

**Separation of Utility Functions from Local Governments**

**Synopsis**

- Smaller water authorities, particularly those run by local governments, are not as competitive as larger authorities and may not be as well positioned as those authorities to capitalise on economies-of-scale.
- Costs to consumers in areas served by smaller utilities may not be as economically efficient as those delivered through larger utilities.
- The skills base of smaller authorities may not be robust, a situation likely to be exacerbated by the emerging skills shortage in the water industry and the smaller authorities’ lesser capacity to bid for the services of those skilled practitioners who are available.
- Governance arrangements surrounding water utilities owned by local governments may be weaker than those surrounding larger, more regularly scrutinised authorities.
- There is a case for examining the future viability of smaller authorities, particularly those operated by local governments

**Contents**

Issues..... 2

    Local Government Utilities in the Context of the Water Reform Framework..... 2

    Areas of Concern..... 3

    Skills Shortage..... 3

    Integrated Planning..... 3

    Integration of Functions..... 3

    Ability to Compete in Market for Services ..... 3

    Governance ..... 4

Summary of AWA’s Position ..... 4

References..... 4

**Background**

Most Australians are supplied with water from major urban authorities servicing more than 50,000 people.<sup>1</sup> Generally speaking, historically, these authorities grew out of local governments or were substantially controlled by local government representatives. The 1994 COAG Water Reform framework created the conditions whereby water suppliers were encouraged to become more commercially focussed and efficient. Accordingly,

<sup>1</sup> The full members of the Water Services Association of Australia (WSAA) are those authorities which provide services to more than 50,000 people either directly, or indirectly as wholesalers. The 30 full members of WSAA provide water services to more than 15 million Australians.

while all suppliers remain government owned, they operate as independent entities whose objectives are commercially focussed and which are dedicated to the provision of utility services (Some authorities are also responsible for electricity supply).

Those customers not serviced by the major utilities receive reticulated supplies from either smaller authorities or the water supply departments of local governments. The Australian Water Association has a number of concerns about the continued provision of services under such arrangements:

- It is not clear whether in all circumstances the water supply departments of local governments can operate in a fully commercial manner in line with the COAG Water framework principles.
- Smaller authorities may not be able to take advantage of economies of scale or compete in the marketplace for the provision of services as effectively as major players
- The skills base of smaller authorities may not be sufficient to ensure services are provided effectively
- There is a general skills shortage in the Australian water industry. Advances in water and wastewater treatment technology are exacerbating this shortage. Smaller authorities that are already confronted with a skills deficit will find conditions all the more difficult in future, as the major authorities are better able to compete for the specialists who are available. This may place the services provided by smaller authorities at risk, or may prevent smaller authorities from upgrading equipment to state-of-the-art.
- There is a risk that smaller authorities may not have enough influence in discussions about the future directions in water resource management in the areas for which they are responsible. Thus, there may be poor integration between planners, operators, regulators and, where applicable, bulkwater suppliers.

## Issues

### Local Government Utilities in the Context of the Water Reform Framework

Over the past 15-20 years the water industry in Australia has become more commercially focussed. This has led to enormous efficiency gains and a more complete understanding of the economic performance and condition of the assets used to provide water services. These improvements have been brought about largely as a result of the COAG Water Framework which, among other things, led to the following:

- Corporatisation of the industry, which has made water suppliers responsible for their own commercial and operational outcomes, including the achievement of an adequate rate of return on investment, customer service standards – particularly the maintenance of water quality – and the achievement of regulatory standards
- The separation of operational and regulatory functions
- Clarification of water property rights
- A significant reduction of cross-subsidies between user groups and between government and the water industry

All State and Territory governments formally endorsed the 1994 Framework. While each jurisdiction has been free to determine the structures it feels best suit the conditions established by the Framework, broadly speaking, each government responded by creating large, integrated state-owned corporatised water service providers with significant outsourcing of capital acquisition and facility management in partnership with the private sector.

Furthermore, in June 2004 COAG renewed its commitment to a national approach to water management through agreement to a National Water Initiative (NWI) overseen by the National Water Commission. The NWI included a commitment to continue urban water reform focused particularly, but not exclusively, on further improving water industry efficiency, enhancing the functionality and efficiency of the market for water and for

water services and restoring ecosystems damaged through over-allocation. In response to these reforms there is a renewed focus on institutional reform in the urban water industry.

There is, of course, nothing intrinsically wrong with smaller authorities or the involvement of local governments. However, such authorities may be at a disadvantage in the provision of water services, particularly as the market for these services becomes more competitive and the technology required to treat water and wastewater and to manage existing assets becomes more sophisticated. Furthermore, a combination of the National Water Initiative *and* the pressures placed on the water industry by drought and potential climate change has led to a renewed push for further institutional reform. The Australian Water Association is concerned about the impact of these reforms. Within this milieu smaller authorities may be unable to find a voice.

