements and an implementation schedule.

Where the draft ROP provides for water allocations, it must state: rules for conversions of existing and interim licences; processes for meeting future water requirements; and environmental management, water sharing, water allocation transfer (including limits on transfer between locations and for different purposes) and seasonal water assignment rules.

The final ROP and any amendment are approved by the Governor in Council.

A resource operations licence (ROL) is issued to an infrastructure operator once a ROP is finalised; most (but not necessarily all) of the operating conditions will be specified in the ROP. ROL conditions include operating and supply requirements and may include monitoring and reporting requirements.

In addition, an interim ROL can be granted for existing or proposed water infrastructure.

Water allocations

Water allocations provided for under a ROP commence when it is finalised. Allocations (and transfer) must be recorded on the water allocations register. A water allocation is subject to the ROP. Allocations may be transferred in compliance with the ROP or if approved by DNR. A process for this approval is provided for in the Bill. The Bill also provides for interim water allocations where an interim ROL is granted.

In addition, seasonal water assignments (either under a WRP, ROP or otherwise) may be made. Such assignments do not have to be entered on the water allocations register.

Water Licences and Permits

Water licences are issued for the taking of water and interfering with water flow. Where there is a WRP, water licences must be decided in accordance with it. Further, if there is no WRP matters similar to those considered in developing a WRP are relevant. A water licence is issued for a period and states the water to which the licence relates, the location from which water may be drawn and, in certain circumstances, is linked to the land. The Bill also provides for a carry-over of many of the existing processes under the (QLD) Water Resources Act 1989,

A regulation may provide for the transfer of a water licence - otherwise a water licence may not generally be transferred other than on transfer of the land to which it relates.

Water permits are granted for activities, such as road construction or mineral exploration, that have a reasonably foreseeable conclusion date. Water permits may not be transferred.

The State Development and Public Works Organisation Act 1971

This Act provides, at S89, for the Co-ordinator General to take water to the extent necessary for authorised works. The Bill provides that this power: must be exercised in a manner consistent with a moratorium notice or WRP or in other circumstances, having regard to specified principles. Queensland officials have advised that DNR will be consulted on proposed taking of water pursuant to S89 and where agreement cannot be reached, the matter will be referred to Cabinet for decision.

Progress on developing WRPs.

Since the second tranche assessment in June 1999, the following plans have been published:

- the Fitzroy Basin Water Allocation and Management Plan;
- the Cooper Creek Water Management Plan;
- the draft Moonie River Catchment Water Management Plan;
- the draft Boyne River Basin Water Management Plan; and
- the draft Condamine-Balonne Water Allocation and Management Plan.[23]

[23] This draft plan was released on 15 June 2000 and the Council has not, at the time of the assessment, been provided with a copy of it. The comments that follow therefore do not apply to this draft plan.

The Council notes that the outcomes of these plans are not the subject of this supplementary assessment. They will be assessed at the third tranche assessment. This is because the Council's ability to assess reforms is confined by the nature of the assessment process with which it is charged. In a supplementary assessment the Council can only assess those matters specifically identified in the second tranche report as being subject to supplementary assessments. The Council is unable to assess ongoing developments that occur after the second tranche assessment until 1 July 2001 (NCC 1999b).

Interested parties have raised a number of concerns as to the consistency of each of the plans or draft plans with COAG water reforms. Some of these relate to the transparency in the decision making processes, particularly as regards the amount of water that may be extracted or the matters to be included in the planning process. The Council notes that these matters are crucial to both outcomes and the extension of the new tradeable water allocations system. For example, the Council notes:

- for the Fitzroy Plan, planned development limits are in excess of environmental flow limits, the level below which there is an increased risk of unacceptable environmental degradation. In addition, the level of development across the Basin may not be consistent with best scientific evidence. Further the plan does not encompass overland flow; and

- for the draft Moonie plan, it does not encompass overland flow. Nor does it provide for tradeable water allocations separated from land. Further, the draft plan provides for increased water extractions. The Council notes that the Moonie River Catchment is one of the northern Murray Darling Basin catchments. While it is comparatively small, it forms part of a system in acknowledged stress.

In discussion with Queensland concerning these matters, the Council was advised that the plans were developed using the Water Resources Act 1989 provisions, and that this did not permit for overland flow to be controlled or the provision for tradeable water entitlements. Because of this:

  - the plans should not be used to judge the new legislation;

  - the plans and draft plans will be reviewed on passage of the new legislation so that they conform with the objectives of the legislation; and

  - that amendments in the Bill are increasing the transparency of decisions made by government regarding water planning.

The Council accepts the advice of Queensland that the plans were developed having regard to the legislation presently in place. That said,

the Council will, at the third tranche, closely monitor reviews of these four plans that are already in draft or final form to ensure conformity with the new statutory provisions.

Assessment

Discussion of proposed reforms

Where there is a WRP, the new Bill provides for arrangements that can be consistent with reform commitments. In particular, a WRP:

- may provide for a comprehensive system of water entitlements backed by separation of water property rights from land title and clear specification of entitlements in terms of ownership, volume and transferability;

- will provide for environmental water provisions that have regard to relevant scientific information; and

- may provide for tradeable water entitlements, including any relevant trading rules.

The Bill provides an opportunity for planning that has regard to the environment's needs, specifies clearly users' rights, has regard to intergovernmental agreements and downstream users and includes substantial community consultation. It is a dramatic improvement on existing legislative arrangements.

The Council recognises that, for each jurisdiction, the challenges for water management will be different. In Queensland, for example, many water systems are not allocated to the extent of those in the Murray Darling Basin, and there may be potential for further development of water resources. Further, there may not as yet be competition for water in some areas such that detailed water planning including provision of tradeable water entitlements is warranted in the short term.

The multi-level planning in Queensland recognises this, by providing that the existing water licensing system continues and for WRPs to provide for water allocations (as opposed to water licences) in some, but not all circumstances.

That said, the Council has identified particular issues and sought to advance these in discussions with Queensland officials since the last assessment. These issues include:

- that the legislation does not explicitly exclude water extraction that results in degradation of ecosystems. In this respect, the Council notes that while regard must be had to this matter when preparing WRPs, plans such as the Fitzroy WAMP indicate that water extraction

outcomes (for example, Planned Development Limits) may be in excess of identified Environmental Flow Limits.

Any significant water diversion or in-stream barrier will effect ecosystems. The question of what is an acceptable degradation, the Council accepts, is ultimately a matter for the government, guided by communities it serves and advice it receives including, importantly, scientific advice. The Council has been concerned that existing provisions in the Bill may not provide sufficient transparency in the decision making process by Cabinet. These concerns have been significantly addressed in the latest draft of legislation;

- that the legislation or other arrangements provide no guidance as to:

  – when planning should be commenced. While processes to identify at risk water aquifers are underway[24] no such process has been commenced for remaining surface water systems. In this respect it is noted that there are only a limited number of Queensland surface water systems that are not presently slated for a WRP;

  – what matters (other than those prescribed and overland and subartesian water) should be included in the planning process. The Council's principle concern is that, appropriate tradable water allocations and overland and subartesian water should be provided for in water planning processes. The Council considers that the decision as to what is included in the planning process goes to the very heart of the legislation's integrity. Given the two tiers of water planning provided for in the legislation, the Council would look to water licences remaining only where there is no pressure on the water resource (in whatever form) and that this is likely to be the case for the life of the WRP; and

  – the matters that guide the Minister's decision to issue a moratorium notice including those factors that will inform the Minister's choice of water resources to be included in the notice.

These matters aside, the Council is satisfied that, with appropriate administrative arrangements, the legislation provides a framework consistent with second tranche commitments.

Assessment of present arrangements

The Council was of the view in 1999 that the arrangements in place in Queensland did not meet reform commitments. Given that those arrangements largely remain, it is inevitable that, for this supplementary assessment, the Council assesses Queensland as not having met reform

[24] A groundwater risk assessment project

commitments. It is noted that comments in the discussion papers and EM support the Council's assessment in this respect.

The Council recognises that legislation and other measures to implement new arrangements are complex. They affect a large number of people and corporations, and are of interest to the entire community, rural, regional and metropolitan. While there is a need to ensure that reforms are timely, it is also important to provide information for community understanding of the reforms and the opportunity for meaningful consultation. In addition, there is a need for government and Parliament to have sufficient time to consider and debate the proposed legislation.

That said, as noted above, the water allocation reforms are a lynchpin of the COAG reform framework. Tradeable water allocations including allocations for the environment will be an instrumental part of arresting widespread natural resource degradation. The allocations framework is also central to addressing the economic, environmental and social implications of the water reforms. The failure to have implemented arrangements consistent with reform commitments is a significant matter.

The Council has previously stated that water reform is an area that extends beyond competition matters to embrace social policy issues and recognises the environment as a legitimate user of water. The Council has said that full implementation of the reform package could do more to benefit the broad community than any other single measure under NCP. The Council has indicated its intention to give high priority in the assessments to the timely implementation of agreed water reforms. (NCC 1998a)

Implementation of a water allocation and trading regime consistent with commitments:

- provides scope to significantly increase the value of rural produce through movement of water to higher value activities;
- will contribute to healthy and sustainable water ecosystems;
- provides significant opportunities to advance social objectives, especially through water trading;
- will provide a framework for future allocations consistent with ecologically sustainable development in those systems where more water allocations are able to be granted;
- will contribute to the development of rural communities; and
- impacts on water users and communities in other downstream states, including New South Wales, Victoria, South Australia and the Australian Capital Territory.

The Council also notes that the legislation to establish tradeable water entitlements is integrated with other important reforms, and in particular institutional reforms.

However, there is a potential in this case, with landmark legislation not only redefining water property rights, but also implementing new arrangements for the conduct of the water industry, for strict adherence to timeliness to curtail proper public and Parliamentary debate, resulting in arrangements that are poorly understood by the community and which fail to address relevant issues in the most appropriate manner.

These are all relevant considerations for the Council when making recommendations to the Treasurer regarding NCP payments.

Payment recommendation (institutional reform, allocations and trading)

As noted above, given the similarities in the implementation issues associated with the institutional reform and allocation and trading the Council provides a combined payments recommendation in respect of these matters. The Council considers that the most appropriate recommendation is that there be no immediate reduction in NCP payments on account of the failure to have legislation establishing institutional, allocation and trading arrangements substantially in force.

The Council will undertake a supplementary assessment in December 2000 to ensure that legislation consistent with the water framework is substantially in force. Between this assessment and that time the Council will review the finalised legislation and consider any further submissions it receives to ensure that proposed arrangements are consistent with reform commitments.

Should the legislation not be substantially in force by 31 December 2000, the Council is presently of the view that it will recommend a reduction in NCP payments for failure to meet reform commitments. The Council considers that, having regard to all the competing factors, this failure should have implications for 15 per cent of the State's NCP payments for the year 2000-01. This figure is comprised of 5 per cent for failure to achieve timely institutional reform and 10 per cent for delays in allocations and trading reform.

The Council considers that the appropriate manner to implement this recommendation is as follows:

- that 7.5 per cent of NCP payments for the year 2000-01 not be paid for the failure to have legislation substantially in force between July and December 2000; and

- that 7.5 per cent of NCP payments for the year 2000-01 be suspended for the period January to June 2001. Following passage of the legislation the Council will make a recommendation as to what part of the suspended payments, if any, should be paid to Queensland.

