

Submission-ACCC Inquiry into water markets in the Murray Darling Basin

Victorian Farmers Federation Sunraysia Branch

About the branch. The branch represents a wide range of irrigators in the Sunraysia region, with the majority of members irrigating wine grape, citrus and dried fruit properties. Branch members have an ongoing active presence on Lower Murray Water Customer Service Advisory Committees, and the branch has maintained a long time active presence on the Victorian Farmers Federation Water Council, Victoria's leading water policy advocacy group.

The branch has advocated with respect to many local, state and national water related issues over the last two decades, notably the Deakin Project, the amalgamation of water authorities, Managed Investment Schemes, and the Sunraysia Modernisation Project stages 1 and 2. It has made submissions to various Victorian and Federal inquiries, including those into unbundling, the Murray Darling Basin Plan, the Windsor Inquiry, carryover, water trading rules, the 4% cap, and so on.

Members have additionally attended hearings and provided submissions to the South Australian Royal Commission, the Murray Darling Basin Water Infrastructure Program inquiry, and the Productivity Commission review into progress of the MDBP.

In 2007 the branch conducted an outlook forum with guest speakers Professor Mike Young and the Australia's leading climatologist to discuss the implications of the CSIRO's Sustainable Yields findings.

The branch has been, and remains focused primarily on the particular interests of irrigators within the LMW pumped districts of Red Cliffs, Merbein and first Mildura Irrigation District, whose members pay relatively high water rates compared to irrigators in like districts in NSW and South Australia.

INQUIRY DRIVERS- “SPECULATORS”- “THE SILENT MAJORITY”- WATER REFORM and MDBP ANGST

This submission acknowledges the circumstances which have brought about the current Victorian and ACCC inquiries into water markets. Both inquiries have been in response to irrigator, and to the broader public's reaction to the difficulties that ongoing drought, and resultant high water prices, are causing to irrigators throughout the MDB. That response has been inflammatory and unevidenced, and this submission is aimed at reiterating the largely unheard “silent majority” view of water markets held by informed irrigators.

CHALLENGING TIMES-THE TRUE DRIVERS OF CHANGE, what are the water inquiries up against???

The water market inquiries are timely, but they are being conducted at a time of discord, and in an inflamed, angst ridden atmosphere. That atmosphere has been amplified by the drought, but was engendered by populist responses to water recovery under the MDBP.

Prior to the MDBP, basin irrigators and communities faced sustained terms of trade issues with respect to their commodities, including the dumping of subsidised imports, European and United States subsidies and tariffs, and high \$AU dollar values due to the mining boom. There have been sustained commodity gluts such as with wine grapes, and the competition for oversupplied commodity markets with taxpayer funded Managed Investment Schemes.

Some of those challenges are ongoing, but difficult times in the basin occurred simultaneously with water market reform including unbundling and enhanced water trading (COAG, NWI, MDBP).

The existing confluence of challenge and change in the basin was then overlaid with the Water Act 2007 and the subsequent roll out of the MDBP and water recovery including buybacks. The result has been enduring endemic confusion in the basin as to water and economic cause and effect.

And more unsettling change has occurred in parallel as the basin states have competed for development dollars, and large scale horticultural development has unrolled rapidly and without adequate allowance for the inevitable impacts on system capacity and on the water market.

This confusion as to the impacts of water reform and the MDBP has been exploited and compounded by populist politicians and action groups, and by uninformed and egregiously inflammatory media coverage.

CONFUSION, EXPLOITATION, CONFLATION, RURAL DECLINE

The farm lobby, governments, and politicians have utilised the confusion regarding water issues to progress their own agendas with respect to limiting the scope of MDBP water recovery in order to keep the maximum possible amount of water in consumptive use. In the absence of an effective counter narrative from the MDBA or any other body or group, they have successfully conflated rural decline in the public mind with the politically friendless MDBP.

Now, in the public eye, and in the eyes of many irrigators, the perceived downsides of water reform and water trading are the fault of the MDBP, when in fact the substantive drivers of rural decline remain terms of trade issues and water availability (rainfall).

As a result the water market inquiries will be conducted in challenging circumstances, and that has been acknowledged by the ACCC's strict forum guidelines (including Chatham House rules), and the injunction to forum participants that broader water issues will not be discussed. That might prove difficult when in the minds of many irrigators high water prices are caused by water reform, including water trading, which they often perceive to be enabled by the MDBP.

ARE IRRIGATORS ACROSS THE ELEMENTS OF WATER?

