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Reform: what have we learnt? Insights from water reform in South East Queensland and Tasmania

Background

Reform: what have we learnt? A pertinent question for observers of the water industry in two Australian states, where the move to corporatised structures for local government businesses, and a shift to state-based ownership in the case some industry entities, has produced mixed results.

Globally, the transition from local government adjunct to corporatised and regulated independence in the water sector tends to be tectonically slow, but occasionally rapid local shifts can leave the landscape deeply altered. The water industries in South East Queensland (SEQ) and Tasmania have been subject to seismic transition over recent years and are still feeling the aftershocks. For jurisdictions where reform is a future option, lessons can be drawn from these two states.

In SEQ, the trigger for the upheaval of recent years was the onset of major drought, which left a city of 1 million inhabitants with less than 12-months" supply. Delivering a well-conceived and co-ordinated response to drought was constrained by the need to achieve consensus amongst 16 local government businesses, each with their own agendas, historical and legacy issues and differing capabilities.

The solution – a unique regional grid model with a vertically-disaggregated supply chain and discrete bulk, transmission and consolidated distribution/retail entities (shown in Figure 1 below) – promoted regional, rather than local, thinking and enabled rapid project implementation.

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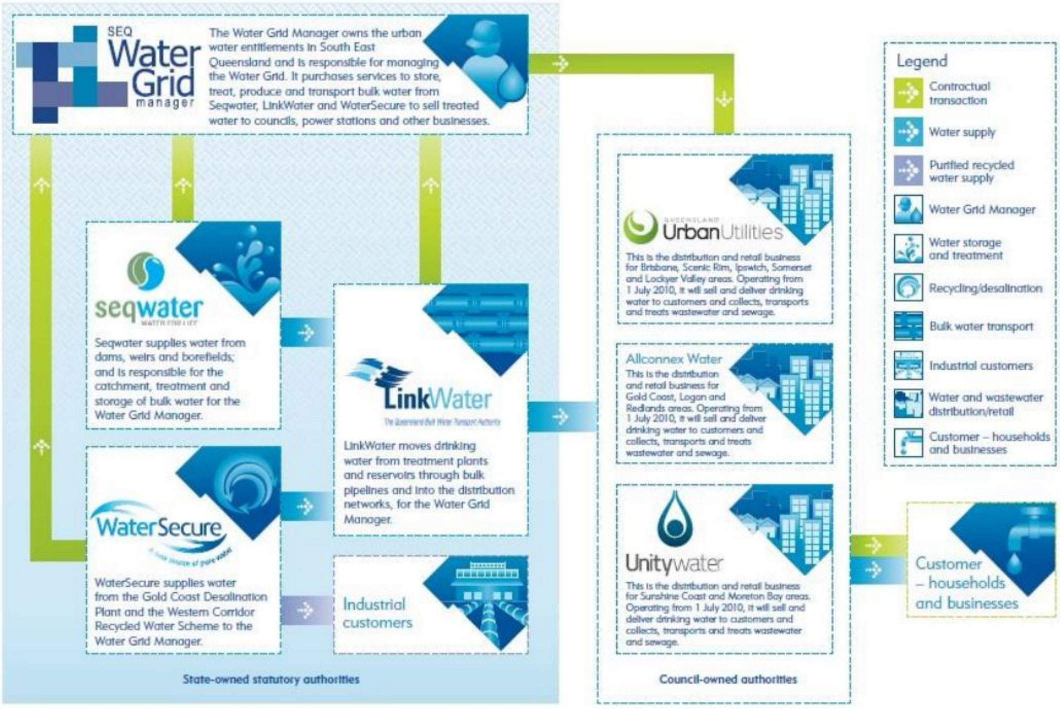

Figure 1: SEQ water grid (Source: The SEQ Water Grid - South East Queensland Water Grid Manager)

For Tasmania, reform was the outcome of a review of the challenges facing the industry; namely, concerns over service levels and asset management coinciding with a need for major capital investment and predicted price increases. Again, an innovative model was developed: consolidating 32 local government businesses into three independent water corporations considered to have sufficient scale to advance performance, supported by a single shared services provider delivering all billing, procurement and IT services (shown in Figure 2 below).

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Figure 2: Tasmanian water industry (Source Comparison of Victorian and Tasmanian Urban Water Reform Institutional Models – Northern Tasmanian Water and Sewerage Reform Program)

In both cases, reform has brought benefits, trade-offs and innovation for the water businesses, governments, and consumers involved, but both reforms have been plagued with shifting policy priorities.

Economies of scale and tariff equity benefits can flow to water businesses and consumers

The upside to reform is significant – both models provide a wealth of benefits, stemming from the consolidation of smaller entities. Duplicated overheads across businesses are eliminated while the new, large water businesses achieve both economies of scale and attract industry-leading delivery partners. In particular, Onstream (the shared services provider for Tasmania) will be able to substantially cut the procurement and implementation costs of new systems – including Customer Information and Billing systems, and Asset Management systems – by acquiring and managing single systems for all three water businesses.

The new models rationalise and align tariffs, bringing greater equity to consumers, as well as central responsibility for price planning for the future. Tariff regulation will help ensure prices are linked to justifiable costs and are supported by the principle of "user pays". Additional benefits to the consumer will include a higher, more transparent level of service – driven by regulatory frameworks which promote investment into justifiable service outcomes and reduce the long-term risk of price shock and service interruption.

