

## Water Buy-Back in Australia: Political, Technical and Allocative Challenges

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## **Abstract**

*State and Federal governments are increasingly reliant on the re-purchase of water access rights as a vehicle for bringing 'over-allocation' in the Murray-Darling Basin into check. Not surprisingly, this has attracted criticism from several quarters, usually on the basis that such mechanisms produce unnecessary hardship for rural communities. Set against this are the views of many economists who have bemoaned the modest endeavours of governments to actively use water markets and the ongoing proclivity of agencies to instead embark on public projects under the guise of water use efficiency (see, for example Watson 2008).*

*This paper focuses specifically on water buyback and traces recent policy episodes in this context. The paper also offers details of alternative market instruments which have the potential to improve on the current, relatively fragmented arrangements. We use contemporary examples to test the efficacy of alternative buyback instruments in the hope of informing policy formulation.*

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# Water Buy-Back in Australia: Political, Technical and Allocative Challenges

## Introduction

The transformation of water policy in the Murray-Darling Basin of Australia over the past 20 years is instructive on many fronts, particularly for those with an interest in seeing political economy at work. If nothing else, the previous two decades of policy formulation have poignantly illustrated the intractable nature of reallocating resources once governments have assigned (or implied) liberal use rights. Arguably, the 'developmentalist' ethos that typified water policy for most of the twentieth century has now manifested in a series of path dependencies that would challenge even the wiliest political player.

Amongst the most instructive barometers of the changing water policy landscape has been the modified conceptualisations of market instruments as a vehicle for clawing back water extractions. Initially judged by politicians as 'not on the table', the direct purchase of water rights by governments has now become an important element for shoring up environmental claims. And yet this has not happened overnight and the recasting of 'buyback' has moved through several phases. Currently water buyback is overtly claimed as a virtuous instrument aimed at "boost[ing] the overall health of rivers and wetlands that are extremely stressed after years of over-allocation, drought and climate change" (Wong 2008). This view was not always held and, notwithstanding the enthusiasm evident in recent pronouncements, we argue that the status and application of buyback warrants closer scrutiny.

This paper is used to outline the progress of water buyback in the Murray-Darling Basin between the initial CoAG reforms of 1994 and the most recent policy episodes. The aim of the paper is not simply to provide a historical account of the political economy of water buyback over this period. Rather, the ambition is to point towards some of the continuing challenges and potential mechanisms for resolving them. Moreover, we argue there is still some way to go before Australian governments can claim to have met their 1994 commitment to allocate water in line with the Agricultural and Resource Management Council of Australia and New Zealand [ARMCANZ] and Australian and New Zealand Environment and Conservation Council [ANZECC] National Principles for the Provision of Water for Ecosystems (see, NCC 1994).

The paper itself is organised into five main parts. In section two we trace the development of water buyback as a component of the policy framework. A synoptic overview of the contemporary status of buyback is then presented in section three. The fourth section is used to highlight some of the limitations with the existing policy approach and identify areas where improvement may occur. This is undertaken in the context of a specific case site in the Ovens Valley of Victoria before offering some brief concluding remarks in section five.

## The Transformation of Water Buyback 1994 - 2008

### *1994 Water Reform Framework*

Observers of water policy in Australia point to a number of significant reform episodes. Notwithstanding the progressive realisation throughout the 1980s that the Australian water economy had 'matured' (Randall 1980), the Council of Australian Governments (CoAG) pronouncements on water reform in 1994 represent a significant milestone in their own right. The 1994 *Water Reform Framework* embodied five key principles encompassing: modifications to pricing practices such that water prices reflected cost; introduction of two-part tariffs where practicable; separation of regulatory and water management functions; a commitment that all future infrastructure investments would meet economic and environmental criteria, and; the development of volumetric water allocations that were to be tradeable and such that they made allowance for ecological needs. Importantly, as part of their commitment to the last of these principles, governments undertook to provide water for ecosystems in a manner consistent with the underlying principles prescribed by ARMCANZ/ANZECC. Principles 2, 4 and 5 are particularly relevant in the current context and are reproduced below for convenience:

Principle 2: Provision of water for ecosystems should be on the basis of the *best scientific information available* on the water regimes necessary to sustain the ecological values of water dependent ecosystems.

Principle 4: In systems where there are existing users, provision of water for ecosystems should *go as far as possible to meet the water regime necessary to sustain the ecological values of aquatic ecosystems whilst recognising the existing rights of other water users*

Principle 5: Where environmental water requirements cannot be met due to existing uses, *action (including reallocation) should be taken to meet environmental needs* (Sustainable Land and Water Resources Management Committee Subcommittee on Water Resources 1996, pp. 7-9 – emphasis added).

These deceptively straight forward principles embody substantial practical and political challenges, particularly where the quantum and timing of current water extractions challenge even modest benchmarks for environmental sustainability. Perhaps not surprisingly then, relatively little 'real water' was made available over the next decade to meet these ambitious environmental objectives. Rather, most progress had focussed on modifications to legislation and the development of planning processes, all of which attracted financial reward from the Commonwealth since the 1994 CoAG arrangements brought water reform under the ambit of National Competition Policy and its related funding tranches. The status of progress against the environmental principles by 2005 is summarised in Table 1.