### Areas of Concern

Particular areas of concern are as follows:

#### Skills Shortage

The Australian water industry faces a significant skills shortage. While the industry as a whole is taking steps to address this shortage, there is no doubt that the major metropolitan authorities are better positioned than the smaller ones to compete for skilled employees. The skills shortage may become more acute in future as new technologies such as micro-and ultra-filtration come on line. A shortage of skilled workers may prevent smaller authorities from utilising new technologies in a manner that ensures that all regulatory requirements can be consistently met.

#### Integrated Planning

Large integrated authorities are generally well positioned to ensure there is a matching of demand and supply. Consideration is being given in the current round of institutional review to disaggregating integrated authorities. AWA is concerned that any such reform maintain the efficiency of planning by ensuring that there supply/demand imbalances do not arise as a result of disaggregation. These imbalances may be a particular risk for smaller authorities which may not have the skills or 'weight' to have an effective voice in planning discussions.

#### Integration of Functions

Recent reform proposals contemplate, variously, the separation of bulkwater supply from operational functions, distribution from retail, and planning from operational functions. AWA has some significant concerns about some of these proposals the benefits have not been proven and because of the potential for coordination between functions to be reduced. Within this milieu, the capacity of smaller authorities, especially those operated by local governments, to have their voices heard may be lost. A mismatch between demand and supply may, for example, lead to poor investment decisions (e.g. over investment or too-early investment in supply) or shortages where there is too low a level of investment or too-late investment in expansion of water supplies.

#### Ability to Compete in Market for Services

The 2004 COAG agreement encourages the further contracting out of contestable services by water authorities. Capacity is also created for new players to enter the water industry, such as those which may be able to supply water from alternative sources. In these circumstances, smaller authorities may struggle to obtain the lowest cost for the services provided as they may be unable to take advantage of the economies of scale that may be available to the metropolitan water authorities. Furthermore, new, or at least enhanced skills will be required by water authorities in the contracting out of services to ensure that undue risk does not accrue to the authority and that the best value is obtained. As noted, smaller authorities are not well positioned to obtain additional skills. Finally, the entry of new water suppliers raises questions about the maintenance of water quality at consumers' taps and the competitiveness of supplies from traditional sources. These questions will exist throughout the industry, but smaller authorities are likely to be less able to address them.

## Governance

There remains concern about the governance arrangements surrounding water service provision by local governments. As noted, principles of the COAG reform process have included the introduction of a greater commercial focus and, generally, the removal of cross subsidies. Achievement of these ends requires the establishment of the local government's water supply functions as a separate business entity, with its own commercial objectives and with a remit to make future investments – such as expansion of the system – on the understanding that full costs will be recovered, including a return on the investment made. Larger local governments, such as Brisbane City Council have achieved these goals through the establishment of Brisbane Water. The demarcation of responsibilities and financial systems between water suppliers and smaller local governments has not always been as transparent. Furthermore, there has been a general tendency in some jurisdictions over the past few electoral cycles for there to be a blurring of the boundary between water supply authority and ministerial responsibilities. This raises the possibility cross-subsidisation – whether implicit or explicit – once again emerging. Within the less well-regulated structures of some local governments political intrusion may be hard to resist.

## Summary of AWA's Position

AWA respects the right of each jurisdiction to determine the best means of meeting its COAG and NWI responsibilities. There are numerous models that can be pursued and it is doubtful that there is a template that should be followed by all. AWA believes, however, that each institution must:

- have sufficient 'weight' to operate efficiently (e.g. by taking advantage of economies of scale)
- be sufficiently skilled to operate within a more highly contested market utilising increasingly more sophisticated technology; and
- have sufficient 'gravitas' to have its voice heard in debates about regulatory, planning and customer service outcomes
- operate independent of undue political influence, to the benefit of its customers

Without pointing a finger at any particular institution or local government, AWA believes there is a case for review of the water supply functions of smaller local governments to determine whether water services are best delivered at that scale and within existing governance arrangements or whether larger institutions should be established which are more likely to be able to maintain customer standards and reduce costs into the future. COAG would be an appropriate vehicle for stimulating such a review, which could be managed by, say, the NWC. AWA also believes that even if amalgamation does not occur, COAG should reinforce the principle of the establishment of separate trading entities for water supply which are responsible for their own commercial outcomes in line with sound business practice and the COAG water reform agenda.

## References

Council of Australian Governments (COAG) (25<sup>th</sup> January 1994) *Council of Australian Governments' Communiqué. Attachment A: Water Resource Policy*

National Water Commission (2005) *Intergovernmental Agreement on a National Water Initiative*