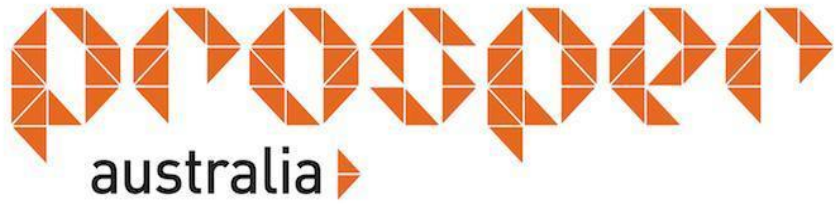

SUBMISSION TO THE PRODUCTIVITY COMMISSION'S NATIONAL WATER REFORM (2020) DRAFT REPORT

Prosper Australia thanks Productivity Commission for accepting feedback on its draft National Water Reform Report. As a non-government organisation with a focus on economic rent taxation and monopoly, our feedback to the Commission is weighted toward markets and trading.

Water markets and policy should exist to benefit users and the environment.

It is our position that the unearned and unproductive streams of private income derived from property rights should be more heavily taxed. Meanwhile, levies on the productive sector should be eased, making for a more equitable and more efficient economy.

Water entitlements and planning
Water like minerals and land, is a natural resource that exists in the commons independent of people. It is not the product of labour or capital. As a common resource, water should be held in common for all citizens, and future citizens, under the stewardship of their government.

As common property, any economic rents derived from ownership of scarce water resources must be retained by the public. The conversion of water into private property rights through a market, should only be done to the extent that enables efficient allocation of scarce water resources. However in order for *efficient and equitable* allocation to exist, water must not be granted as *perpetual* freehold or an *open-ended share*.

As per 6.1, the Commission advises "*...in renewing the NWI, the Commission advises that jurisdictions recommit to the key NWI outcomes related to water access entitlements, including ensuring that entitlements are statutory-based, that they provide a perpetual or an open-ended share of the consumptive pool, and that they are separate from land.*

A fixed number of perpetual water entitlements is inherently a public sanctioned private monopoly, and undermines efficient allocation by allowing water rights to be subject to monopoly pricing, hoarding etc. It also undermines equity, by allowing incumbent monopolists an advantage over potential market entrants, and allows them to retain scarcity rents from dwindling water resources.

In principle, the private sector should not be able to profit from the *mere ownership* of water entitlements. This does not serve the public interest, as there is no productive economic or environmental benefit to be derived from this. Rather profit should be derived from *using water resources*, which advantages those who use water the most efficiently and add the most economic value.

Currently the market is poorly designed in that investors can invest in (or retain) water entitlements as a profitable asset class, rather than surplus water allocations being sold off to cover ownership/holding costs if water cannot be put to highest and best use by the entitlement holder. *This problem could be vastly reduced if water entitlements were reconceived as leasehold property.*

In an economic sense, there is no case for perpetual water entitlements to exist. Security of entitlement holding is only necessary to the extent to facilitate long term investment decisions.

Given most long term agricultural investments e.g. orchards, have average investment horizons of 30 years, it should be entirely feasible for water entitlements to be auctioned off by the public at open tender for 30 year leasehold terms - facilitating annual payments to reduce cashflow and capital outlays. Once the terms expire, leases should be returned to the public again and the process repeated. This would ensure leases are eventually offered to the highest and best users, and that the public captures (as revenue) a significant portion of the rents that derive from owning these licenses.

To further improve the entitlements framework, we endorse the Commission's advice (6.1) to remove exemptions for mineral and petroleum industries and agree that *[b]ringing [mineral and petroleum] industries within entitlements and planning arrangements would promote greater transparency and confidence in water rights, and incentivise trades to higher-value uses.*

We also endorse the Commission's advice (6.2) regarding government commitment to community engagement, including engagement related to water planning. The inclusion of *principles to frame the process for assessing and reflecting the relative values placed by communities on environmental, social and economic outcomes to inform the trade offs that have to be made in water planning* is welcome. These changes should improve both the efficiency and equity of the water access entitlements framework.

However, we wonder how the voice of future generations will be incorporated into these principles? This is a stakeholder group for whom there can never really be adequate "community engagement". It seems to us that the NWI risks privileging extant stakeholders to the detriment of future stakeholders. This risk underscores the need for a statutory voice for future generations, which could demand stronger sustainable environmental management, perhaps even regenerative management. Such a voice could be vested in the architecture of a well resourced, Independent Statutory Authority responsible for strategic leadership of the NWI.

Water trading and Markets

We endorse the Commission's advice (7.3), *[a] renewed NWI should continue to include guidelines on water registers to support jurisdictions' decision making about the provision of basic entitlements and trade data*.

Water is a vital market for key industries, as well as our environment. Land benefits from legal treatment as real property in a number of ways: *public registration, public valuations, taxation, declaration of interest, transparency, and other legalities.* Yet water does not receive the same treatment. This results in clearly absurd situations where state MPs (e.g. in NSW) are not required to declare their water interests, and foreign owned multinationals (unlike domestic

entitlement holders) can profit from trading water entitlements free of capital gains tax.[1] Australia does not have a clear public valuation of all water entitlements either.