Jurisdiction (Legislation/ proposed legislation)	Consideration for the Environment
NSW (Water Management Act 2000)	Prima facie, the environment has prior right over consumptive use; Water for environmental purposes is ascribed in water sharing plans; 36 water sharing plans have been gazetted for major rivers and groundwater systems; There remains some doubt whether the plans allocate sufficient water for the environment (NCC 2005, p. 3).
Victoria (White paper – <i>Securing our water future</i> 2004 to replace Water Act 1989 and Water – Irrigation farm dams Act 2002)	Bulk entitlement for the environment established in 19 of 25 water supply systems; Rehabilitation plans in place for 5 of 11 stressed and over-allocated river systems identified in 1999 and White Paper identifies a timetable for development of others; Volumes assigned to the environment subject to review by an independent Technical Audit Panel to ensure plans are based on supporting science; White Paper foreshadows the establishment of an environmental reserve with a defined entitlement; Introduction of an environmental contribution by water users (5% payable by urban water authorities immediately, 2.5% payable by irrigators and to be phased in).
South Australia (Water Resources Act 1997 and Land Management Bill 2004)	Planning for environmental needs is based on a water planning hierarchy, ranging from the State Water Plan at the top to Catchment Water Management Plans and optional Local Water Management Plans at the bottom; Water allocation plans have been developed for all 15 prescribed water resource areas identified in 1999; Additional plans have been developed as the need has arisen; The planning framework allows for the monitoring of environmental demands for water and permits a reduction in consumptive use without compensation.
Tasmania (Water Management Act 1999)	Establishment of a state-wide Water Development Plan; Specific allocations of water for environmental purposes have been identified – minimum flows on basis of Water Management Plans – although the use of ‘community values’ to set environmental thresholds prevents rigorous assessment of trade-offs; Since 1999, 43 of the 45 environmental water assessments have been completed and the implementation of the Great Forester catchment plan has led to streamlining of processes.
Queensland (Water Act 2000)	Water Allocation and Management Plans have been developed to establish the balance between environmental, social and economic demands and these are to be executed through Resource Operation Plans; By the end of 2004, the state had completed only 3 of the 19 Resource Operation Plans for the systems identified in the 1999 CoAG implementation program; Independent scientific reviews have been used in some cases to inform Resource Operation Plans; In some cases (e.g. Fitzroy and Boyne Basins) safeguards within the Act can be used to vary resource allocation to meet environmental flow objectives
Western Australia (Rights in Water and Irrigation Act 1914 and its recent amendments; State Water Strategy Irrigation review 2005)	A total of 41 water planning areas are identified in Western Australia; By 2005 around two-thirds of these plans were expected to be complete; Recognized environmental water assessment methods have not been used to establish some plans and adequate record keeping to underpin planning has been found wanting in some agencies; Renewed effort to resolve these matters has come from the Department of Environment following the amalgamation of the Department of Environmental Protection and the Water and Rivers Commission.
Northern Territory (Water Act 1992)	Water planning occurs as part of the Territory’s integrated resource management process; Currently, six water control districts have been declared: Darwin rural, Katherine, Gove, Tennant Creek, Ti-Tree and Alice Springs; The water management strategy for Ti-Tree has been completed and three others were scheduled for completion in 2005; Notwithstanding some debate about the robustness of some of the science used to develop this strategy, the NCC has concluded that the process adequately accounts for the needs of the environment.
Australian Capital Territory (Water Resources Act 1998)	A Water Resources Management Plan is developed under Environmental Flow Guidelines before any consumptive use allowances are made; Plans are made at the sub-catchment level; Planning for all 32 sub-catchment and groundwater has been completed.

Table 1: Progress against delivering environmental objectives by jurisdiction (Source: Adapted from NCC 2004)

It is also informative to briefly consider how the state jurisdictions were considering the issue of reallocation (i.e. Principle 5) during this phase. In Victoria, for example, the Government released its White Paper titled *Securing Our Water Future Together* in June 2004. The stated environmental aspiration of the Victorian government at that time was “to have healthy rivers, floodplains, estuaries and catchments” (DSE 2004, p. 38). The principal means of achieving this was via the establishment of Environmental Water Reserves for each of Victoria’s river systems. Where over-allocation was already apparent, the level of each Reserve was to be set in a manner that was consistent with the principles of adaptive management and by applying the precautionary principle (DSE 2004, p. 44-47). Arguably, this would appear not to deal directly with the thorny issue of reallocating water.

On a more practical note, the reforms in Victoria resulted in what was formerly termed ‘sales water’ (i.e. a low reliability access right) being converted to a tradable right, of which 20 percent was then administratively assigned to the Environmental Reserve with the residual accruing to irrigators. Other measures envisaged as building the Environmental Reserve included “practical restoration measures” like decommissioning Lake Mokoan, funding of water use efficiency in irrigation, investing in infrastructure to reduce distribution losses, donations and the substitution of recycled water of suitable quality. At this point markets and buyback were mooted as possible options although the government was keen to point out that it was “aware of the potential socio-economic side-effects” of this approach and emphasised that its main criteria was to “as far as possible ...provide long-term, environmental, social and/or industry benefits” (DSE 2004, p. 49). Interestingly, relatively little was made of the need for economic efficiency in delivering these outcomes.

In sum, the response to the original CoAG framework was characterised by variable progress across state jurisdictions and a heavy emphasis on planning and the development of legislation and administrative processes. Commitment to noble philosophies was clear but relatively limited delivery of fungible water to satisfy environmental claimants actually occurred. The prospect of purchasing water rights to achieve environmental ends had received some policy attention although this was far from the preferred response. When water was being assigned to an Environmental Reserve, it often had inferior claims – say in the form of converted sales water in Victoria. Moreover, at this point there was (and remains) little evidence to suggest that the Environmental Reserve was itself being considered in any other form than a volume of water, where more Gigalitres were seen to crudely equated to greater environmental benefits.

