

Submission

to the

Australian Competition and Consumer Commission
Murray-Darling Basin water markets inquiry

Interim report

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1. Introduction

The water market has perhaps had far less reform attention than any other aspect of Basin management. Reform is well overdue.

By providing a comprehensive and thorough investigation of all aspects of the Basin water market, the Interim Report presents the information and analytical base from which a reform program can be constructed.

While being a valuable resource in this way, the breadth and detail of the 550 page Interim Report mean that framing a clear narrative for a short submission on what the reform program should be, requires some judgements about the issues to cover.

These are not the best of circumstances in which to be thinking about water market reform. For one thing, across governments, the most senior minds will be occupied with the Covid pandemic for the foreseeable future.

For another, the appetite and capacity for water reform has been limited for some time. It is less than it was in 2009, when the National Water Market System (NWMS) was agreed. Then, in the wake of the *Water Act 2007* and the 2008 referral of powers by states, Commonwealth leadership was strong, and states were more than usually minded to engage in reforms.

The past ten years of tussling over the Basin Plan has eroded whatever goodwill there was in 2009. Without goodwill, Basin politics will struggle to rise to the challenge of significant water market reform. And yet, reforms are demonstrably required.

The approach taken here to articulating a reform program is to narrow the subject scope to addressing what the Interim Report calls the 'market architecture'. This comprises the functions of regulatory governance, information provision and trade transfers (p394).

The submission examines what ought to be the priorities in relation to the three functions, and how to deliver these priorities.

2. The Priorities for Reform

In relation to market architecture, the Interim Report identifies three key problems: inadequate information, regulatory fragmentation, and differences in trade processes and water registries (see pp7, 353 and 485).

Improving information must be a reform priority.

Accurate, up to date, comprehensive and accessible price, volume and product information is critical to an efficient market. In this regard, the water market is no different from any other. Disturbingly, the findings of the 2019 Murray-Darling Basin Authority (MDBA) audit on price disclosure are not so different from the position that underpinned the NWMS ten years earlier (MDBA, 2019, 'Water Trade Price Reporting under Basin Plan').

Efficient markets require a sound regulatory framework, that minimises transaction costs, is transparent, provides certainty and delivers the balance society wants between the market working freely and achieving social ends.

The existing regulatory framework does none of these things. As the Interim Report observes, regulation is the responsibility of a very large number of often-dissimilar entities. The regulatory framework could not be more fragmented and complicated if it tried. One of the reasons it has evolved in this way is that the paradigm for water planning and management is a catchment-based approach, which regulates physical volumes and flows. Water is not treated as an economic commodity. The regulation of markets is, as the MDBA observes in its submission, an adjunct to water management (p425).

Although improving trade processes and water registries is undoubtedly important, it should not be an immediate priority. Reforming registry processes is a substantial task, requiring commitment, time and resources. Establishing a single exchange platform should have priority over registry reform.

Basin water trade would be best served by a single Basin exchange platform.

Presently, there are six exchange platforms, some established and managed by water brokers (pp525 – 528). Having multiple exchange platforms makes price discovery difficult, hinders water being allocated to its most valuable use and is a regulatory challenge. To the extent they are managed by brokers, trading is vulnerable to brokers having a conflict of interest.

A single exchange platform for trade would yield transparency, efficient price discovery and lower transaction costs. It would facilitate regulation, because there would be only one exchange system to regulate. The role of brokers would be confined to facilitating transactions

Beyond these benefits, accumulated trading experience through the exchange platform may grow the constituency for reforming registry processes. By crystallising differences between states, a single market would leverage pressure for reforming registry processes, including interoperability between states.

3. Actions to deliver the three priorities

To deliver priorities, actions must be:

- effective. This means actions must yield worthwhile results of themselves, and be either a base from which further reforms can evolve or a leverage that pressures other reforms; and
- implementable, both administratively and politically.

Water markets are without doubt complicated. In the face of complexity, the best way through is simplicity. The more complex the issue, the more important it is to find a simple way.

The method of implementation needs to be as simple as possible, so that a reform is delivered in the way the policy intends, is not be open to varying interpretations and applications, and can be monitored accurately.

Each reform action needs to be carefully bounded, to manage costs and ensure timely delivery. A benefit of programs structured around the ease with which they can be implemented, is that they require less political commitment.