Water entitlements should be legally viewed as real property, or treated in the same way, including its registration and declaration. There is no good case for providing special legal privileges to water entitlements holders when these assets function in very similar ways to land titles.

While we thoroughly endorse the Commission's advice 7.2 & 7.3 to strengthen water market governance and the sentiment *"[w]here the changing of trading rules is necessary and well justified, the communication of these changes should be clear, timely and accessible to the market."* (PC Supporting paper B, p22), we submit to the Commission that it is not enough to communicate changes in rules. There ought to be a form of public-interest revenue policy that removes the 'honeypot'.

We note that whenever regulatory changes are made that disadvantage entitlement holders, compensation is paid. Yet when changes are made to benefit entitlement holders, compensation is never demanded by governments in return for additional rights granted.

Changes to what is permissible under an entitlement are similar to upzoning or downzoning in an urban development context. The value of the water entitlement is dependent on government policy/regulatory constraints that cap when and how much water can be removed from the system. In real property these regulatory windfalls create strong incentives for rent seeking. Lobbying, corruption and collusion are the inevitable result of a market in which there is a government-granted 'honeypot'. We would like to see the NWI jurisdictions innovate a tax instrument that can ameliorate this political-economic risk.

Ensuring integrity in water use

We note the Commission's advice 10.2, that *inclusion of leading-practice compliance principles would also strengthen the agreement.*

The need for proper enforcement of water use is a basic essential for regulating any market. While the report appropriately considers these issues, questions must be raised as to whether enforcement for users is an adequate deterrent to non-compliance or breaches - inadequate enforcement resourcing issues aside. There appears to be little mention of ensuring an adequate penalties and sanctions regime.

[1] https://www.ato.gov.au/law/view/document?docid=EV/1051658347424

Obviously as water becomes more scarce and its price escalates, the return to stealing water becomes greater. Greater rewards require heavier penalties and deterrents. We ask the following questions:

- How many convicted water thieves have got away with greater commercial returns even after pleading guilty and paying out fines?
- Do successful prosecutions result in effectively harsh penalties?
- How many water thieves have gone to prison?

Water theft cannot be effectively deterred if the risk of penalties and getting caught do not outweigh the returns to theft, and fines become another "cost of doing business". Penalties need to be proportionate to the rewards of the crime. Financial penalties may not be enough, but may require corresponding asset forfeitures, or prohibition from ever being able to access water again.

Compliance also requires the regime to be broad enough to be effective. In the case of floodplain harvesting and other inception activities, water can be legally captured before it enters the system.

However there is a higher-order question: who is watching the 'enforcers'?

As the Commission states,"*[g]iven the potential impacts of water system managers' decisions on water users and the broader community, processes need to be in place to hold them accountable.*" (p131)

To quote the South Australia MDB Royal Commissioner: *"it is manifestly inadequate to simply recommend that these jurisdictions should 'collaborate' and 'take joint responsibility', without also taking into account and considering the historical context of why those jurisdictions failed to collaborate and take joint responsibility.*"

It is clear from the S.A. MDB Royal Commission, the interim report of the ACCC Inquiry, and the present draft National Reform Report that there is a question mark over whether the NWI jurisdictions can be held accountable.

Without an independent, well resourced and empowered final point of accountability for failings with the system, these issues will persist. Blame can always be shifted around, and when things go wrong there is little recourse for the victims (including the environment). The opaque decision of NSW to release environmental water stocks during the recent drought are a case in point.

On this basis, we note and endorse the calls of others (e.g. Australian National University's Institute For Water Futures) that in order for any NWI to be effective, there needs to be an expert, Independent Statutory Authority that provides strategic leadership, support and accountability under the NWI.

Government investment in major water infrastructure

Prosper mostly agrees with the Commission's call for a new water infrastructure element to *"...restate the high-level principle that all infrastructure is to be assessed as economically viable and environmentally sustainable prior to the commitment of funding, with cost recovery from users as the norm* (13.1)." However the emphasis on cost recovery from users solely is clearly inequitable in the wider context of water markets.

As noted previously, entitlement holders possess a monopoly property right that accrues economic rent which presently is not adequately recovered by the public. It seems grossly inequitable and inefficient that holders of these entitlements who do not need to engage in any productive water use or value added production, face little onus to contribute to the infrastructure which facilitates their trading activities.

There is clearly an unfair apportionment of cost recovery onto productive water users. Water users in many instances must pay more than water investors who don't use water productively, but merely profit from ownership. *This is not a level playing field in the water market*. Entitlement holders are still beneficiaries from water infrastructure development.

Prosper supports the principle of Value Capture in infrastructure, and believes that cost recovery needs to be more weighted towards holding of entitlements, rather than use of water in productive enterprise. If fees are shifted away from water users and towards entitlement holders, then fees for all water users (including those who own entitlements) should fall, but investors whose returns are purely dependent on owning entitlements and do not use water would contribute more to productive infrastructure.

We note that entitlement holders (in particular investors who do not use water) who do not view it as fair or worthwhile to continue holding entitlements after paying for the majority of infrastructure cost recovery, are free to sell their excess entitlements to productive users.

Yours faithfully,

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