The Council notes that, should reforms not be substantially in force by the third tranche assessment, it will consider whether a reduction in NCP payments of at least 15 per cent should continue until passage of legislation consistent with COAG water reform commitments.

Western Australia

REFORM COMMITMENT: ALLOCATIONS AND TRADING

Outstanding issue, June 1999

In the second tranche assessment report, the Council noted that Western Australia proposed to legislate for a new system of water licensing to provide for allocations consistent with water reform commitments. This was to be achieved through amendment to the Rights in Water and Irrigation Act 1914 (RIWI Amendment Bill). Further, elements of arrangements to provide for environmental water were dependent on passage of the amendments. In addition, the current trading arrangements only provided for water leasing or a cumbersome interim trade arrangement. The Council was of the view that the proposed arrangements to be implemented by the amending legislation would enable water trading reform commitments to be met.

The Council therefore recommended that a further assessment of reform be undertaken in June 2000 to ensure passage of the amending legislation.

Developments since June 1999

Rights in Water and Irrigation Amendment Bill

In November 1999 the RIWI Amendment Bill passed its second reading in the Legislative Assembly.

The Legislative Assembly referred the matter to the Legislation Committee on 29 March 2000. Western Australia advised on 27 June 2000 that the report tabled by the Committee makes a number of recommendations and the Government is now considering amendments to the Bill in response to those recommendations. A revised Bill will be tabled in the Spring Session of Parliament commencing on 8 August 2000.

Assessment

The Council was of the view in 1999 that the arrangements in place in Western Australia did not meet reform commitments. Given that those arrangements continue, for this supplementary assessment, the Council assesses Western Australia as not having met its reform commitments.

However, the reforms proposed in the RIWI Amendment Bill will usher in a new scheme of water management in Western Australia. They will, in particular, affect a large number of rural and regional businesses, and industries, and the communities that rely on them. The Council has followed the debate of the legislation Parliamentary inquiries, discussions with stakeholders who have contacted the Council, and government media releases. The reforms have sparked a lively debate that reflects their importance for the future management of water in Western Australia.

That said, as noted above, the water allocation reforms are a lynchpin of the COAG reform framework. Tradeable water allocations including allocations for the environment will be an instrumental part of arresting widespread natural resource degradation. The allocations framework is also central to addressing the economic, environmental and social implications of the water reforms. The failure to have implemented arrangements consistent with reform commitments is a significant matter.

The Council has previously stated that water reform is an area that extends beyond competition matters to embrace social policy issues and recognises the environment as a legitimate user of water. The Council has said that full implementation of the reform package could do more to benefit the broad community than any other single measure. The Council has indicated its intention to give high priority in the assessments to the timely implementation of agreed water reforms (NCC 1998a).

Implementation of a water allocation and trading regime consistent with commitments:

- provides scope to significantly increase the value of rural produce through movement of water to higher value activities;
- will contribute to healthy and sustainable water ecosystems;
- provides significant opportunities to advance social objectives, especially through water trading;
- will provide a framework for future allocations consistent with ecologically sustainable development in those systems where more water allocations are able to be granted; and
- will contribute to the development of rural and regional communities.

However, there is the potential for strict adherence to timeliness to curtail proper public and parliamentary debate. This may result in legislation that fails to address issues in the most appropriate manner.

These are all relevant considerations for the Council when making recommendations to the Treasurer regarding NCP payments.

In this matter, and particularly having regard to the fact that the legislation is before the Parliament, the Council considers that the most appropriate recommendation is that there be no reduction in NCP payments on account of the failure to have legislation substantially in force.

The Council will undertake a supplementary assessment in December 2000 to ensure that legislation consistent with the water framework is substantially in force. Following passage of the legislation by Parliament the Council will review the new Act for conformity with reform commitments. The Council considers that, having regard to all the competing factors, this failure should have implications for 10 per cent of the State's NCP payments for the year 2000-01.

The Council considers that the appropriate manner to implement this recommendation is as follows:

- that 5 per cent of NCP payments for the year 2000-01 be deducted for the failure to have legislation substantially in force between July and December 2000; and

- that 5 per cent of NCP payments for the year 2000-01 be suspended for the period January to June 2001. Following passage of the legislation the Council will make a recommendation as to what part of the suspended payments, if any, should be paid to Western Australia.

The Council notes its view that, should reforms not be substantially in force by the third tranche assessment, it will consider whether a reduction in NCP payments of at least 10 per cent should continue until passage of legislation consistent with COAG water reform commitments.

South Australia

COST REFORM AND PRICING

Outstanding issue: trade waste charges, free water allowances and property based water and sewerage charges

Clause 3(a)(i) of the COAG water reform framework notes governments' commitment to the adoption of pricing regimes based on the principles of full cost recovery and consumption based pricing. The COAG framework also states that where cross-subsidies continue to exist they be made

transparent and notes the desirability the removing cross-subsidies which are not consistent with efficient and effective service use and provision.

In South Australia sewerage prices are based on property values. The composition of sewerage rates for 1999-00 is shown below.

Table 7.1: SA Water Sewerage Tariffs, 1999-00

	Metro	Country
Tariff[1]	0.256% of annually assessed improved property value with a minimum charge of $219	0.323% of annually assessed improved property value with a minimum charge of $219

1 Consistent with South Australia's universal price policy, a 26 per cent differential is applied between property rates for country and metro customers to reflect differences in average property values.

The Council's second tranche assessment expressed concern that the inclusion of a property-based component in sewerage charges could lead to non transparent cross-subsidies which are not consistent with the agreed COAG framework. Similarly, it was concerned that the absence of a comprehensive trade waste regime meant that industrial customers were receiving a non transparent cross-subsidy. The Council also noted that accurately identifying and reporting any cross-subsidies arising from current arrangements would be a very difficult task.

In South Australia, water charges for commercial and non commercial customers are based on different pricing structures. For most customers (including the residential, industrial and rural sectors) water charges are made up of a fixed access charge and a volumetric charge. The volumetric charge increases when annual consumption exceeds 125kL (see Table 7.2).

Commercial water users (including wholesale, retail and financial businesses as well as other service sectors) pay a volumetric charge but the access charge is based on improved property value with a minimum charge of $136. Further, the volumetric charge only applies once consumption is above a free water allowance equal to the access charge divided by 91c/kL.

In conducting its second tranche assessment, the Council was concerned that free water allowances are not consistent with the principle of consumption based pricing (clause 3(a)(i)). The Council was also concerned that both free water allowances and property value-based charges provide potential for non transparent cross-subsidies which are not consistent with clause 3(a)(i) of the agreed reform framework.

Table 7.2: SA Water Tariffs, 1999-2000

	Residential	Industrial, Rural	Commercial
Access charge	$123	$136	$136 plus $2.13 per $1000 of improved property value above $63 850
Water usage charge			
0-125kL	36c/kL	36c/kL	91c/kL above free water allowance
>125kL	92c/kL	91c/kL	

Developments since December 1999

Defining cross-subsidies

The Council's second tranche assessment defined cross-subsidies in the following manner:

'For the purposes of the framework a cross-subsidy exists where a customer pays less than long run marginal cost and this is being paid for by other customers. An economic measure which looks at prices outside of a Baumol Band, which sets prices between incremental and stand alone cost, is consistent with the COAG objective of economically efficient water usage, pricing and investment outcomes.'

The second tranche assessment also suggested that any shortfall in revenues from charging prices below incremental cost should be met through a transparent CSO.[25]

In supplementary information provided to the Council, South Australia note that a number of definitions of cross-subsidy exist, including those of:

- the Queensland Department of Natural Resources which looks at whether customers pay above or below long run marginal cost (LRMC) and then how any shortfall is funded;

- a Water Services Association of Australia report suggesting that prices below avoidable cost (incremental cost or LRMC) lead to cross-subsidy while those above stand alone cost result in inefficient by-pass; and

[25] The Council consulted with jurisdictions on its interpretation of this and other reform commitments prior to the commencement of the second tranche assessment.

- the Industry Assistance Commission's Government (Non Tax) charges report that suggests two tests for cross-subsidy, an incremental cost test and a stand-alone test.

Given the above, South Australia notes that potentially, testing for and measuring cross-subsidies could be based on two definitions, a narrow definition focusing simply on whether pricing for any customer is less than incremental cost, or a broader definition which also considers pricing in excess of stand-alone cost. South Australia provides information against these two definitions (see below) but also express the view that:

'... recognising that different interpretations and understandings of what constitutes a cross-subsidy do exist, it seems clear that the focus of the COAG obligations is on cross-subsidies that have efficiency implications.'

Trade waste charges

There are approximately 7000 non-residential customers registered to discharge trade waste in South Australia. South Australia has adopted a selective negotiated approach to trade waste charges which differs from other States where scheduled trade waste charges apply to all trade waste dischargers.

South Australia states that the aim of the current approach is to either bring dischargers below acceptance limits (which are consistent with national guidelines developed by ARMCANZ and ANZECC) or apply a trade waste charge based on the cost of treating that part of the pollutant load that exceeds acceptance limits.

The Council understands that the approach currently adopted by South Australia involves a two stage process. In the initial stage, SA Water works with the discharger to identify avenues for reducing waste emission. No penalty charges apply during this period, which can take anything from 3 to 18 months. The second stage involves the discharger either committing to a timetable to undertake investment to reduce discharges below acceptance limits or incur a trade waste charge based on biochemical oxygen demand, suspended solids and flow volume.

Over the last 18 months, trade waste charges have been introduced to 17 of the State's largest waste dischargers. However, the Council understands that, where a trade waste charge is applied, no charge is levied for discharges below acceptance limits. The Council also understands that two of the State's largest dischargers, have been granted exemptions under Ministerial Agreements. Under these agreements, the dischargers concerned are allowed to continue their current level of discharge whilst incurring payments that are significantly less than what would apply in the absence of the agreements.

South Australia has also advised that a further 16 of the State's largest 50 dischargers still exceed acceptance limits but currently do not apply trade waste charges because they are either:

- still in the initial stage of the process; or
- have in place interim permits linked to further upgrading of their processes and on-site treatment.

South Australia has stated that past experience suggests that most of the above 16 will be below acceptance limits or paying trade waste charges within two years.

South Australia argues that the current approach is achieving reductions in pollutant load and volume (around 15 percent on average) and salinity (around 5 per cent) among participating firms despite increases in production in some cases. However, in supplementary information provided to the Council, South Australia notes that:

'... in the absence of a comprehensive trade waste charging regime, it must be conceded that potential does exist for some large trade waste dischargers to pay less than the incremental costs they impose on the system. For this reason trade waste charges are a key focus of the current review of sewerage pricing.'

Available information suggests that trade waste dischargers currently pay around $860 000, which is considerably below their estimated total incremental cost of around $3 million.

Property based sewerage charges

In March 2000, South Australia released *Sewerage Pricing in South Australia: A Discussion Paper* to assist public consultation on future sewerage charges. The paper notes that fixed costs dominate total costs and the uncontrollable influence of storm water is a significant determinant of the large amount of spare capacity built into systems.