There is a trade-off between effective change and the eventual cost to consumers


Business told to brace for water shock
The Gold Coast Bulletin | November 23, 2007

Now for $220 water torture
The Mercury | April 16, 2009

For any major, wide-ranging reform process there is a trade-off between detailed planning and execution to ensure an effective change, and achieving this change within a reasonable cost and timescale.

Hindering the success of the change programs in SEQ and Tasmania has been the management of the cost impact of reform on consumers. In both jurisdictions, the same change program – which aims to promote greater efficiency – has coincided with an upward step-change in price. Whilst justified in terms of expenditure – $9 billion investment in supply security in SEQ – the cost to consumers is significant and ill-timed.

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In both SEQ and Tasmania, the process of asset valuation and transfer has exposed a legacy of underinvestment by some local governments in their infrastructure, with corresponding upgrade programs needed to bring the asset base to a sustainable standard. These costs were largely predictable, and have been endorsed by the economic regulators, the QCA in Queensland and OTTER in Tasmania. Despite this, there has been vociferous rejection of the price rises, most notably on the Gold Coast and in Hobart, and price has been elevated in the political arena rather than through an objective regulatory mechanism.

Pricing debates in SEQ and Tasmania have been exacerbated by a lack of transparency throughout the process. The simple assertion – that the community has invested for a secure future – has been lost.

Attempts to revolutionise an industry through innovative models can prove challenging


Report pours doubts on Premier's local water reforms
The Australian | August 15, 2007

Water bills spark confusion
The Mercury | September 23, 2009

Being unable to divorce the sector from political risk has jeopardised many potential benefits in both jurisdictions, with SEQ and Tasmania now re-examining their innovative models in an attempt to address price concerns.

In SEQ, adopting a new model brings with it additional uncertainty: the Grid Manager role is a new and untested concept in the traditionally conservative industry. The use of commercial contracts between elements of the supply chain and a central management authority could arguably dilute the operational links between the water businesses and slow down the chain of responsibility in dealing with potential emergencies – a review of the industry's response to the recent floods may prove an early test of the model's effectiveness.

Already, the economic sense of having two bulk-supply businesses in Seqwater and Watersecure has been exposed, with the entities merging in July 2011.

In Tasmania, creating Onstream as a single, shared services entity aligns with the concept of industry best practice; however, putting this model into practice has been a challenge, given the history of the predecessor businesses. Consolidating diverse datasets from 32 small businesses – pertaining to customer property and usage, tariff and billing arrangements, supplier details and procurement strategies, system vendors and IT strategies – has proven extremely difficult. Often these records have been in different formats and varying degrees of accuracy, resulting in a number of well-documented and very public customer communications and billing issues.

Consumers and the government ultimately pay the price for shifting policy priorities


Bligh backflips on water reforms
Brisbane Times | April 7, 2011

Got it wrong, admits Premier
Sue Neales | December 1, 2009

The reform processes in both jurisdictions have recently been subject to potential reverse. In SEQ, an offer to allow each of the predecessor businesses to repossess the distribution and retail businesses is coupled with a two-year price cap which forestalls necessary investment. The haste with which a final repossession decision must be made is likely to leave the door open for a subsequent reopening of the issue, and should at any time just one water business revert to council control, there is a strong case for the remaining water businesses to merge into a single umbrella entity. Such an action would present SEQ consumers with another substantial tranche of restructuring costs.

In Tasmania, the original Interim Price Order (IPO) for the sector provided for year-on-year price increases of a maximum of 10 per cent for three years. Amid community backlash on price increases, the government reassessed this to a maximum of 5 per cent – meaning the Tasmanian government will subsidise water and sewerage charges by an extra $9 million a year.

So, what have we learnt?

Even world-class water sectors can fail to deliver graceful industry reform under the scrutiny of an interested public. Australia’s water sector is internationally regarded as well managed and a benchmark to others, but these two major reform processes have not been untroubled.

The decision to raise prices or impose two-part tariff arrangements during the transition period has proven a hindrance to reform activities. The issues of price increases and transition should have been considered separately to enable the water businesses, political environment and community to evaluate and respond appropriately.

The clear benefits of industry reform are underpinned by transparency, business consolidation and tariff rationalisation. The decision to not enforce transparency or continually promote the benefits to SEQ and Tasmania from an objective standpoint, even in the face of high levels of public scrutiny, has compromised reform efforts.

These experiences have shown that the cumulative risk of price increases, structural change, ownership transfer, consolidation, and crisis response can prove too much. Successful reforms should recognise and weigh these risks in advance, and develop a practical, consistent and supportable approach to managing these risks through communication, engagement and where necessary, staged implementation. Timely and effective planning is crucial to avoid „crisis response" situations – and attempts to unpick a partially completed reform could prove to be very costly in the long term.

The April 2011 Productivity Commission Report on the Urban Water Industry recommended a review of NSW metropolitan water services and rationalisation of the NSW regional water sector. Clearly, those considering embarking on this path should capitalise on the lessons learnt from other jurisdictions like SEQ and Tasmania – to ensure the least negative impact on their water businesses, government and consumers.

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