The ACCC's outline of issues under the five headings, from “1-Market trends and drivers”, to “5- Competition and market outcomes”, is an excellent thumbnail sketch of the realities, features and characteristics of the water market in the Southern Connected System. The reality is that many irrigators are not across the elements as outlined. The ongoing challenge of government will be to wind back unhelpful populist perceptions of what the water market is and how it operates, and to assist in educating irrigators to confront and deal with market realities in an informed way. Hopefully this inquiry can be the first step in enhancing transparency and reinforcing broader confidence in the water trading system.

EXPERIENCED IRRIGATORS, THE “SILENT MAJORITY”

This submission might best serve the purposes of the inquiry by laying out in general terms the attitudes of the many experienced and informed irrigators who have survived challenging terms of trade for their commodities, and paying up to \$1000 for allocation water during the years of the millennium drought. These irrigators have generally accepted, with reservation, the realities of the water market and learned to work within

them.

They get zero media attention and are themselves concerned by the media and political attention given to uninformed reaction by particular individuals commodity identities, and politicians.

REACTION, POPULISM, MEDIA SENATIONALISM

In the eyes of what might be described as the silent majority, the sensationalised media coverage given to a few unrepresentative players attributing high prices to “speculators”, and to perceived market manipulation by water traders operating multiple ABAs , is giving rise to the real danger of politicians making reactive policy changes that cannot make water cheaper, but will ultimately weaken the quality, and therefore the value of water entitlements.

THE BETTER VIEW, THE ACCEPTED REALITIES ***How the “silent majority” of irrigators see the market.***

Water IS a commodity, irrigators define their own risk, entitlement quality should be protected

-The water market is accepted as being here to stay, and is a necessary element in doing business as an irrigator.

-it is up to the irrigator to construct and maintain their own water portfolios according to their own liquidity and projected use, and their own perceptions of market risk, with the tools and products available, including carryover, leases, forwards and options.

-the market is accepted as a market, with standard market characteristics. Prices rise and fall according to demand and availability. At times of low availability prices will be high. Water is not distributed on the basis of patronage and qualification of rights cannot be expected.

-Irrigation water, as distinct from sewer and urban water, is in fact a commodity and treating water as a commodity is the best model.

-Irrigators demanding that allocation is always affordable regardless of availability, have been misled and are being unrealistic.

-a business model relying solely or largely on allocation purchases rather than permanent entitlement is acknowledged as being a high risk model, and long established irrigators have tended to hold on to their entitlement.

Risks of the allocation only model

Comment -Permanent entitlement holdings tie up capital for little or no return in times of high water availability but provide a high level of water security. Allocation only models free up capital, and allocation purchases are tax deductible, but leave irrigators exposed in times of low water availability.

Many dairy farmers went over to the allocation only model during the early to mid noughties, freeing up capital to expand their herds and buy new blocks. Also the many new plantations in the LMW region, NSW and SA generally rely on the allocation model as well, but in the form of “managed risk” leases and other allocation products.

The allocation only model has proven risky, and a lot of political pressure is now coming from dairy/ gravity districts to re bundle land and water and to constrain the activities of so called “speculators” incorrectly perceived to be driving the price of water beyond affordability.

The value of entitlement, entitlement as superannuation

-in concert with increasing demand and rising allocation prices, unbundling has given increasing value to entitlement, which irrigators appreciate.

Comment -For local irrigators, most of whom are in the retirement window, the value of their average 50 to 100 ML of entitlement amounts to the only real reward they can hope to realise for their years of effort producing low value commodities. Property plantings and improvements have low or zero market value, and entitlement holding are effectively the only superannuation retiring irrigators will realise.

Like wise, the majority of dairy farmers still own entitlement in the order of 500 to 1500ML and are water multi millionaires, and are similarly appreciative of the value of their entitlement.

entitlement as a property right, enhancement of markets

Irrigators want entitlement to retain it's present characteristics as a property right, and are concerned that reactive ad hoc changes to the quality of entitlement will erode it's value, and therefore their own equity.

-irrigators accept the water market but want to see it enhanced in various ways, including clarity as to the activities of investors and water traders and whether their perceived manipulation of markets has any basis in reality.

IVT, market interference, transparency v privacy

-irrigators are concerned as to trading restrictions, for example IVT restrictions and exemptions, and to what extent these might amount to politically motivated market interference in the Southern Connected System.

-irrigators want cheap and expeditious water trading but don't want to pay substantially more in trading fees.