South Australia also advises that variable costs are largely limited to those associated with treatment and treatment plant augmentation and these are principally determined by pollutant loads rather than wastewater volumes. Consequently, South Australia suggests that for the residential sector and much of the non-residential sector there is limited scope for changing behaviour in response to usage charges. South Australia also suggests that, given metering all customers is not cost effective, any volumetric charge would have to be based on some proxy measure of volume rather than pollutant load.

In regard to whether current arrangements lead to some customers paying below incremental cost and thus receiving a cross-subsidy, South Australia has advised that because costs are largely fixed and are

dominated by infrastructure costs with augmentation generally not being a significant cost driver, incremental costs are likely to be low. SA Water estimates that incremental costs represent less that 5 per cent of total costs and for the average customer are in the order of $10. Further, given the minimum charge of $219 no residential customer would pay less than incremental cost. However, this does not appear to be the case for some trade waste emitting customers (as discussed in the previous section).

In regard to whether some customers are paying above stand alone cost, South Australia states that most customers pay less than individual stand alone cost as alternatives to sewerage do exist but are extremely costly to install and operate. South Australia also notes that in rare instances some customers with exceptionally high property values may have charges that exceed stand alone cost.

In initial advice to the Council, South Australia noted that it was theoretically possible to incorporate several abutting suburbs with relatively high property values as part of a grouping of customers that could be topographically be drained by a common system. South Australia also notes that:

'This would provide potential for a hypothetical stand-alone system that would be sufficiently large to capture some economies of scale, and likely to achieve an average cost lower than that currently charged under the common property based rating system for the Adelaide metropolitan area.

Whilst this analysis is rudimentary, if the Stand-Alone Test is considered appropriate to identify cross-subsidy, the results suggest that there is potential for some small degree of cross-subsidy to exist under property based sewerage rating. Note, however, that this situation is unlikely to result in any efficiency impacts and therefore should not be considered a cross-subsidy in terms of the COAG obligations.'

In subsequent advice South Australia strongly disputes the validity of using this type of combinatorial stand alone cost test as a basis for establishing cross-subsidies stating that *'… this concept of cross-subsidy is an extraordinarily artificial one'*. South Australia further states that:

'The meaningfulness of this version of the Stand Alone Tests in all circumstances is moot. By definition, if an actual on the ground water or sewerage system recovers no more than total stand alone costs (including an appropriate rate of return on assets) and employs differential access charges, the class of customers which pays above average charges might be said to be cross subsidising others if the customers base were large enough to envisage two (or more) hypothetical systems with sufficient economies of scale replacing the one system actually in existence. This is close to an arithmetic truism rather than a compelling basis for abandoning or restricting an otherwise preferred system of differential access for the actual water or sewerage system in place.'

Property based water charges

In relation to the incremental cost part of the test for cross-subsidies (defined above), South Australia has advised that under the current pricing arrangements, taking account of access charges, two-tiered water prices and free water allowances (for commercial customers), no customer in South Australia pays less than 91c/kL on average. South Australia also notes that this is more than the long run marginal cost for the vast majority of systems. In addition, for those few small and remote systems where this may not necessarily be the case, a substantial country CSO is provided that more than compensates for any shortfall compared to long run marginal cost.

In regard to the stand alone cost part of the test for cross-subsidies (defined above), South Australia states that most commercial users are not grouped together geographically. The exception to this is the Adelaide central business district where a large number of high value commercial properties are grouped together. The combination of high property values and the potential scale economies associated with providing services to these customers as a group provides (as South Australia notes) the potential for a lower combinatorial stand alone cost than their total charges and hence a cross-subsidy. However, as with sewerage charges South Australia disputes the validity of this type of analysis.

Free water allowances

Supplementary information provided to the Council, South Australia indicated that, in its view, *'current water allowances do not provide correct incentives and do create some perverse outcomes.'* As a result of this South Australia intends to give serious consideration to not including water allowances in future pricing arrangements irrespective of any assessment of cross-subsidy. However, the Council has not been provided with a firm government commitment on when, or even if, free water allowances will be removed from commercial customers.

Discussion

Trade waste charges

The Council notes that South Australia has in place a selective, negotiated trade waste process targeting the State's largest dischargers. However, information provided by South Australia suggests that current arrangements are insufficient to discourage inefficient service use by trade waste dischargers (especially over the short to medium term) and are not consistent with COAG commitments. While the current system is achieving reductions in waste emissions among those customers participating in the program, the Council is concerned that a number of very significant exemptions have been granted and that the current

system leads to insufficient incentives for businesses to minimise their waste discharge.

The Council suggests that, if the aim of these exemptions is to provide government assistance, then the water reforms allow for through a transparent CSO. The Council also notes that an important aim of the COAG framework is to achieve efficient service use through appropriate pricing signals. Information provided by South Australia suggests that under current arrangements some trade waste dischargers may pay less than the incremental cost of the services they receive, which provides an insufficient incentive to minimise trade waste discharge. Current pricing arrangements for trade waste dischargers are also leading to non transparent cross-subsidies which are not consistent with clause 3(a) of the agreed COAG framework. For example, current total revenue from trade waste dischargers is more than $2 million below estimated incremental cost.

The Council is also concerned that, under current arrangements where a firm pays a trade waste charge, no charge is levied for waste discharged below the acceptance limit. Providing these services essentially free of charge is not consistent with the principles of full cost recovery or consumption based pricing agreed to under the COAG framework. South Australia's March 2000 discussion paper on sewerage pricing notes that the combination of property values (for services below acceptance limits) and a trade waste charge may result in some customers paying very high charges. The Council suggests that South Australia's concerns highlight the limitations of using property values as a mechanism for charging for water and sewage services.

The Council accepts that the current trade waste system has achieved reductions in emissions by some dischargers and acknowledges that a targeted approach may be appropriate given advice that the largest 50-60 dischargers account for around 90 per cent of trade waste. However, the Council is also of the view that the limitations identified above undermine the effectiveness of the current system. The Council understands that South Australia is giving consideration to a revised trade waste regime and that it may be included as part of a reform proposal to be considered by Cabinet soon after 1 July 2000. However, the Council has received no firm Government commitment that the existing scheme will be revised or any advice on what a revised regime would entail or when it would be implemented.

Property based charges

In assessing pricing arrangements in South Australia and other jurisdictions, the Council has, among other things, endeavoured to establish the likelihood of any cross-subsidies and their potential significance. In doing so, the Council has looked at the potential for

significant groups of customers to pay less than incremental cost or greater than the stand alone cost of the services they receive.

Where the potential for cross-subsidies is identified, the Council has looked for the cross-subsidy to be transparently reported or mechanisms put in place (such as independent regulation) to ensure that the issue is addressed in an ongoing and transparent fashion. Where inconsistent with efficient and effective service provision and use, the Council has looked for the cross-subsidy to ideally be eliminated or the potential for any distortionary effects minimised.

SA Water provides water and sewerage services to customers across the State. Overall, SA Water does not appear to earn monopoly returns however, information provided by the State suggests a potential for some areas with relatively high property values to pay sewerage and commercial water charges greater than the stand alone cost of the services they receive. South Australia disputes the validity of the analysis on which the above finding is based. However, the lack of transparency in current arrangements makes a definitive answer on this issue virtually impossible.

The use of property values by other jurisdictions in the past has led to significant cross-subsidies. In addition, property based charges do not reflect costs, although the Council does accept that property based charges may not significantly distort efficient outcomes where property values accurately reflect willingness to pay. However, as stated in South Australia's March 2000 sewerage pricing discussion paper, the link between property values and income streams is 'not necessarily apparent'. The Council also notes that commercial water users accounted for 5 per cent per cent of total water use but contributed around 10 per cent of total water revenues (Government of South Australia, SA Water 1999).

South Australia states that efficiency effects are unlikely from any cross-subsidy identified by sub-grouping customers because of factors such as compulsory access charges and very inelastic demand. South Australia further states that cross-subsidies are relevant to COAG obligations only where they have efficiency implications.

The Council disagrees with South Australia's view that only those cross-subsidies that have efficiency implications are relevant to COAG commitments. The COAG reform framework does note the desirability of removing cross-subsidies where they are not consistent with efficient and effective, service use and provision. However, clause 3(a)(i) of the agreed framework also states that:

'Where cross-subsidies *continue to exist they should be made transparent.'*

This reference to transparency is not predicated on an assessment of efficiency. Thus, the Council's view is that to meet COAG commitments

and encourage efficient, effective and accountable service provision all significant cross-subsidies should be transparently reported. Transparency is particularly important in prices set by monopoly providers of essential services such as water and sewerage where there is significant scope for charging high prices.

In addition, the Council also notes that full cost recovery commitments made by jurisdictions under clause 3(a)(i) and clarified through the COAG pricing Guidelines require jurisdictions to set prices between a band of prices that closely approximates that provided by incremental and standalone cost. Thus, even if any property based charges above stand alone cost are not considered cross-subsidies, they are still not consistent with COAG commitments.

Generally, the absence of transparency in current South Australian arrangements makes it virtually impossible to clearly establish the extent of pricing outside incremental or stand alone cost. The Council's concerns regarding the lack of transparency in current arrangements and thus compliance with clause 3(a)(i) of the COAG framework could be addressed by a range of measures including introducing some form of independent prices oversight. This would provide for ongoing transparent consideration of any cross-subsidies arising from current arrangements and would significantly alleviate the Council's concerns regarding the potential implications of using property values in sewerage charges.

Independent price regulation (based on either a recommendatory or deterministic process) would also be a significant step towards meeting third tranche institutional separation commitments under clause 6 of the COAG framework.

The Council notes South Australia has consulted publicly on water and sewerage prices and may introduce independent regulation in the future. However, no definite Government position has yet been provided.

Free water allowances

With no price signal attached to the water, significant free water allowances dilute incentives to use water economically and can contribute to over consumption and potentially significant resource misallocations. The Council, therefore, considers that significant free water allowances undermine the principle of consumption based pricing agreed to by jurisdictions under clause 3(a)(i) of the COAG water framework. In addition, free water allowances provide potential for non transparent cross-subsidies, which are also not consistent with clause 3(a)(i).

It would appear that current South Australian arrangements are leading to signficant free water allowances. For example a $200 000 commercial property would receive a free water allowance of around 486kL. This is more than double average and median household consumption (WSAA

1999). Further, South Australia concedes that free water allowances can lead to perverse outcomes but the South Australia Government is still to formally commit to eliminating allowances, let alone to specify when or how this will be achieved.

Assessment

It is now 12 months since the Council noted that it was not satisfied that COAG commitments had been met in relation to water and sewerage pricing. South Australia is still not in a position to advise the Council on when, how or even if its concerns will be addressed. However, acknowledging the progress achieved by South Australia overall, and advice at officer level that the Council's concerns may be addressed shortly, the Council is reluctant to recommend a reduction in NCP payments.