### *The Living Murray*

Before moving to consider how buyback has evolved as part of subsequent rounds of CoAG, it is worth noting that other policy initiatives were circumscribing the water reform agenda at this time. In response to growing concerns about the environmental health of the River Murray, the Murray-Darling Basin Ministerial Council released its *Living Murray* discussion paper in July 2002. The discussion focused on three main reference points, (350, 750 and 1500 Gigalitres) again specified solely in terms of a volume of water

to be allocated to satisfy ecosystem needs. After a tortuous consultative process (see, Crase, Dollery and Wallis 2005) the MDBMC settled on reallocating 500 Gigalitres as a first step to restoring the ecological health of the River Murray. This outcome was heavily influenced by the Federal government with the Prime Minister of the day announcing that \$500 million would be allocated to address the declining health of the River Murray. Each of the southern jurisdictions agreed to contribute to the 500 Gigalitre target with the majority being sourced from New South Wales (249 Gigalitres) and Victoria (214 Gigalitres).

As with progress against the CoAG water reforms, the achievements of the Living Murray initiative vary across states. For instance, by July 2008 the Murray-Darling Basin Commission was reporting that 133 Gigalitres of water had been 'recovered', most of this being attributed to Victoria (120 Gigalitres). New South Wales had 'recovered' no water at all, although projects expected to yield 237 Gigalitres were listed as 'ready for implementation' and a further 30 Gigalitres was attributed to projects that were 'under investigation'. Again, the definition of environmental restoration in the Living Murray is distinguished almost exclusively in volumetric terms. The mechanisms by which various water products are accounted for is also somewhat opaque and variable. For example, the legislatively-converted sales water in Victoria, which coincidentally equates to the entire 120 Gigalitres claimed to have been 'recovered' in that state, needs to be meaningfully comparable with a range of other 'recovery' mechanisms. In this context, the reconfiguration of irrigation systems in the Goulburn-Murray irrigation district will purportedly yield 25 Gigalitres of water for the Living Murray. It is not at all clear how these 25 Gigalitres which derive from 'water use efficiency' measures, that are themselves of questionable status, will ultimately stack up against those Gigalitres sourced by legislative fiat<sup>1</sup>. A similar question circumscribes the status of different water products purchased from the market.

In 2008 the Living Murray Initiative had three projects focussed on purchasing water on the market and which met the criteria for the Eligible Measures Register. The projects were anticipated to yield up to 195 Gigalitres of water and were viewed by jurisdictions as being "essential if the Living Murray Initiative is to reach its volumetric and financial targets" (NWC 2008, p. 12). Clearly, buyback was being acknowledged as a realistic means of dealing with the reallocation issue in the context of the Living Murray project by this time, and yet there remains considerable doubt about the sincerity with which it is being managed, which we deal with later in the paper.

#### *2004 National Water Initiative*

The earlier description of the initial CoAG reforms suggests that limited real progress was evident against the key environmental principles embodied almost a decade after reaching consensus on the 1994-95 agreement. This was in no small part due to the political difficulties associated with reallocating water and left most jurisdictions selecting options considered more politically

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<sup>1</sup> For a review of the logical flaws with water use efficiency see, for example, Crase and O'Keefe (2009). An explanation of the water accounting used to convert TLM water to a common metric is scrutinised later in this paper.

feasible – modifying administrative, planning and consultation processes and/or using public monies to purportedly ‘create’ water via difficult-to-quantify water use efficiency measures.

However, increased enthusiasm for water reform emerged in 2004 when CoAG settled on the National Water Initiative. The National Water Initiative sought to resolve some of the more vexing issues that had emerged from the earlier reform agenda. More specifically, the Initiative sought to harmonise the property rights structure for water access by having all jurisdictions define rights as a share of a variable consumptive pool. Risks were also to be more clearly specified and, importantly in the current context, integrated management of water for environmental purposes was foreshadowed (NWC 2005). The specific outcomes expected to emerge from this element of the National Water Initiative were fourfold. First, there was an expectation that environmental and public benefit would be “identified with as much specificity as possible”. Second, management and institutional arrangements were to be put in place to realise those environmental outcomes. Third, environmental water managers were to be given adequate “authority and resources” to meet the environmental objectives ascribed in planning documents. Fourth, there were to be “cost effective measures to provide water for environmental outcomes” (NWC 2008, p. 11).

To manage the National Water Initiative the 2004 CoAG reforms ratified the formation of the National Water Commission. In September 2004 the Prime Minister also announced the establishment of a \$2 Billion Australian Government Water Fund with the lion’s share (\$1.6 Billion) dedicated to the Water Smart Australia Program which aimed primarily to “accelerate the uptake of smart technologies and practices in water use across Australia ...[with most support] directed to practical on-the-ground projects” (NWC 2005, s1-1). Very limited financial support was foreshadowed for buyback at this time with most emphasis given to supporting “improvements in irrigation infrastructure”, or activities that “advance efficiency improvements on on-farm water use”, or “develop water efficient housing design” (NWC 2005, s2-1). This was arguably at odds with the overarching desire to have “cost effective measures to provide water for environmental outcomes” (NWC 2008, p. 11) since it was widely acknowledged at the time that the market purchase of water from willing sellers was the most cost effective mechanism for recovering water (see, for instance, ACIL Tasman 2003; Crase, Byrnes and Dollery 2007; Watson 2007; Quiggin 2006).