-irrigators don't want full transparency to the extent of their own holdings and trading activities being identifiable. They want a working balance between transparency and privacy, but they want any possibility of market manipulation prevented.

THE CASE FOR “SPECULATORS”- SPECULATORS GOOD???

It will be helpful to the inquiry that the perceptions around water traders and “speculators” are examined and the realities acknowledged.

What are “speculators” and how much water do they control? The DELWP fact sheet put out in July to inform the DELWP/VFF water market forums conducted across Northern Victoria put Victorian non water ownership in the SCS as being still about 85% attached to land. About 10% was unattached but still owned and used by irrigators, the remaining 5% or so is held by institutional holders, the so called “speculators”.

“Speculator” manipulation unproven, unlikely.

Forward, leases, options, corporate reliance

5% is a lot of water, but not enough to enable the supposed market dominance and manipulation being hysterically reported and reacted upon. In reality institutional investors provide valuable products which many irrigators, especially large scale corporates including almonds plantations, rely on for their irrigation requirements in the LMW region. Investors use the allocation from their entitlements to bundle together leases, forwards and options packages. These allow buyers to spread their risk and ensure adequate water at a known price across several years.

These packages might be lucrative for investors in times of high water availability, but in droughts the investors are likely to take a haircut, for instance perhaps having to forgo the \$1000 and beyond prices on offer this year, and being obliged to honour their commitments to supply scarce allocation at perhaps \$300 to \$500 per meg.

The “Real” Speculators????

The real speculators at present are perhaps the often vocal large scale irrigators who bet on substantial rainfall delivering cheap allocation, and who have as a result been exposed by not covering their position with entitlement or the allocation products on offer. This is akin to selling short on the stock market then expecting the stock market to be dismantled when prices rise.

The villains in the piece with respect to withholding water and driving up prices are more likely to be irrigators making rational decisions to sell scarce allocation rather than grow crops, rather than investors. So irrigators are paying high prices to other irrigators rather than speculators.

Investor products “buffer” water prices.

Investor products this season have stabilised the water market to a degree. Many large corporate users, notably almond plantations, have covered their positions with the products on offer by investors. As a result, they are not in the market competing for allocation with farmers, or prices would be higher than they are now. On an ongoing basis investor products to a degree provide a stabilising effect with respect to market upswings and downswings.

Investor holdings underpin entitlement value, irrigator equity, political interference unwelcome.

The holdings of entitlement by investors has also underpinned the value of entitlement. Should the Victorian government cave in to calls from the Victorian farm lobby to effectively re bundle land and water through the linking of ABA's to site use licences, and to ill advised calls from Sunraysia industry figures to prevent investors from accessing carryover or purchasing allocation, then entitlement would no longer be seen as a reliable property asset. It would revert to being a second class asset with attributes changeable at the beck and call of politicians dispensing favour. Investors would divest their entitlement along with non land holders. The value of entitlement would plummet and, and further impacts would occur because the valuable products investors provide would no longer be as readily available.

WATER TRADERS, MULTIPLE ABA'S, MARKET MANIPULATION

The political heat is also on water traders and their perceived use of multiple ABA's to manipulate prices. What are the realities as opposed to the perceptions?

All systems are subject to rorting, but no evidence to date has been shown to back up the popular claims with respect to water traders. The larger water trading companies relied on by the majority of irrigators do not take a market position on water or use their ABAs to reinforce a market position. There are various reasons water traders require the use of multiple ABA's/WAL's to run their businesses and these include.

- a) help reduce fees for customers that would apply to multiple parcels.
- b) facilitate transfers to zones where clients do not have accounts but have obligations.
- c) facilitate related party trades for no consideration (eg father to son.
- d) to assist with protecting allocation as part of the permanent entitlement transfer/sale process; and
- e) give customers, at their request, the opportunity to sell allocations in a different zone.

Summary- More clarity and education yes, political interference with entitlement quality no, maintain privacy yes.

-informed irrigators accept the market, with irrigation water treated as a commodity, as the best way to distribute the scarce resource. But they want more clarity and assurances with respect to the integrity and accessibility of the water market, and to the oversight of the activities of major players including government, investors and traders.

They appreciate the value added to their entitlement by the water market, by the institutional investors and by water trading, although they need further clarification as to the roles of investors and traders. They understand that the substantive drivers of water prices are not the activities of “speculators”, but rather supply and demand.

They want the quality and integrity of entitlement protected and do not want to see the de-facto re-bundling of land and water and other ad hoc rule changes which would create market uncertainty without creating cheaper irrigation water.