Therefore, given the above, the Council considers that the appropriate recommendation is that 5 per cent of the NCP payments due to South Australia for the year 2000-01 should be suspended until 30 September 2000. By 30 September 2000, the Council will complete a further assessment. It will recommend that the above suspension be lifted by this time if the South Australian Government announces an acceptable way forward on both water and sewerage pricing. However, should an acceptable path not be identified, the Council will recommend that the suspended payments be converted to a permanent reduction from the State's NCP payments for 2000-01.

Outstanding issue: bulk water charges

SA Water is a vertically integrated service provider. At the time of the second tranche assessment, the Council was advised that bulk water charging arrangements were yet to be determined. The Council was also advised that a process for identifying regional charges was underway and that an internal trial of bulk water pricing would be undertaken over 1999-00 with a view to finalising the pricing structure in 2000-01.

Consequently, while the Council was not satisfied that South Australia had met it second tranche commitments in regard to volumetric pricing of bulk water services, it acknowledged that a process was in place that would see the commitment met in a timely way. Therefore, the Council agreed to revisit this matter as part of the June 2000 supplementary assessment.

Developments since December 1999

South Australia has advised that SA Water has trialed bulk water pricing during 1999-00 and has now refined a bulk water pricing framework that will allow pricing of bulk water purchases by internal business units. The framework takes account of variations in the cost structures of various

supply systems and provides for pricing based on both a fixed and usage component. Implementation of the framework can now take place in 2000-01 to allow reporting of bulk water purchases at the business unit level.

The Council understands that a significant input to this framework was a consultancy project that established estimates of the cost of providing bulk water to 18 water infrastructure zones. The methodology adopted by the consultants included identifying the boundaries of each zone with the primary considerations in this process being differences in the price of the water delivered, the conditions, availability and source of supply, and quality of water available. The consultancy also allocated operating costs and capital costs (depreciation and a return on capital) across zones as an interim step in identifying the net present value of the maximum allowable revenue that can be earned in each zone for a 20 year period and ultimately an average two-tier effective cost of delivery per megalitre for each zone.

The consultant's report states that the calculations undertaken represent a first step in obtaining a clearer picture of the full cost of delivery of bulk water to a number of geographic areas in South Australia. The outcomes will be improved by using better and more complete data as a basis for forecasting as they become available over time, and extra degrees of sophistication are introduced into product differentiation and pricing.

Assessment

The evidence provided by South Australia suggests that sound progress is being made towards fully implementing a bulk water costing and charging system consistent with COAG commitments. The Council will continue to monitor progress on this matter and look for evidence that SA Water has effective, volumetrically based, bulk water charging arrangements in operation when it undertakes its third tranche assessment prior to 1 July 2001.

Tasmania

REFORM COMMITMENT: COST REFORM AND PRICING

Outstanding issue: two-part tariffs where cost effective

The Council's second tranche assessment noted the progress achieved by Tasmania in relation to cost and price reform. However, the Council also expressed significant concern regarding the level of progress in introducing two-part tariffs where cost effective.

Under the agreed COAG framework two-part tariffs were to be implemented by the end of 1998. By mid-1999, two-part tariffs had only been applied to 3 of Tasmania's 28 local government water providers. No

advice could be provided as to whether tariff reform was cost effective for the remaining providers and, if so, when it would be implemented.

The Council decided to defer any reduction in NCP payments given that Tasmania had committed to a process for addressing the Council's concerns within a reasonable time, the progress achieved overall and the extenuating circumstances faced by the State (including the discontinued local government amalgamation program). Therefore, consistent with the timetable provided by Tasmania, the Council agreed to:

- review progress in December 1999 to ensure that all reviews of the cost effectiveness of two-part tariffs had been completed and an implementation timetable established; and

- review progress against this timetable prior to July 2000 and as part of the third tranche assessment.

The Council's December 1999 supplementary assessment noted that the timetable provided by Tasmania meant that two-part tariffs would be applied to 19 of the 90 water supply schemes administered by local government providers around the State. While this result meant that two-part tariffs would only be applied to a small proportion of the State's water supply schemes, the Council concluded that, as this result had been derived from a rigorous cost effectiveness assessment process, it was consistent with COAG commitments.[26]

In reviewing the timetable provided by Tasmania, the Council noted that implementation for all providers would be completed by 2001-02 with one exception, New Norfolk, where implementation was scheduled for 2004-05. In regard to the New Norfolk scheme, the Council noted that a strong justification would need to be provided for such a significant delay in implementing a commitment originally due by the end of 1998.

In providing its assessment, the Council also noted that, although substantial progress had been made, the reform commitment had still to be met in full. The Council therefore undertook to review progress against Tasmania's implementation timetable prior to July 2000. The Council also stated that the composition of these tariffs would be considered at this time.

[26] A detailed discussion of the process used by Tasmania to assess the cost effectiveness of two-part tariffs is provided in the Council's December 1999 supplementary assessment.

Developments since December 1999

Progress with implementing two-part tariffs where cost effective

Tasmania has provided information on the six schemes scheduled to implement two-part tariffs by 1 July 2000 (See Table 7.3).

The Council has been advised that the Northern Midlands Council (NMC) has recently undertaken a scoping study for the Cressy scheme that estimates costs for the provision of water treatment. NMC or the community has not considered the study. Given the extent of funds required for water treatment, it is unlikely that the project will proceed in the near future without substantial Government assistance. The pricing structure provided for the Cressy scheme in Table 7.3 is based on the existing system with revenue generated covering the existing chlorinated supply.

A free water allowance of 200 kL currently applies but this will be eliminated under the proposed new pricing structure. The new pricing structure will also see the elimination of a service charge based on property values. The proposed pricing structure will be considered by the NMC on 13 June.

Table 7.3: Local Governments Implementing Two-Part Tariffs from 1 July 2000

Scheme	Administering Council	Proposed tariff		Free water allowance
		Fixed component	Variable component	
Cressy	Northern Midlands Council	$130.00 p.a.	37.5 cents/kilolitre	No
Evandale and Longford-Perth	Northern Midlands Council	1 July 2000: $110.00 p.a. 1 July 2001: $130.00 p.a. 1 July 2002: $150.00 p.a.	1 July 2000: 37.5 cents/kilolitre 1 July 2001: 50 cents/kilolitre 1 July 2002: 75 cents/kilolitre	No
Deloraine	Meander Valley Council	Between $140-$160 p.a.	70 cents/kilolitre	No
Kempton	Southern Midlands Council	to be advised	to be advised	Possibly
Sorell	Sorell Council	$152 p.a.	55 cents/kilolitre	No

The Tasmanian Government stated that major water treatment works are planned for water supplies at Evandale and Longford-Perth. The works are to be constructed in two stages with a State Government grant ($500 000) and local government funding for Stage 1. Stage 1 will commence on 1 July 2000, Stage 2 on 1 July 2001 and treated water will be available on 1 July 2002. It is proposed that water prices will be increased to coincide with the construction phases of the water treatment works.

The new tariff structure (see Table 7.3) will be considered by the NMC on 13 June. The Council has been advised however, that the costs and revenue provided by the NMC for the new water treatment works are estimates only and that a 20 year financial model is being developed to provide detailed figures.

As with the Cressy scheme, the current free water allowance of 200 kL will be eliminated under the proposed new pricing structure. The property value based service charge will also be removed.

The new Deloraine water supply scheme will not come on line until 1 January 2001 rather than 1 July 2000. Tasmania noted that it is a requirement of the new scheme that it operate on a two-part tariff basis, and that an interim two-part charge will be put in place for the old scheme until 2001.

Tasmania advised the Council that initial modelling work has been done on the determination of full cost recovery levels and work has been undertaken with the Hunter Water Authority on funding of a new water treatment plant and associated pricing issues.

A number of issues need to be resolved before settling on the appropriate composition of the two-part tariff. These issues include:

- the current valuation of water assets;
- financing of a new water treatment plant;
- delays in building a new treatment plant (to be commissioned in January 2001); and
- the need to consider the pricing of untreated as well as treated water.

The tariff to be applied will be finalised at the Meander Valley Council 2000-01 budget meeting on 11 July 2000. Table 7.3 provides an indicative tariff structure. The Council understands that under the new charging arrangements the current free water allowance of almost 300 kL will be eliminated.

The Southern Midlands Council has confirmed its intention to implement two-part tariffs for the Kempton scheme commencing on 1 July 2000. As

at June 2000, the structure of the tariff had not been established. However, Tasmania did note that it would be based on guidelines developed by GPOC. The following assumptions have been made:

- an allowance for a 10 per cent reduction in demand;
- the calculation of the volumetric component is intended to recover 20 per cent of required revenue;
- the calculation of the fixed component will be based on the residual;
- the approach to allocating the fixed component is yet to be finalised, with the Southern Midlands Council considering three options but yet to adopt a preferred option;
- incidence analysis – various scenarios have been modelled; and
- transition arrangements are to be confirmed.

Tasmania also notes that the finalised structure may include a free water allowance.

In regard to the Sorell scheme, the Sorell Council has endorsed the introduction of two-part pricing from 1 July 2000 and has approved the tariff structure shown in Table 7.3. Tasmania also notes that, over the past 6 months, the Sorell Council has been reading water meters and informing consumers about the amount of water used and that two-part pricing will be introduced on 1 July 2000.

The Council has been advised that additional information acquired by the NMC now suggest that implementation of two-part tariffs to the Ross scheme (originally due by 2001-02) is no longer cost effective. Factors driving the revised position were the availability of actual rather than estimated consumption figures, advice from Hunter Water Corporation suggesting a significant increase in capital works is appropriate, and revised operations and maintenance costs.

Tasmania has confirmed the validity of the NMC's recommendation and noted that the Ross scheme was below the 1000 connections threshold adopted by the GPOC model. Consequently, Tasmania has recommended that the scheme be removed from the implementation timetable. However, both Tasmania and the NMC noted that should a decision be made to supply treated water to the township of Ross then implementation of two-part tariffs is highly likely to be cost effective. Tasmania also noted that it would expect implementation if this decision were made.

Tasmania has also provided advice that the Derwent Valley Council has decided to move forward the application of two-part tariffs to the New Norfolk scheme from 2004-05 to 2002-03. However, Derwent Valley Council also states that implementation will occur provided that no more

additional calls are made on its capital works program. The Derwent Valley Council has recently discovered that 1000 meters will need to be replaced to enable implementation.

Finally, the Brighton, Devonport, St Helens, Smithton and Stanley schemes already applied two-part tariffs. However, two of these (Smithton and Stanley) include an annual 50kL free water allowance. In regard to this allowance Tasmania noted that the Circular Head Council (which is responsible for both schemes) reads meters four times a year and issues accounts to customers once the allowance is exceeded. The number of accounts issued for the last three quarters are shown below.

Reference period	Accounts Issued (Number)
October	400-500
February	1100-1200
June	1800-1900

Tasmania states that, given the total number of customers for both schemes is 2021, the above data suggest that customers face volumetric costs.

Community service objectives

The second tranche assessment noted that the Council did not have sufficient information on CSOs provided by local governments in relation to water and sewerage services. However, the Council also noted that the State and local governments had undertaken to work co-operatively to develop an appropriate CSO framework.

Tasmania has provided the Council with a copy of *Community Service Obligation Policy and Guidelines for Local Government* (the Guidelines). The Council understands that the Guidelines have been endorsed by the Premier and will be circulated to local governments shortly.