In reviewing the progress of jurisdictions against the requirement to comply with the principles for water recovery to achieve environmental outcomes, the National Water Commission (2008, p. A30) subsequently reported that most states had “substantially completed” this action. Poignantly and in the context of water buyback, New South Wales was noted as “having a range of water recovery programs being progressed with Commonwealth support, including infrastructure and market based” mechanisms. Victoria was considered to be in a position to have “strategies dealing with environmental water ... completed by 2009”. South Australia was also rated as having “substantially completed” this task and it was specifically observed that this state “supports



and utilises market options to recover water”. Arguably, in the jurisdictions with the most expansive irrigation sectors the National Water Commission would appear to have substantially modified its views on the acceptability of water buyback by 2008. Nevertheless, on a more cautionary note the Commission continued to observe that “selecting the most appropriate mechanisms for water recovery is a complex and challenging task with important economic and social dimensions in addition to the environmental requirements” (NWC 2008, p. 12). Perhaps the Commission is not yet completely convinced that the reallocation Principles agreed to in the early CoAG agenda require the forthright and coordinated use of market instruments – a view not shared by the authors.

#### *National Plan for Water Security*

The National Plan for Water Security was amongst the final policy declarations of the Howard government and was released in January 2007. The Plan attracted scathing criticism from some quarters, having emerged in a manner that seemed to reflect the political concerns of the time more than the environmental demands of the Murray-Darling Basin. Watson (2007, p. 1) noted that the authors of the Plan were “not claiming spurious accuracy for their major proposals. As subsequently emerged, the ten-point Plan to spend \$10 Billion over ten years was prepared in haste, well away from the troublesome gaze of Treasury and Finance officials and the experienced eye of the Murray-Darling Basin Commission”.

The Plan overtly supported buyback of water inasmuch as it assigned an unspecified portion of the proposed expenditures earmarked for addressing over-allocation in the Murray-Darling Basin (\$3 Billion) to buyback. Nevertheless, greatest emphasis was still given to alternative policy approaches in the form of “assistance to irrigation districts to reconfigure irrigation systems and retire non-viable areas” along with measures “to help relocate non-viable or inefficient irrigators, or help them with exiting the industry” (Howard 2007, p. 4). This was in addition to the \$6 Billion already specified in the Plan for modernizing irrigation at taxpayer expense. In a more tepid tone, it was suggested that “where necessary, entitlements will also be purchased on the market” (Howard 2007, p. 4).

One of the major legacies of the Plan was the Commonwealth Water Act 2007 which sought the ceding of state powers over water resources in the Murray-Darling Basin to the Federal government. After considerable political maneuvering, all states finally agreed to relinquish control over the Basin’s water resources in March 2008. Greatest resistance to the Act emanated from Victoria and it came as little surprise that Victoria’s eventual agreement coincided with the decision by the Commonwealth to co-fund Stage Two of the Food Bowl Modernisation Project in Victoria’s Goulburn Valley. This is estimated to cost Australian taxpayers up to \$1 Billion (CoAG 2008a, p. 7) and is in addition to the funding garnered from the state government via increased water charges to be borne by Melbournians.

### *Water for the Future*

In April 2008 the recently elected Rudd Government announced its Water for the Future manifesto. The policy committed the government to spending almost \$13 Billion over ten years via “investment in strategic water priorities; sound water governance and policy; and renewed purpose and commitment in water reform” (Wong 2008b, p. 4). Reminiscent of earlier proclamations like the Howard Government’s National Plan for Water Security, the policy is heavily skewed towards the ‘modernisation’ of irrigation at taxpayer expense. More than \$5.8 Billion was assigned to “investment towards improving the efficiency and productivity of water use and management” (Wong 2008, p. 9).

Notwithstanding the similar enthusiasm for spurious engineering ‘fixes’ embodied in the Howard government’s Plan and the Rudd government’s policy, the pronouncements on buyback were *prima facie* more forthright. In this context Wong (2008b, p. 14) plainly announced that the government “will be purchasing water to put back in the rivers”. The budgetary allocation for this activity was to be in excess of \$3 Billion and was foreshadowed as being complementary to the infrastructure programs and other earlier commitments made under the Living Murray program and the Snowy initiative.

On the basis of these recent declarations proponents of buyback could be forgiven for feeling cautiously optimistic. After all, buyback programs have clearly moved on from having been initially conceived as the least preferred political alternative in the early phases of reform. They would also appear to have surpassed the phase where they received lukewarm support with relatively undefined budgets and almost begrudging acceptance of their policy usefulness. Finally, there appeared to be some enthusiasm for buyback programs with a defined budget allocation, albeit less than the sum assigned for subsidising irrigation infrastructure. Surely, this would become an important vehicle for restoring balance in over-allocated systems in the Murray-Darling Basin.

### **An Overview of the Status of Water Buyback in the Southern Murray-Darling Basin**

In the previous section we noted that the status of water reform generally varies across state jurisdictions. This is no different for water buyback programs, although buyback is also complicated by programs developed and managed under the auspices of the Murray-Darling Basin Commission and the recently established Commonwealth Environmental Water Holder. To shed some light on buyback we briefly summarise the publicly available data on some of these programs but specifically focus on activities in New South Wales and Victoria and the Commonwealth’s water buybacks. We acknowledge that other buyback programs have operated in the Basin, such as the pilot program operated by the Murray-Darling Basin Commission in 2007 and the earlier activities of Water for Rivers. However, we restrict our discussion to contemporary programs in the interest of brevity.