(i) Improving Information

Price is the means by which alternatives are compared and economic choices made.

The companies listed on the Australian Stock Exchange range across all manner of industries, operating environments, company size, financial strength, management skills and risks. These differences are distilled to a single share price. In the same way, improving price information would assist comparing and trading the vast range of water products.

The most effective, first step way of improving information would be to make a trade approval conditional on price disclosure. The rule would be 'no price, no trade'. This would mirror the 'no meter, no

pump' rule developed in late 2017, as a way of improving compliance of water extractions with allocations.

A 'no price, no trade' principle would considerably improve the accuracy and comprehensiveness of price data.

Accessibility of price information requires a further reform. A single web information portal was part of the NWMS and is noted as an option in the Interim Report (p30). In the ten years since the NWMS, the capacity of information technology to construct and manage a portal has increased considerably.

The portal would be an access point to data held by state registers. It would not create new data. While, in the beginning, the portal would be confined to price data, over time, the range of data to which the portal gave access could be expanded.

(ii) A single exchange platform

Improving price information through a 'no price, no trade' rule, and increasing access through a portal, relates to past data. A single exchange platform would centralise live price offers.

As described in the Interim Report, 'a single exchange platform would post and match trade offers by creating a single, mandatory platform for matching buyers and sellers' (p30).

While establishing a single, mandatory exchange platform is undoubtedly a major project, there is some cause for optimism. Most importantly, there are six existing platforms for reference. There are also models from other markets, ranging from stock exchanges to commodity markets, that would guide developing a single exchange.

Delivering an exchange platform is now well within the capacity of information technology knowledge. The project design should not be at the frontiers of that knowledge. A critical element for successful implementation is that a 'plain vanilla' information technology solution is sought. This is not a project for innovative information technology, because securing agreement between governments on the design specifications will be difficult.

State registers would continue to conduct trade application and approval processes. In time, once an exchange platform is operating robustly, a central clearing house could be established. This would require reforms to state registry processes.

(iii) Governance

Addressing regulatory fragmentation is critical to water market reform and perhaps the most intractable of the reform challenges. Considerable pragmatism will be required to find a way forward.

As to what that way forward might be, regrettably this submission provides no more than a view about what will not work and a modest suggestion about a process for progressing reform, rather than a governance framework. Although this is less than what is needed, often the only way of solving a difficult problem is to establish a robust process for addressing it.

In relation what will not work, the Interim Report notes that better governance may require revisiting the division of responsibility between the Commonwealth and states (p492). While that may well be true, it is not a realistic option. There is no evidence that states would give up their power to issue and manage water property rights in the foreseeable future. For its part, the Commonwealth is probably not in a good position to take on a greater role.

Noting energy market arrangements, the Interim Report posits an independent regulator (pp28, 222 and 256). This is also an unlikely option. There are significant differences between water and energy. On the politics, the principle difference is that water rights are property rights instruments of state governments. Energy is a reproducible commodity, generated by corporations. Some are privately owned and others are government trading enterprises.

Workable governance changes must reflect and evolve from existing arrangements. For the time being, this means the Ministerial Council retaining responsibility. The potential for change lies in the arrangements below the Ministerial Council. The standard model is delegate tasks to a group of officials representing ministers. A variation of this model may be possible and would certainly be desirable.

An independent person could chair an officials steering group. Expert and stakeholder panels could be established to assist the steering group. Although this seems a modest arrangement, it would far and away be the easiest to implement, and that matters. It is, of course, only a process for recommending and managing reforms and not a new market governance framework. One of its tasks, however, could be to develop a proposal for a governance framework.

The steering group should be appointed for a fixed term, with clear deliverable tasks.

4. Next steps

There are some parallels between water market reform and the Basin compliance reforms. In December 2018, the Commonwealth Government and Basin states committed to a Basin Compliance Compact.

The Basin Compliance Compact was a response to critical reviews by the MDBA, and NSW and Queensland governments of compliance and the integrity of Basin water management. Based on the recommendations of the reviews, the Compact set priorities for action and committed governments to report on implementation.

A water market compact could perform the same kinds of functions. Such a compact needs an agreement on the priorities for reform and the actions to deliver them. For this, the ACCC Inquiry is the opportunity to make the case for reform and to set out a staged, implementable program.