The Guidelines state that their main objectives are to:

- *'ensure that a Council's social and other objectives are achieved without impacting on the commercial performance of its significant business activities; and*

- *improve the transparency, equity and efficiency of CSO service delivery.'* (p.2)

The Guidelines provide advice on how to most appropriately identify, cost and fund CSOs. In establishing whether a CSO exists, the Guidelines note that the following factors should be taken into account:

- the function, service or concession provided, allowed or performed must arise as a direct result of a direction by Council; and

- the function, service or concession provided, allowed or performed would not be undertaken if the significant business activity were a business in the private sector operating in accordance with sound commercial practice.

In regard to costing CSOs, avoidable cost is recommended as a preferred approach but other methods such as revenue forgone, fully distributed cost, marginal cost and stand alone cost may be appropriate in some circumstances. The Guidelines advocate the use of contracting to clearly specify the local government's expectations, include performance indicators in contracts to enable regular monitoring, and review CSOs annually.

Finally in regard to implementation, the Guidelines state that:

'Council must identify existing CSOs and establish costing and funding, reporting and contracting principles of this policy in sufficient time to demonstrate adequate compliance with this NCP reform commitment prior to the third tranche assessment to be undertaken by the NCC in June 2001.

Councils are required to develop a programme for identification and review of CSOs and provide sufficient evidence to demonstrate ongoing compliance with this NCP reform commitment.'(p6)

Assessment

Progress with implementing two-part tariffs where cost effective

The Council notes that, although well beyond the agreed deadline, the State and relevant local governments are continuing to demonstrate a commitment to achieve appropriate reform as soon as practicable. The Council notes that local governments have completed assessments of cost effectiveness, committed to definite and timely implementation deadlines and have demonstrated a genuine commitment to meet implementation deadlines as they arise.

The Council supports the removal of free water allowances from new charging arrangements for the Cressy, Evandale Longford-Perth, Deloraine and Sorell schemes. It also supports removal of the service charge based on property values by Cressy, Evandale and Longford-Perth, thus eliminating a potential source of non transparent cross-subsidies which are not consistent with COAG commitments.

The Council is concerned however, over the possible inclusion of a free water allowance for the Kempton scheme. The Council's view is that free water allowances are not consistent with COAG commitments in that they

encourage over use, provide potential for non-transparent cross-subsidies and are not consistent with the principles of consumption-based pricing.

The information provided by Tasmania suggesting that most customers of the Smithton and Stanley schemes face a volumetric charge is noted by the Council. The Council also notes that a 50kL allowance is low relative to those granted in some other jurisdictions. However, the presence of free water allowances creates a disincentive to use water economically and works against the principle of consumption-based pricing. The Council will revisit this matter as part of its third tranche assessment.

The Council endorses Tasmania's decision to remove the Ross scheme from the implementation timetable.[27] However, the Council will look for the timely implementation of two-part tariffs should a decision be made to provide treated water to the Ross township if this proves cost effective.

The Council also welcomes the decision by the Derwent Valley Council to bring implementation forward to 2002-03,[28] although it notes this decision is subject to there being no additional calls on Derwent Valley's capital works program. A significant public benefit justification would need to be provided to justify any delay beyond 2002-03.

In summary, given that two-part tariffs are still to be implemented where cost effective and that some schemes incorporate free water allowances the Council is not satisfied that second tranche pricing commitments have been met. However, as the State and local governments have demonstrated a continuing commitment to timely reform the Council does not recommend any reduction/suspension of NCP payments. That said, evidence of continued progress will be a significant matter for the Council when it undertakes its third tranche assessment. Strong justification will be needed for any slippages in the implementation timetable provided by Tasmania in December 1999. The Council will also revisit the use of free water allowances and property values by local governments as part of its third tranche assessment.

Community service obligations

The Council supports the CSO Guidelines prepared by Tasmania. As noted by the Guidelines:

'NCP does not preclude Governments from administering subsidies and Government businesses are able to set prices below cost on certain activities where there is a strong public interest in doing so. However, where prices are set below the efficient level it is essential that governing bodies are

[27] A revised timetable is provided as Attachment 3.

[28] A revised timetable is provided as Attachment 3.

aware of the full cost of the activity and can continually monitor and review its delivery.'(p2)

The Council's aim in reviewing CSO arrangements is to ensure that they do not undermine the objectives of the agreed reform framework. In doing so, the Council looks for well defined CSOs that facilitate achieving social outcomes as efficiently and effectively as possible and that the cost of achieving these outcomes is accurately and transparently reported to the community.

The Council's view is that, if fully implemented, the Guidelines should lead to significant improvements in the transparency and provision of CSOs among local government water businesses in Tasmania. The Council is satisfied that second tranche commitments in regard to CSOs have now been met but will look for evidence of implementation consistent with section nine of the Guidelines when it undertakes its third tranche assessment.

REFORM COMMITMENT: INSTITUTIONAL REFORM

Outstanding issue, June 1999

In the second tranche assessment report, the Council noted that the lack of separation between water management standard setting, regulatory enforcement and service provision meant that Tasmania's then current institutional arrangements were not consistent with the State's COAG commitments.

The Council considered that the measures proposed by the Water Management Bill were sufficient to meet second tranche institutional separation commitments. However, the Council recommended that it revisit this issue be revisited in June 2000 to ensure that appropriate arrangements are in place.

Developments since June 1999

Water Management Act 1999

The (TAS) Water Management Act 1999 (the Act) received Royal Assent on 27 October 1999 and was proclaimed on 1 January 2000. The Act provides for the management of Tasmania's water resources.

Relevant to this assessment, the Act provides for the Minister (currently the Minister for Primary Industries, Water and Environment) to manage the water resources of Tasmania, to develop and co-ordinate policies relating to the sustainable use and development of water resources and to allocate available water (s 8).

Part 4 of the Act provides for the Minister to determine water management plans (WMP) that include an assessment of how much and when water is needed by ecosystems and an assessment of the likely detrimental effects on ecosystems and water quality arising from taking water. Division 4 provides that the Minister may order that a water entity (for example, a government business enterprise, council or hydroelectric corporation) is responsible for implementing the plan subject to reporting requirements.

Part 8 provides for the construction of dams and relevantly provides that applications to construct or modify dams are made to the Assessment Committee for Dam Construction. Members of the Committee include ministerial appointments (3), a local government representative (1) and industry representatives (2). Information may be requested concerning water resources of hydrology, dam safety, environmental management and conservation or protection of flora, fauna and cultural heritage.

Rivers and Water Supply Commission Act 1999

The *Rivers and Water Supply Commission Act 1999* (RWSC Act), proclaimed on 1 January 2000, establishes the Commission as a government business enterprise (GBE) with responsibility for the commercial management of government water schemes.

Tasmanian Annual Report for the year ended December 1999

Tasmania's Annual Report on NCP progress for the year ended December 1999 (the annual report) notes that, with the passage of the RWSC Act:

- RWSC has no natural resource management functions other than implementing WMPs and to meet licence conditions; and
- the Department of Primary Industries, Water and the Environment (DPWIE) has no role in service delivery.

In respect of efficient delivery of water services, the Department of Treasury and Finance (DTF) monitors the performance of GBEs. Annual reports of GBEs include a statement of corporate intent detailing core business, major undertakings, CSOs, strategic directions and business performance targets.

Tasmania states that through the strategic and operational planning requirements local governments are being required to incorporate efficient operating principles for water supply. This includes local governments being required to make operational plans publicly available prior to being considered for resolution.

Other information

At a meeting between the Council Secretariat and Tasmanian officials, the Council was advised that the Board of RWSC comprises four members including one government member. The Treasurer and Minister are shareholders in RWSC.

Assessment

In the second tranche assessment, the Council foreshadowed that, provided the Water Management Bill was passed, second tranche commitments for institutional separation would be met. Given the Water Management Act is now proclaimed, the Council is satisfied that second tranche reform commitments in relation to institutional reform have been met.

The Council will again consider Tasmania's institutional arrangements in the third tranche assessment. For that assessment, the Council will look for further information in respect of the arrangements, including:

- the nature of Ministerial arrangements given that the Minister is the shareholding Minister for the service provider (RWSC) and the regulator (the Minister or the Department of Primary Industries, Water and the Environment);

- the nature of institutional arrangements for local government service providers. In particular, the Council will examine the arrangements for regulation of service standards for local government providers such as drinking water quality and health, arrangements with customers and complaints mechanisms, and any relevant enforcement matters. Where the local government sets both standards of service and owns and runs the service provider, the Council will look to, at a very minimum, rigorous ring-fencing of functions and clear transparency in decision making;

- the nature of institutional arrangements for other service providers (such as RWSC and the bulk water service providers) including arrangements for the regulation of service provision and enforcement of those standards; and

- the ongoing progress of institutional arrangements for pricing outlined in the second tranche assessment.

The Council notes that assessment of progress with these matters will focus on mechanisms or arrangements to ensure that potential and actual conflicts of interest are addressed to promote the best outcomes from institutional reform.

REFORM COMMITMENT: ALLOCATION AND TRADING

Outstanding issue, June 1999; establishing an appropriate framework for water allocation and trade.

In the second tranche assessment, the Council noted that arrangements in the then Water Management Bill provided a system that recognised both consumptive and environmental water needs. The Council also stated that the process for identifying environmental needs, based in part on the provisions of the Bill, was consistent with reform commitments. Finally, the Council was satisfied that the Bill removed regulatory restrictions on trade, promoted effective water use and provided adequate safeguards to ensure that trades are sustainable. The Council foreshadowed that it would undertake a supplementary assessment in June 2000 to ensure that the Bill was passed by the Tasmanian Parliament.

This part of the assessment provides a brief summary of the *Water Management Act 1999*, which commenced on 1 January 2000. Given the comprehensive assessment of proposed arrangements in the second tranche assessment, this report does not repeat all the matters canvassed at that time. In addition, the Council has not sought to raise additional matters with Tasmania, given the views expressed in the second tranche assessment. However, relevant amendments resulting from Parliament's consideration are considered.

Developments since June 1999

Water Management Act 1999

Rights in water

Part 3 of the Act vests all rights to the taking of water in the Crown. Riparian rights are largely preserved in Part 5. Part 5 also provides for the taking of ground and surface water for any purpose. These rights are subject to licensing provisions of the WMP and the taking of water is not permitted if it would cause material or serious environmental harm.

Water management plans

Part 4 of the Act provides for the preparation of WMPs which include an assessment of the quantity of water needed by ecosystems, the time water is needed, the likely detrimental effects of taking water and the effect of the WMP on water quality. In addition, a WMP may provide for the allocation and use of water, the licensing of persons taking water and the transfer of water allocations.

When preparing a WMP, the Minister is required to have regard to matters including relevant environmental agreements and the objectives of the Act; these objectives frame water management around economic, ecological and community needs. In addition, Schedule 1 of the Act sets

out the objectives of the resource management and planning system. The Minister, Secretary, relevant water entity or other person are obliged to perform functions or exercise powers so that these objectives are furthered. Community consultation is provided for in the WMP and licensing process.

A review of the entire WMPs must take place at least every 5 years. In addition, each year (and at other required times) a water entity must provide a written report to the Minister on its administration of the WMP.