### *RiverBank*

The New South Wales government established RiverBank in 2005 as its designated purchaser of water in order to address the deterioration of

wetlands and river systems. State level funding for the initial components of RiverBank's work derived from taxes levied on hard waste disposal to landfill in Sydney<sup>2</sup> (set at about \$100 Million) and the Commonwealth also provided additional funding (\$72 Million). The program purportedly seeks to target specific sites in the first instance, such as the Macquarie Marshes, Lowbidgee Wetlands and Narran Lakes. The goals and objectives specified in the Program Plan 2006-2011 focus predominantly on environmental, cultural and business outcomes (DECC 2008a) although the extent to which this then translates into annual targets and activities is less clear. For example, the 2008-09 Annual Plan traces indicative investment targets - measured in terms of the total dollars expended (see, DECC 2008b p. 2) - but the Plan is less clear on the actual achievement of environmental targets. RiverBank water was first used in April 2008 to support a bird breeding event in the Macquarie Marshes. This amounted to the modest release of 693 Megalitres to accompany an 8,000 Megalitre release as part of the Macquarie-Cudgegong Water Sharing Plan. Regrettably, there appears to be no mechanism for tracing the effectiveness of the use of the resource in this or other contexts that would allow for an ongoing assessment of the cost effectiveness of achieving environmental impacts.

Although the Program Plan leaves open the possibility of employing a number of acquisition methods, most licences to date have been acquired using an expression of interest (EOI) process. The published criteria upon which EOIs have been assessed include the size of the licence; restrictions that pertain to a licence; the price per unit share; and the type of licence (DECC 2008c). Reference is made in the RiverBank Planning documentation to a range of other criteria which may be invoked to rank the water that is on offer, such as the "opportunities for enhancing the current environmental water rules with additional flows" and "potential for strategic alliances" (DECC 2008a, p. 13). However, it is not at all clear how each of these is rated by the agency in the context of specific bids.

In 2008 RiverBank also acted as the single purchasing desk for the New South Wales component of the Living Murray Initiative and all other water buyback programs in the state. This adds some confusion to the activities of RiverBank inasmuch as the Living Murray Initiative purportedly aims to target different environmental sites to those specified in RiverBank's original planning. This is further complicated by the fact that the criteria by which 'new environmental water' [new e-water] are assessed under the Living Murray should differ from that used for RiverBank's targeted environmental assets. To illustrate this point it is necessary to understand some of the administrative accounting measures in place to track progress in the Living Murray Initiative.

Earlier we noted that the Living Murray Initiative was a cross-jurisdictional agreement where states agreed collectively to return a total of 500 Gigalitres of water to the River Murray. This relatively simple policy goal belies the complexities of water accounting and, as we will see, it is these complexities that can encourage perverse outcomes. Since each jurisdiction has specified

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<sup>2</sup> Economists would invariably struggle to rationalise the efficiency impacts of these arrangements.

its water entitlements in different forms, a volumetric measure in one state is not always equivalent to that in others. Even within jurisdictions there will be non-trivial differences that reflect the reliability with which a given volume of water can be accessed in a given location. For example, New South Wales has three main categories of water access licences or water products. High security products have a fixed and relatively secure volume of water where the frequency, timing and delivery are largely controlled by the licence holder. General security products vary in volume depending on seasonal conditions and inflows to storages. Annual allocations for general security licences only accrue once higher claims (e.g. high security holders) have been met, although release and control of the allocation is largely at the discretion of the licence holder. The lowest priority accrues to supplementary access products. Here, magnitude, frequency and timing of access are all subject to specific declarations – say in the event of a very high flow in a stream (DECC 2008a, p. 17). In simple terms a Gigalitre of high security water is not the same as a Gigalitre of supplementary access water and a mechanism is required to convert these to a common metric since the Living Murray Initiative has specified the objective in a single volumetric measure - 500 Gigalitres.

The Murray-Darling Basin Commission has developed a number of Living Murray Business Plans approved by the Murray-Darling Basin Ministerial Council. Despite the use of some rather daunting terminology, the Business plans provide insights into how this methodology has evolved over time and the implications for water buyback. At the core of the issue is the calculation of what is termed ‘long term cap equivalent’ [LTCE] water. The LTCE is the volume of water calculated using the best practice modelling of the Cap on extractions to determine the long term contribution of the ‘water parcel’ to the Cap or its “potential contribution to long term average flows in the relevant river valley” (MDBC 2005, p. 49). In essence, what this process attempts to do is capture and control for the variability that attends different water products and reduce it to an ‘average’ contribution to flows.

There are three potential limitations to this approach that need to be kept in mind. First, the modelling that is used in this instance is not a precise science and if future predictions of climate change prove accurate, the impacts on the actual water availability seem likely to be significant. More specifically, the estimated volumes generated by the LTCE method rely heavily on historic data relating to yield and rainfall. Thus, low surety products like supplementary access licences, may well yield very little, if any, water in the future as the frequency of high flow events decrease with climate change. There is no evidence that this has been deliberately included in the LTCE calculations or the manner in which agencies have considered buyback options presented as part of the Living Murray. Moreover, this must surely shed some doubt on the usefulness of low reliability products in achieving the prescribed environmental outcomes.

Second, whilst administratively convenient, when deployed as the sole metric the LTCE approach potentially increases the focus on the *volume* of water as a policy objective in its own right. Ecological systems are far more complex than this and the environmental health of any stream will be influenced by a

range of ecological and hydrological factors, not just the volume of water. Hillman (2009) summarises a number of these dimensions such as the differing classes of flow and water temperature, for example. Put simply, the purported *volume* of water at the disposal of an environmental manager appears to have become the sole de facto environmental metric in many instances. The upshot is that agencies may be buying water products (which may or may not ever deliver a flow) on the basis of volume and the link between the purchase and environmental restoration is weakened as a result

Third, notwithstanding the collaborative façade of programs like the Living Murray, strong rivalries remain between states and their water bureaucracies. Against this backdrop, the determination of the LTCE for different water products has the potential to take on a political dimension in spite of the insistence that the LTCE “in itself does not represent a policy position” (MDBC 2005, p. 49). After all, if a jurisdiction can influence the LTCE calculation such that a relatively low value product in their state is granted a generous LTCE then that state can claim to have met its obligations to recover water but limit the economic and political costs of redistribution.

A review of the LTCE (Cap Factor) over a number of years shows that in 2005 the parties to the Living Murray were aware that its configuration at that point did “not encourage the purchase of supplementary allocations as its long term Cap equivalent may reduce over time” (MDBC 2005, p. 52). Nevertheless, by 2007 a Cap Factor of 0.37<sup>3</sup> had been assigned to Lower Darling Supplementary Licences in New South Wales providing some incentive for their purchase<sup>4</sup>.

Against this background the New South Wales Department of Environment and Climate Change announced in November 2008 that it was “ahead of the pack on environmental water” (DECC 2008c, p. 1) having purchased 23 Gigalitres of supplementary access licence from Tandou Limited. The press release from the Department proudly proclaimed that this single purchase “represent[ed] almost one tenth of NSW’s water recovery target” making a representative of the Department “confident that it is on track to achieve its share of the program by 30 June 2009” (DECC 2008d, p. 1). Given the aforementioned caveats about the calculation of the volume of water that attends this \$34 million purchase and the doubt over the environmental outcomes that it might deliver, a more circumspect response might have been expected. Attending the press conference that accompanied the press release the Minister was reportedly quizzed “about the benefits of the purchase, given the savings would only be realised in big wet years when the environment would be receiving a big drink anyway” (Skulthorp 2008). The Minister reportedly justified the expenditure on the grounds that “‘times are tough’ for companies like Tandou” (Skulthorp 2008) although apparently not

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<sup>3</sup> The higher the Cap Factor the more Gigalitres the state can claim to have purchased for the environment. High security products have Cap Factors of 1.0 or higher.

<sup>4</sup> No Cap Factor was specified for supplementary licenses in the Darling in New South Wales in 2005 and the documentation notes that the published Cap Factors for 2007 were revised and “agreed by jurisdictions at 15 Sept 2006” implying a partially negotiated process at least (MDBC 2007, p. 59).

so tough that it could be persuaded to part with any of its general or high security water products.

In sum, there appear to be some grounds for questioning the link between the water products being purchased by RiverBank and the environmental objectives assigned to the Living Murray and the other state-based environmental programs for which RiverBank acts. There would also appear to be grounds for greater scrutiny of the range of political and administrative influences that may come to bear in these cases since there is potential for these to substantially undermine the efficacy of the buyback approach.

#### *DEWHA Commonwealth Environmental Water Holder*

Earlier we noted that the Water for the Future manifesto announced the Commonwealth government's intention to allocate about \$3 Billion to purchase water over five years. In February 2008 the Minister declared that the first allocation of funding was set at \$50 Million and purchases were to be completed by the end of June 2008. Funding was also announced for the following three years ranging from \$157 Million to be spent in 2008-09 to \$468 Million for purchases in 2010-11. At the completion of the first round \$47.1 Million had been expended and 34.3 Gegalitres of water product purchased (Breckwoldt 2008).

Like the RiverBank model, the DEWHA process requires the seller to submit a non-binding EOI with offers then being assessed by DEWHA on the basis of 'value for money'. To help guide the process DEWHA reportedly employs two principles to help prioritise purchases. These are:

- "The availability of the water for regular allocation to high and medium priority environmental assets such as wetlands that have been significantly adversely affected by water extractions
- The extent to which the withdrawal of the water from the regular allocation to irrigators will improve the overall health of the catchment from which it is taken and/or the Murray-Darling system as a whole" Breckwoldt (2008, p. 7).

The combined impact of these principles was that the first round of DEWHA buyback focussed on water that could be delivered to 'priority assets', being limited to Ramsar wetlands; those wetlands listed in the Directory of Important Wetlands in Australia; ecosystems supporting listed threatened species and; those migratory birds and communities listed as being threatened. This manifested in a purchasing strategy that sought water entitlements from the Murray and its tributaries downstream of Menindee Lakes and the regulated portions of the Lachlan, Macquarie and Gwydir Rivers. At the time DEWHA acknowledged that purchases of water from other catchment areas of the Darling had the potential to deliver benefits, but the unregulated nature of these entitlements and the conditions that attended them<sup>5</sup> made purchase

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<sup>5</sup> In essence, there is no way of using these water products to deliver water to an environmental asset since, under current conditions, it is not possible to prevent downstream irrigators from then extracting the passing flow, given the nature of the licences.

“much lower priority compared to the catchments identified above” (Breckwoldt 2008, p. 7).

Notwithstanding these criteria, DEWHA and the New South Wales government attracted considerable attention when they publicly announced the purchase of Toorale Station, located at the junction of the Darling and Warrego Rivers slightly downstream of Bourke<sup>6</sup>. The primary motivation of the \$24 Million deal was to deliver “a significant boost to environmental flows in the Darling River, whilst also providing a boost to the NSW reserve system” (Wong and Tebbutt 2008, p. 1). The water products that came with the purchase were announced as being equivalent to 20 Gigalitres per year<sup>7</sup> (Wong and Tebbutt 2008, p.1), although former National Party leader and director of the firm that until recently owned the property had a more jaundiced view. In an interview with ABC television Mr. Anderson noted that “Toorale hasn't grown anything for years because there hasn't been any water” and “that unless everything's going to turn around and we're suddenly going to get reliable water flows again ... I'm afraid what the taxpayer's actually bought is air” (ABC 2008, p. 1).