Water allocations and licences

S 54(1) of the Act states: *'A person must not, without a licence, take – water from a watercourse, lake or well; or surface water'*. Part 6 of the Act provides for the licensing and allocation of water. Licences (Division 1) are not required where water is taken: under Part 5; where the person has been granted an exemption; for temporary (three month) water allocations; from a dam or works if the water was previously taken in accordance with the Act. Licences are subject to any WMP and any condition specified. A licence specifies the water resource and is endorsed with a water allocation. It may provide for matters such as surety and conditions in which water may be taken. The Minister may determine that a water allocation of a licence may be taken from or used on only a specified area of land or only for a specified purpose. A licence is personal property and is alienable in accordance with the Act.

A water allocation (Division 2) may be fixed by specifying the volume of water that may be taken and used, by reference to the purpose for which the water may be taken or in any other manner. Water must be allocated in accordance with any relevant WMP or (where there is no WMP) so as to give effect to the objectives of the Act. A water allocation (or component) of a licence may be transferred if the licence so provides and the Minister approves. Allocations may be reduced to give effect to a WMP and there is an entitlement for compensation. In addition, there is a provision (Division 3) for restrictions on the taking of water where, for example, it is adversely affecting water quality or having a serious effect on another water system.

Division 6 provides for special licences where a body corporate intends to use water for electricity generation. These licences have paramount surety against all other rights except for: riparian rights; local government rights; the *essential needs of ecosystems dependent on the relevant water resource*; certain rights conferred under the previous legislation. A WMP cannot affect special licence rights unless:

- the special licensee agrees; or
- an Advisory Committee of Ministers recommends the variation.

There is an entitlement to compensation. Special licences cannot be suspended or revoked except with the approval of both Houses of Parliament. Special conditions also apply for renewal and transfer of special licences

Trade in water licences and allocations

Division 4 provides for the temporary or permanent transfer of water licences and allocations. A transferee who does not hold a water licence must apply for a licence when applying for the transfer of an allocation. A transfer application must be approved where it meets certain conditions, including that it is consistent with a WMP and the objectives of the Act. Conditions may be imposed including a reduction in the water allocation or variation of licence condition. Consent to the transfer by a person holding a financial interest in a licence is required.

An *absolute transfer* is not permitted until three years after the commencement of the Act unless: the transfer is pursuant to the transfer of land with a specified water allocation; (in which case the allocation may only be used on this land); or the proposed transferor has certified in writing that he or she has obtained independent financial advice on the likely effects of the transfer on any business activities dependent on the allocation.

Transitional provisions

The transitional provisions provide for, amongst other matters:

- savings of Hydro-Electric Corporation rights;
- saving for RWSC rights (*commissional water right*) until the rights are replaced by a Part 6 licence. Certain limited rights granted *in fee* are converted to 50 year licences and remain annexed to land. Some other rights are not permitted to be abrogated during a WMP process.

Other matters

The Act provides for a register of licences (s 12) and notification of financial interests (s 61). Part 11 provides for the Minister to affix meters or direct that it be affixed for the purposes of measuring water flows or water levels; a meter may be a licence condition.

Tasmanian Annual Report on NCP progress for the year ended December 1999

In addition to the matters noted above, the annual report provides the following relevant information.

- The transitional arrangements provide that pre-existing legal entitlements will be preserved where they are sustainable and where

DPWIE believes that the majority of current entitlements are sustainable. However, allocations can be varied/reduced to meet environmental requirements; and

- A moratorium on new water licences was imposed in 1995. It principally applied to the taking of water during summer. The moratorium has been lifted on particular water resources only when appropriate flow regimes have been established.

Other information

In a meeting between the Council Secretariat and Tasmanian officials on 30 March 2000, the Secretariat raised the issue of triggers to commence the water planning process and to determine what matters should be included. In later correspondence, Tasmania advised that: *'Obviously, there is a need for Guidelines to determine when a water management plan should be developed, to avoid an ad hoc approach. To this end, we intend to develop a set of principles for Ministerial endorsement to provide for a transparent mechanism to prompt action under s 13 of the Act. We expect that this policy will be finalised during 2000/2001'.*

Tasmania also advised during the meeting that:

- although transitional provisions provided *that commissional water rights* would not be reduced, environmental needs could be met through water restrictions if necessary;

- *relevant environmental agreements* in Part 4 of the Act would include the COAG water reform framework; and

- WMP reviews can be brought forward where environmental monitoring indicated that this is necessary.

Assessment

The Council has previously advised that the new arrangements foreshadowed in the Water Management Act 1999 met COAG reform commitments. The amendments that the Council has been advised of resulting from the consideration of the legislation by the Tasmanian Parliament do not alter the Council's assessment. In this respect, the Council notes the following matters.

- Although the savings provisions for *commissional water rights* mean that they cannot be reduced, officials have advised that environmental needs could be met through water restrictions if necessary. The Council will look for evidence of this mechanism when assessing WMPs prepared by Tasmania;

- Although there are particular restrictions (concerning financial advice) on permanent trades for a transitional period, this will provide for the

community to become familiar with water trading. The restriction is for a fixed period. It does not prohibit permanent trade. In some respects, such as through increasing the information available to persons trading water for the first time, the restriction may result in the long term facilitation of water trading.

The Council therefore remains satisfied that the legislation is broadly consistent with clauses 4 and 5 of the COAG water resources policy. In particular:

- the legislation provides for a system of water entitlements backed by separation of water property rights from land title. Property rights can be specified in a number of ways including surety, volume and source.

- the legislation provides for the needs of the environment to be recognised. The Act's objectives focus in part on sustainable water use to maintain ecological process and genetic diversity for aquatic ecosystems.

- water licences and allocations can be traded, provided that the trade conforms with the relevant WMP or the objects of the Act.

The Act does distinguish between some water rights, which remain linked to land, and others, especially some of those to be determined through the WMP process, which are completely separate from land. The Council has acknowledged that, in systems where there is no development pressure on the resource and the resource is otherwise not stressed, it may be appropriate to retain a less comprehensive licensing system. This is provided that there is a mechanism for review of the resource from time to time and for rights to be *upgraded* where this will result in positive environmental, economic and social outcomes.

The Council acknowledges that many of the arrangements provided for in the new legislation will be dependent on the outcomes of the WMP process. The Council continues to investigate with Tasmania how progress on these plans can be accelerated in a manner consistent with reform commitments. The Council notes that all governments, including Tasmania, must demonstrate substantial progress in implementing agreed and endorsed programs, including, at least, allocations for the environment in all river systems which have been over-allocated or are deemed stressed. The Council will consider the progress of WMPs at the third tranche.

One outstanding matter is the criteria for determining whether a WMP should be commenced and, if so, what matters it should incorporate. Tasmanian officials have undertaken to progress this matter during 2000-01. The Council considers that this is a critical matter, and should be completed as soon as possible and certainly prior to June 2001. The Council will assess the relevant policy/legislative arrangements at this

time. Matters that the Council will focus on include: what circumstances will trigger the WMP process; whether a WMP will provide for the allocation and trading of water; and whether riparian rights and the taking of surface water and groundwater are to be licensed.

Northern Territory

REFORM COMMITMENT: COST REFORM AND PRICING

Outstanding issue: bulk water charging

Under clause 3(c), governments have agreed to ensure that bulk water providers charge on a volumetric basis. The Council's second tranche assessment framework notes that Metropolitan bulk water suppliers must establish internal and external charges to include a volumetric component or two-part tariff with an emphasis on the volumetric component to recover costs and earn a positive real rate of return.

In June 1999, the Council concluded that it did not have sufficient evidence to be satisfied that bulk water and retail activities had been sufficiently ring fenced to facilitate internal and external charges. Additional information provided by the Northern Territory to the Council's December 1999 supplementary assessment noted that, as of 1 July 1999, PAWA's ledger had been restructured on product and service lines. The Northern Territory advised that the new ledger structure permits ring fencing of costs as well as pre and post treatment internal bulk water prices.

In reviewing the new arrangements, the Council noted the substantial progress achieved by the Northern Territory but concluded that second tranche commitments had not been met in full as the new arrangements were still not fully operational. Consequently, the Council concluded that in June 2000 it would look for evidence that:

- an automatic link to depreciation costs relevant to assets used by the bulk water services was established;
- an automatic link to the customer billing system was established to facilitate automatic calculation of unit costs; and
- the significant number of executive, business, retail and infrastructure costs still to be allocated or cross charged had been processed.

Developments since December 1999

On 31 May, the Council was advised that work on the automatic allocation of fixed asset depreciation costs in PAWA's ring fenced accounts for bulk water operations had been completed. However, the Council was also advised that the link between ring fenced bulk water costs and the billing

system to enable automatic calculation of cost per kilolitre had not been completed. The Northern Territory stated that work on this project had been halted pending potential upgrade or replacement of the billing system.

As an alternative, the Northern Territory advised that costs per kilolitre would be established using a spreadsheet external to both the ring fenced accounts and the customer billing system. In relation to unallocated costs the Northern Territory had advised that those costs that had not been cross charged to specific business divisions by the end of the financial year will be automatically allocated across departments.

Assessment

In considering internal bulk water charges, the Council has endeavoured to ensure that appropriate arrangements are in place to ensure that bulk water businesses are effectively ring fenced and that the volumetric and fixed costs associated with bulk water businesses can be readily identified.

The Council is now satisfied that the Northern Territory has the accounting mechanisms in place to facilitate identification monitoring and reporting of the cost of bulk water services in an efficient and transparent way. In regard to the link to the customer billing system initially planned by PAWA, the Council notes that the current arrangements, while not optimal in terms of ease of calculation, are consistent with COAG commitments, as any remaining unallocated costs will be automatically allocated at the end of the financial year. The Council is therefore satisfied that second tranche commitments in regards to bulk water charges have now been met but will revisit this issue as part of its third tranche assessment.

REFORM COMMITMENT: INSTITUTIONAL SEPARATION

Outstanding issue, December 1999

In December 1999, the Council was concerned that PAWA was responsible for setting its own service standards and that regulatory functions remained to be transferred. The Northern Territory advised that a review of legislation was to be completed, with a target date for new arrangements of June 2000, or at the latest August 2000.

Developments since December 1999

Review of Water and Sewerage Legislation

A National Competition Policy Review of Water and Sewerage Legislation[29] (the review) found that PAWA retains regulatory responsibility for matters such as the terms and conditions of supply via by-laws – a role more properly held by government. Other regulatory roles included regulation of plumbing inspection and standard setting and powers to declare a district, sewered area and water supply area. The review concluded that current arrangements *do not implement the essential separation of roles and functions envisaged by the Strategic Framework*.

In addition, the review found that the pricing process was not independent, consultative or transparent.

In broad terms, the review recommended:

- licensing of all service providers by the Utilities Commissioner. The licence would include a duty to supply in specified areas, clarity of performance standards, monitoring by the Commissioner or other relevant agency and Customer Contracts or Charters;
- prices oversight by the Utilities Commissioner;
- regulation of plumbing standards by the Department of Lands, Planning and Environment.