Whilst it might be expected that former political adversaries would differ on this point, this case again highlights the urgent need for a clearer link between the purchasing strategy employed in buyback and the environmental objectives ascribed in the policy. In the context of the first phase of the DEWHA buyback program proper, which comprised mostly general security products purchases from preferred catchments, Breckwoldt (2008, p. 72) urges similar action:

“The evaluation of future purchases will be difficult without clarification of the goals and objectives of the water purchasing program through specification of the required water regimes. The Environmental Water Plan should drive acquisition of water as soon as possible. There is a need to clarify targets to support the overall goal of water for the environment. The objectives and targets of the Basin Plan need to be clarified and then used consistently”

In a more general context the NWC has expressed similar reservations about the slow progress against those components of the National Water Initiative that relate to integrated management of water for the environment. One of the key priorities identified in this field is to “undertake an evaluation of the cost-effectiveness and environmental-effectiveness of the various recovery mechanisms in the Murray-Darling Basin including an examination of any overlap and duplication among programs” (NWC 2008, p. 13).

#### *Streamflow tenders in Victoria*

The Victorian government has invested substantial resources in the development of Regional Sustainable Water Strategies with the first of these

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<sup>6</sup> For those unfamiliar with the geography of the Basin, this area is well upstream of the Menindee Lakes and in the region specified by DEWHA as being of a lower priority for buyback.

<sup>7</sup> Presumably this was the result of a LTCE calculation, although data on this issue are difficult to derive.

being released in October 2006. These strategies cover water resources in a defined area and provided part of the impetus for the development of streamflow management plans that detail the sharing arrangements for streams. In essence, streamflow management plans specify a minimum flow regime to sustain or improve the ecological health of rivers. In order to achieve this flow, limitations are placed on the amount and timing of extractions. For example, in summer months irrigators may be placed on a rotation that limits when they can withdraw water or banned from extracting water entirely, depending on flow conditions.

Streamflow management plans provide for a staged modification to water extractions over several years. However, in order to accelerate progress towards the achievement of streamflow targets, the government conducted a pilot tender process for the Olinda, Stringybark, Pauls, Steels and Dixons Creeks in mid-2007. The streamflow tender involved licence holders offering to modify the conditions that attend their licences in return for financial assistance. This reduced to two main offers from irrigators – agreement to reduce the volume of their licence and/or agreement to cease extractions when streamflow reached a predetermined trigger.

The tender process was managed by Melbourne Water with the broad criterion of ‘value for money’ stipulated as the basis for tender assessment (Melbourne Water 2007a, p. 1). Closer inspection of the tender forms would suggest that the three areas of concern were the extent to which the bid would contribute to environmental flows, the bid price and the rapidity with which changes would be made (see, Melbourne Water 2007b, p. 1). Whilst a review of the tender was proposed, it has yet to be released. Nevertheless, the Department of Sustainability and Environment reports mixed success with some farmers proving more enthusiastic than others and a modest 55 Megalitres being relinquished as part of the tender (DSE 2008, p. 323).

Streamflow tenders have one important advantage over volumetric EOIs insomuch as there is potential to more clearly specify the environmental impacts of a water buyback relative to using a volumetric recovery target. Here there is scope to at least account for the timing of flows in order to address the most significant environmental stresses. However, there are other perverse outcomes that need to be considered. First, the purchaser needs to be assured that the actions on offer will actually deliver against the streamflow target. This will be particularly problematic if data on the history of use are not available or of inappropriate scale. Under these circumstances it becomes possible for holders of sleeper and dozer rights to tender volumetric licences such that no discernable improvement on the flow target emerges. Obviously, this raises the overall cost of delivering the streamflow target as sleeper and dozer rights need to be ‘absorbed’ before any progress can be made against the flow target. Second, the purchaser needs to guard against the myopic focus on the most pressing problem – usually summer flows – at the expense of generating other third party effects. In some instances irrigators (and urban water utilities) have been encouraged to construct ‘winter fill’ storage which can then be accessed in summer to offset bans on extraction. This runs the risk of ignoring the consequences of excessive



winter extractions and is reminiscent of earlier policy episodes when the shift from surface water to groundwater extraction escaped the gaze of the water bureaucracy<sup>8</sup>. Put simply, governments need to guard against paying a premium for permanent ‘solutions’ to over-extraction that later prove wanting and require additional calls on the public purse.

### **Challenges to Buyback – An Example from the Unregulated Ovens River**

The preceding discussion points to at least two of the fundamental challenges facing water buyback. Arguably, these might be classified as tests to the standard concepts of technical and allocative efficiency. On the one hand, the problems associated with predicting the impact of a given buyback expenditure on fungible and deliverable water undermines the conditions required to gauge technical efficiency. After all, you can hardly identify the lowest cost method of sourcing a volume or flow of water if there is considerable uncertainty circumscribing the relationship between different water products and the volume or flow that purportedly attends them. On the other hand, the absence of a genuine environmental metric continues to frustrate the conventional measurement of allocative efficiency. Even if water was being purchased at lowest cost, it may still fail to deliver the required environmental outcome unless it has the necessary delivery characteristics. As noted earlier, this is likely to be particularly problematic when there is a strong focus on a volumetric metric at the expense of all other considerations, like the nuances of flow, and vaguely defined environmental outcomes. Using this broad approach we now briefly examine a water buyback program mooted for the unregulated portion of the Ovens Valley in Victoria. Our aim is to highlight the technical and allocative complications, even though the allocative component is less problematic since the environmental outcomes are more clearly linked to flow rather than volume. This analysis tentatively points towards potential mechanisms for improvement.