Other information

The Productivity Commission report, *Arrangements for Setting Drinking Water Standards*, noted that while Territory Health Services is responsible for providing public health support and information to PAWA regarding drinking water quality, and both agencies work collaboratively to address water quality issues using the Australian Drinking Water Guidelines, there is no specific water quality specified for drinking water. Nor is there independent audit of PAWA's compliance with the Guidelines.

The Council has requested but has not received formal advice as to whether the Northern Territory Government has accepted the recommendations of the review, or what other course of action is proposed.

[29] Marsden Jacob 2000, NCP review: water and sewerage legislation, March.

Assessment

Proposed reforms

The Council notes the ongoing progress of the Northern Territory in implementing reforms to institutional arrangements. The review provided a clear path forward for the Northern Territory to meet second tranche institutional reform commitments. However, there has been no formal government commitment to implementing the recommended reforms.

The Council strongly supports the conferral of regulation powers, including licensing and price regulation, on an independent authority. Such an arrangement meets not only the letter but also the spirit of the water reform framework. It will provide for ongoing improvements to the water services provided by PAWA and others to Northern Territory communities.

However, given that the proposals have not been introduced, and that the report supports the Council's own view that present arrangements are not consistent with reform commitments, the Council assesses current arrangements as not having met second tranche reform commitments as regards institutional reform.

The Council recognises that the reforms will result in a major overhaul of the way in which water services are provided in the Northern Territory. They may require detailed consideration by the Northern Territory Government in consultation with the community.

As noted previously, the Council considers that water reforms, as a package, offer more benefits to the broad community than any other single measure in the NCP program. Institutional arrangements are integral to the COAG water reform policies. For example, proper institutional arrangements:

- provide scope for more efficient and effective water services driven by consumer needs and not provider convenience;
- contribute to the management of significant public investments, being well in excess of a half billion dollars for PAWA; and
- ensure integrity and transparency in price setting and regulation of health and other water service standards.

In this matter, had legislation been before the Legislative Assembly but not as yet debated or passed by the Assembly, the Council may have accepted that there should be no suspension of NCP payments. This is because strict adherence to timeliness may have prevented proper consideration of the reforms, and resulted in arrangements that were poorly understood and failed to meet the unique needs of the Northern Territory.

The Council flagged with the Northern Territory (in correspondence of 28 April 2000) following advice from the Northern Territory of delays in legislative timing, that provided legislation which addressed institutional reform commitments was tabled by the Government by the end of June 2000, the Council would not recommend a reduction in NCP payments.

Not only is there the failure to have legislation before the Parliament, or even drafted, but in addition the Council has not been provided with advice that the Northern Territory Government has endorsed a clear reform path.

This is the third assessment where the Council has assessed that the Northern Territory has not met institutional reform commitments. Given the failure to make significant further progress on this 1998 commitment, the Council is of the view that a suspension of NCP payments is the only appropriate recommendation.

Amount of suspension of payments recommended

Having regard to all the matters outlined above, the Council considers that an appropriate recommendation is that 2.5 per cent of the NCP payments due to the Northern Territory for the year 2000-01 should be suspended until 31 October 2000.

At 31 October 2000 the Council will undertake a further assessment. In particular the Council will look to legislation for institutional reform consistent with the COAG water resources policy to be introduced into the Northern Territory Legislative Assembly. Should legislation not be before the Assembly, the Council will recommend that the suspended payments be converted to a permanent reduction from the Northern Territory's NCP payments, for 2000-01.

Further supplementary assessment

In addition, the Council recommends a further supplementary assessment in December 2000. For that assessment, the Council notes:

- the Council would expect legislation consistent with COAG commitments to be substantially in force for the Northern Territory to meet its commitments;

- should the legislation not have been presented to the Legislative Assembly, the Council is of the view that an appropriate recommendation would be a further reduction of 2.5 per cent in NCP payments; alternatively

- if the legislation has been presented but not substantially in force, this would constitute an ongoing failure to meet reform commitments:

- if payments are reduced on 31 October 2000, the Council is of the view that an appropriate recommendation would be a suspension of 2.5 per cent of 2000-01 NCP payments for the period 1 January to 30 June 2001.

- if payments were not reduced on 31 October 2000 the Council is of the view that an appropriate recommendation would be that:

  - NCP payments for the year 2000-01 be reduced by 2.5 per cent for the failure to have legislation substantially in force between July and December 2000; and

  - 2.5 per cent of NCP payments for the year 2000-01 be suspended for the period 1 January to 30 June 2001.

Following legislation being substantially in force, the Council will make a recommendation as to what part of the suspended payments, if any, should be paid to the Northern Territory. These recommendations reflect the Council's view that failure to meet this reform commitment should have implications for 5 per cent of the Northern Territory's NCP payments for 2000-01.

Should reforms not be passed by the third tranche assessment, the Council will consider whether a reduction in NCP payments of at least 5 per cent should continue until passage of legislation consistent with COAG water reform commitments.

Other matters

In respect of other matters, the Council notes that it will monitor for the third tranche assessment any response to the Productivity Commission findings that drinking water quality is not regulated in the Northern Territory. A preferred arrangement may be an independent audit of the monitoring of water by PAWA, or some other similar arrangement.

REFORM COMMITMENT: WATER ALLOCATION AND TRADING

Outstanding issue, December 1999

In December 1999, the Council assessed proposed amendments to the (NT) Water Act as separating water property rights and land title in a manner consistent with the water resources policy. The Council was also of the view that the legislation established an appropriate framework for water allocations and trading.

The Council recommended that it revisit the Northern Territory's progress against this commitment in June 2000 to ensure that the legislation had been passed by the Legislative Assembly, and that any amendments were consistent with reform commitments.

Developments since December 1999

The Northern Territory Legislative Assembly passed the Water Amendment Act 2000 on 11 May 2000.

The Council was provided with a copy of the Bill presented to the Assembly. The Bill included some very minor wording changes that did not substantively alter the legislation assessed as meeting reform commitments by the Council in December 1999. The amendments commenced on 6 June 2000.

Assessment

The Council is satisfied that, with the commencement of the Water Amendment Act 2000, the Northern Territory has met its second tranche reform commitments for the establishment of an appropriate framework for water allocation and trade.

Attachment 1: Payments under the Second Tranche of National Competition Policy

NCP payments are dividends paid by the Commonwealth to the States and Territories for reform performance consistent with the obligations in the three inter-governmental NCP Agreements.

For the first three financial years (up to and including 1999-2000), NCP payments comprised two elements: maintenance of the real per capita value of the Financial Assistance Grants and NCP payments. However, from 2000-01, as a result of the change in Commonwealth/State financial arrangements whereby States and Territories are to receive revenue raised through the GST (Goods and Services Tax), only the Competition Payment element will apply. Nonetheless, the States and Territories, as direct recipients of GST revenue, will continue to receive dividends from implementing NCP, through increased GST revenues arising from economic growth.

Maximum NCP payments across all States and Territories under the second tranche are $1.106 billion. The maximum amounts which each jurisdiction could receive, assuming satisfactory reform progress, are set out in Table A1 below. Each State and Territory received maximum NCP payments in 1999-2000.

Table A1: Estimated maximum NCP Payments under the Second Tranche, by Jurisdiction ($m)

State/Territory	1999-2000	2000-2001
New South Wales	210.9	155.9
Victoria	153.2	114.7
Queensland	119.9	86.0
Western Australia	62.3	45.6
South Australia	53.9	36.0
Tasmania	19.0	11.2
ACT	10.9	7.5
Northern Territory	14.6	4.7
Total for year	644.6	461.7

Source: Commonwealth Treasury, June 2000.

Attachment 2: Second Tranche Water Reform Assessment Framework

REFORM COMMITMENT: COST REFORM AND PRICING

Major Urbans and Non-Metropolitan Urbans

Drawing on the advice of the Expert Group and complying with the ARMCANZ full cost recovery guidelines, jurisdictions are to implement full cost recovery.

Water businesses must price between a floor price which allows for the continuing commercial viability of the system and a ceiling price which incorporates asset values and a rate of return but does not include monopoly profits:

- the floor price includes provision for future asset refurbishment or replacement using an annuity approach where service delivery is to be maintained; and

- the ceiling price includes provision for asset consumption and cost of capital calculated using a weighted average cost of capital (WACC).

Within the band, a water business should not recover more than operational, maintenance and administrative costs, externalities, taxes or tax equivalent regimes (TERs), the interest costs on debt, and dividends (if any) set at a level that reflects commercial realities and simulates a competitive market outcome.

The level of revenue should be based on efficient resource pricing and business costs. In determining prices, community service obligations (CSOs), contributed assets, the opening value of assets, externalities including resource management costs, and TERs should be transparent. The deprival value methodology should be used for asset valuation unless a specific circumstance justifies another method.

Jurisdictions must implement consumption based pricing. Two-part tariffs are to be put in place by 1998 where cost effective. Metropolitan bulk water and wastewater suppliers should charge on a volumetric basis.

Jurisdictions are to apply two-part tariffs to surface and groundwater comprising a fixed cost of access component and a volumetric cost component.

Metropolitan bulk water and wastewater suppliers must establish internal and external charges to include a volumetric component or two-

part tariff with an emphasis on the volumetric component to recover costs and earn a positive real rate of return.

Jurisdictions are to remove cross subsidies, with any remaining cross subsidies made transparent (published).

For the purposes of the framework, a cross subsidy exists where a customer pays less than the long run marginal cost and this is being paid for by other customers. An economic measure which looks at cross subsidies outside of a Baumol band, which sets prices between incremental and stand alone cost, is consistent with the COAG objective of achieving economically efficient water usage, pricing and investment outcomes. To achieve the COAG objective, potential cross-subsidies must be made transparent by ensuring the cost of providing water services to customers at less that long run marginal costs is met:

- as a subsidy, a grant or CSO; or
- from a source other than other customer classes.

Where service deliverers are required to provide water services to classes of customers at less than full cost, this must be fully disclosed and, ideally, be paid to the service deliverer as a community service obligation.

All CSOs and subsidies must be clearly defined and transparent. The departure from the general principle of full cost recovery must be explained. The Council will not make its own assessment of the adequacy of the justification of any individual CSO or cross-subsidy but will examine CSOs and cross-subsidies in totality to ensure they do not undermine the overall policy objectives of the strategic framework for the efficient and sustainable reform of the Australian water industry.

Publicly owned supply organisations should aim to earn a real rate of return on the written down replacement cost of assets for urban water and wastewater.

Jurisdictions are to have achieved progress toward a positive real rate of return on assets used in the provision of all urban water supply and wastewater services.

Rural Water Supply and Irrigation Services

Where charges do not currently cover the costs of supplying water to users (excluding private withdrawals of groundwater),[30] jurisdictions are to progressively review charges and costs so that they comply with the principle of full cost recovery with any subsidies made transparent.

Jurisdictions should provide a brief status report, consistent with advice provided to ARMCANZ, on progress towards implementation of pricing and cost recovery principles for rural services.

The Council will assess jurisdictions as having complied with the pricing principles applicable to rural water supply where jurisdictions:

- have achieved full cost recovery; or
- have established a price path to achieve full cost recovery beyond 2001 with transitional CSOs made transparent; or
- for the schemes where full cost recovery is unlikely to be achieved in the long term, that the CSO required to support the scheme is transparent; and
- cross-subsidies have been made transparent.

Jurisdictions are to conduct robust independent appraisal processes to determine economic viability and ecological sustainability prior to investment in new rural schemes, existing schemes and dam construction. Jurisdictions are to assess the impact on the environment of river systems before harvesting water.

Policies and procedures must be in place to robustly demonstrate economic viability and ecological sustainability of new investments in rural schemes prior to development. The economic and environmental assessment of new investment must be opened to public scrutiny.

Jurisdictions must demonstrate a strong economic justification where new investment is subsidised.

---

30 Private withdrawals of groundwater include private providers and small co-operatives who extract water from bores for private use, but does not include large co-operative arrangements (including trusts) that act as wholesalers supplying water as a commercial venture and that are subject to control or directions by government or receive substantial government funding.

Jurisdictions are to devolve operational responsibility for the management of irrigation areas to local bodies subject to appropriate regulatory frameworks.

All impediments to devolution must be removed. Jurisdictions must demonstrate that they are encouraging and supporting devolution of responsibility, including through education and training.

REFORM COMMITMENT: INSTITUTIONAL REFORM

Institutional Role Separation

As far as possible the roles of water resource management, standard setting and regulatory enforcement and service provision should be separated institutionally by 1998.

The Council will look for jurisdictions, at a minimum, to separate service provision from regulation, water resource management and standard setting. Jurisdictions will need to demonstrate adequate separation of roles to minimise conflicts of interest.

Metropolitan service providers must have a commercial focus, whether achieved by contracting out, corporatisation, privatisation etcetera, to maximise efficiency of service delivery.

Incorporate appropriate structural and administrative responses to the CPA obligations, covering legislation review, competitive neutrality, structural reform.

Performance Monitoring and Best Practice

ARMCANZ is to develop further comparisons of interagency performance with service providers seeking best practice.

Jurisdictions have established a national process to extend inter-agency comparisons and benchmarking. Benchmarking systems are to be put in place for the NMU and rural sectors, "WSAA Facts" is to be used for major urbans, and service providers are to participate.

The Council will accept compliance for the three sectors subject to the Productivity Commission confirming consistency with the Report of the Steering Committee on National Performance Monitoring of Government Trading Enterprises, *"Government Trading Enterprises Performance Indicators"* (Red Book). The Productivity Commission has already confirmed the consistency of "WSAA Facts" for the major urbans. The Council recognises the first reports for the NMU and rural sectors are likely to be a rough cut in the initial years.

REFORM COMMITMENT: ALLOCATION AND TRADING

There must be comprehensive systems of water entitlements backed by separation of water property rights from land title and clear specification of entitlements in terms of ownership, volume, reliability, transferability and, if appropriate, quality.

A 'comprehensive' system requires that a system of establishing water allocations which recognises both consumptive and environmental needs should be in place. The system must be applicable to both surface and groundwater.

The legislative and institutional framework to enable the determination of water entitlements and trading of those entitlements should be in place. The framework should also provide a better balance in water resource use including appropriate allocations to the environment as a legitimate user of water in order to enhance/restore the health of rivers. If legislation has not achieved final parliamentary passage, the Council will recognise the progress towards achieving legislative change during its assessment of compliance.

Jurisdictions must develop allocations for the environment in determining allocations of water and should have regard to the relevant work of ARMCANZ and ANZECC.

Best available scientific information should be used and regard had to the inter-temporal and inter-spatial water needs of river systems and groundwater systems. Where river systems are overallocated or deemed stressed, there must be substantial progress by 1998 towards the development of arrangements to provide a better balance in usage and allocations for the environment.

Jurisdictions are to consider environmental contingency allocations, with a review of allocations 5 years after they have been initially determined.

Jurisdictions must demonstrate the establishment of a sustainable balance between the environment and other uses. There must be formal water provisions for surface and groundwater consistent with ARMCANZ/ANZECC *"National Principles for the Provision of Water for Ecosystems"*.

Rights to water must be determined and clearly specified. Dormant rights must be reviewed as part of this process. When issuing new entitlements, jurisdictions must clarify environmental provisions and ensure there is provision for environmental allocations.

For the second tranche, jurisdictions should submit individual implementation programs, outlining a priority list of river systems and

groundwater resources, including all river systems which have been over-allocated, or are deemed to be stressed and detailed implementation actions and dates for allocations and trading to the Council for agreement, and to Senior Officials for endorsement. This list is to be publicly available.

It is noted that for the third tranche, States and Territories will have to demonstrate substantial progress in implementing their agreed and endorsed implementation programs. Progress must include at least allocations to the environment in all river systems which have been over-allocated, or are deemed to be stressed. By the year 2005, allocations and trading must be substantially completed for all river systems and groundwater resources identified in the agreed and endorsed individual implementation programs.

Arrangements for trading in water entitlements must be in place by 1998. Water should be used to maximise its contribution to national income and welfare.

Where cross border trade is possible, trading arrangements must be consistent between jurisdictions and facilitate trade. Where trading across State borders could occur, relevant jurisdictions must jointly review pricing and asset valuation policies to determine whether there is any substantial distortion to interstate trade.

Jurisdictions must establish a framework of trading rules, including developing necessary institutional arrangements from a natural resource management perspective to eliminate conflicts of interest, and remove impediments to trade. The Council will assess the adequacy of trading rules to ensure no impediments. If legislation has not achieved final parliamentary passage, the Council will recognise the progress towards achieving legislative change during its assessment of compliance.

As noted above, for the second tranche, jurisdictions should submit individual implementation programs, outlining a priority list of river systems and groundwater resources and detailed implementation actions and dates for allocations and trading to the Council for agreement, and to Senior Officials for endorsement. This list is to be publicly available.

Cross border trading should be as widespread as possible. Jurisdictions are to develop proposals to further extend interstate trading in water.

REFORM COMMITMENT: ENVIRONMENT AND WATER QUALITY

Jurisdictions must have in place integrated resource management practices, including:

- demonstrated administrative arrangements and decision making processes to ensure an integrated approach to natural resource management and integrated catchment management;
- an integrated catchment management approach to water resource management including consultation with local government and the wider community in individual catchments; and
- consideration of landcare practices to protect rivers with high environmental values.

The Council will examine the programs established by jurisdictions to address areas of inadequacy. Programs would desirably address such areas as government agency co-ordination, community involvement, co-ordinated natural resource planning, legislation framework, information and monitoring systems, linkages to urban and development planning, support to natural resource management programs and landcare practices contributing to protection of rivers of high environmental value.

Support ANZECC and ARMCANZ in developing the National Water Quality Management Strategy (NWQMS), through the adoption of market-based and regulatory measures, water quality monitoring, catchment management policies, town wastewater and sewerage disposal and community consultation and awareness.

Jurisdictions must have finalised development of the NWQMS and initiated activities and measures to give effect to the NWQMS.

REFORM COMMITMENT: PUBLIC CONSULTATION, EDUCATION

Jurisdictions must have consulted on the significant COAG reforms (especially water pricing and cost recovery for urban and rural services, water allocations and trade in water entitlements). Education programs related to the benefits of reform should be developed.

The Council will examine the extent and the methods of public consultation, with particular regard to pricing, allocations and trade. The Council will look for public information and formal education programs, including work with schools, in relation to water use and the benefits of reform.

Attachment 3: Revised Tasmanian Timetable for Implementing Two-Part Tariffs where Cost Effective

Scheme	**Program for implementation of two-part pricing**
Bracknell	Implementation in 2001-02
Cressy	Implementation in 2000-01
Deloraine	Implementation in 2000-01
Evandale	Implementation in 2000-01
Exton	Implementation in 2001-02
George Town	Implementation in 2001-02
Hadspen	Implementation in 2001-02
Hillwood	Implementation in 2001-02
Kempton	Implementation in 2000-01
Launceston	Implementation in 2001-02
Longford/Perth	Implementation in 2000-01
New Norfolk	Implementation in 2002-03
Prospect Vale	Implementation in 2001-02
Ross	Revised information suggest implementation no longer cost effective
Scottsdale	Implementation in 2001-02
Sorell	Implementation in 2000-01
Westbury-Carrick	Implementation in 2001-02
West Tamar	Implementation in 2001-02
Wynard-Somerset	Implementation in 2001-02

References

Council of Australian Governments 1994, *Water Reform Framework*, February.

Department of Land and Water Conservation (NSW) 1999, *A proposal for updated and consolidated water management legislation for New South Wales*, December.

Department of Natural Resources (Queensland) 1999, *Water Allocation and Management Plan (Fitzroy Basin)*, December.

Department of Natural Resources (Queensland) 2000a, *Institutional Reform of State Water Projects*, March.

Department of Natural Resources (Queensland) 2000b, *Draft Water Management Plan (Boyne River Basin)*, May.

Department of Natural Resources (Queensland) 2000c, *Draft Water Management Plan (Moonie River Catchment)*, May.

Government of South Australia, SA Water, 2000, *Sewerage Pricing in South Australia*, March.

Government of South Australia, SA Water, 1999, *Water Pricing in South Australia: A discussion paper*, December.

Government of Tasmania 2000, *Tasmanian Annual Report for the year ended December 1999*, May.

Industry Commission (IC) 1997, *Community Service Obligations: Policies and Practices of Australian Governments*, February.

Marsden Jacob 2000, *NCP review: water and sewerage legislation*, March.

Marsden Jacob 1999, *Water Trading Development and Monitoring.*

National Competition Council 2000, *National Competition Policy Supplementary Second Tranche Assessment Road Transport Reform*, 31 March.

National Competition Council 1999a, *Second Tranche Assessment of Governments' Progress with implementing National Competition Policy and Related Reforms*, June.

National Competition Council 1999b, *Supplementary Second Tranche Assessment Report*, December.

National Competition Council 1998, *Compendium of National Competition Policy Agreements – Second Edition*, Melbourne, June.

Productivity Commission 2000, *Arrangements for Setting Drinking Water Standards*, April.

Productivity Commission 1998, *Steering Committee on National Performance Monitoring of Government Trading Enterprises, Government Trading Enterprises Performance Indicators, 1992-93 to 1996-97*, Productivity Commission, April.

Queensland Competition Authority 1998, *Complaint by Coachtrans Australia Against Queensland Rail – Findings and Recommendations*, June.

Queensland Rail, *1998-99 Annual Report*.

Queensland Government 2000, *Fourth Annual Report to the National Competition Council*, April.

Queensland Government 1999, *Third Annual Report to the National Competition Council*, April.

Queensland Rail 1997a, *Submission to the National Competition Council in respect of the Carpentaria Application*, May.

Queensland Rail (QR) 1997b, *Road and Rail Competition*, Discussion Paper prepared by Sinclair Knight Merz, May.

Queensland Treasury 1999, *Community Service Obligations A Policy Framework*, March.

Queensland Treasury 1996, *A Statement on the Application of Competitive Neutrality to Queensland Government Business Activities, A Queensland Government Policy Statement*, July.

Queensland Treasury, *Full Cost Pricing Policy*.

Water Services Association of Australia 2000, *WSAA facts 99*.