The Upper Ovens Valley in northern Victoria comprises a large unregulated system with a substantial volume of licensed extractions for urban and irrigation users. The environmental attributes of the Ovens are also highly prized at the State and National levels with the Lower Ovens listed as a Heritage River, largely because of its active floodplain and healthy native fish communities (Vogell et al. 2007). A draft streamflow management plan was developed for the Upper Ovens in 2003 with the aim of “clarifying how much and when water can be harvested from the Catchment and the minimum flows required in streams to maintain the environmental health of waterways” (DSE 2003, p. 9). The greatest immediate challenge is the maintenance of minimum flows during dry summers when competition for the resource is intense. Since this is an unregulated stream, environmental objectives are managed by constraining the rate at which water is extracted during times of

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<sup>8</sup> It is a moot point whether the radical increase witnessed in groundwater extractions was bureaucratically ‘unpredictable’ or simply politically expedient. In the case of the trial Streamflow Tender, Melbourne Water (2007c, p. 10) lists “increasing the size of your existing off-stream dam”, “constructing a new groundwater bore” and “pumping from your existing groundwater bore” as feasible ways of increasing water availability or water use efficiency. Accordingly, all of these activities potentially qualified for support from the public purse. This would appear to be at odds with the dominant thinking that groundwater and surface water management should be considered jointly.

severe scarcity, say by restricting or banning extractions in line with 'run of river' metrics. A further complication in this instance is the strong interaction between surface and groundwater which has been strengthened by gold dredging in the past (DSE 2003, p. 42).

One of the key recommendations emerging from the draft streamflow management plan for the Upper Ovens was a minimum environmental water provision defined as a daily flow at Myrtleford of no less than 100 Megalitres. This broadly equated to a ban on irrigation 6 years in 10 for an average period of 4.5 weeks. In the context of the current horticultural practices in the region, this represents a significant contraction and points to the need for substantial structural adjustment. It was originally foreshadowed that the plan would achieve this target by the 10<sup>th</sup> year of operation, although earlier implementation was seen as desirable on the proviso that "adequate measures to address supply reliability [could] be implemented" (DSE 2003, p. 36). A community consultation phase followed the release of the draft streamflow management plan which preceded the Minister requesting additional technical work prior to its ratification. At the time of writing, no streamflow management plan is in place although additional work has been undertaken (see, for example, SKM 2006) to inform another round of consultation. The more recent technical work highlights the necessity for a higher daily flow at Myrtleford (137 Megalitres) and thus implies even more radical adjustment to agricultural practices in the region.

Perhaps anticipating the political costs likely to attend implementation of the Ovens streamflow management plan, representatives of the various state departments commenced discussions with landholders about the feasibility of a streamflow tender mechanism in mid-2008. At the time, the model employed by Melbourne Water (described earlier) was being proffered as an option (per com Kerry Murphy December 2008).

There are several significant challenges to the implementation of a tender instrument in this context, particularly given the deficiencies identified with earlier streamflow tender. First, the total volume of licensed extraction in the Upper Ovens vastly exceeds average use. More specifically, the maximum recorded use in the catchment was only 59% of licence volume in 2003 (DSE 2003, p. 39). This has non-trivial implications for the effectiveness of any EOI process, particularly if the buyer is unable to accurately trace history of use. Put simply, accurately tracing history of use is a precondition for ensuring that any purchase of licenses manifests in an authentic reduction in the demands on streamflow.

The agency charged with monitoring water use in the Valley (Goulburn-Murray Water) has a policy of monitoring water supplies "in principle" (DSE 2003, p. 41). This "in principle" approach has resulted in relatively poor calibre historical data upon which a potential buyer might assess the environmental merits of purchasing different parcels of water. For example, the 2003-04 Water Accounts for the Ovens Valley reveal that "licenses on unregulated streams are not currently metered and water usage is an estimate provided by Goulburn-Murray Water" (DSE 2005, p. 81). Coupled with a definition of

sleeper licenses as being those “which have not been used for 10 years or more and have no infrastructure” (DSE 2003, p. 40) it will be difficult to distinguish which are genuine sleeper or dozer rights from those whose purchase by the state would actually impact on extractions.

A historical precedent has also been set that ascribes value to sleeper licences and “these licenses, regardless of use have a legitimate entitlement to water” (DSE 2003, p. 40). This forms a second major challenge for a tender-based buyback in the region. More specifically, a buyback scheme would prima facie need to compete with other potential purchasers of sleeper licences. Historically, relatively little water has been traded in the area (see, for example, Watermove 2009) although it is feasible to trade water downstream to other defined regulated users, albeit at an exchange rate of 1:0.81. Whilst such trades might appear likely to benefit the streamflow target of maintaining water in stream at Myrtleford, the basin-wide impacts could prove detrimental, especially if sleeper or dozer rights are being sold and activated. Thus, whilst the tender process might seek to discriminate against the purchase of un-activated licences or portions of licenses, there may be little choice other than to purchase these licenses or run the risk of their activation downstream.

A third major consideration relates to the congruence between groundwater and surface water in the region and the monitoring that has historically attended extractions from both sources. The floor of the Upper Ovens is characterised by coarse sediments and rocks with large quantities of groundwater interacting with surface flows. Groundwater is easily accessible in most of the Valley by simply digging a hole in the valley floor. These structures are referred to locally as ‘draglines’ and are commonly accessed by irrigators when bans on surface water irrigation are put in place. Historically, some draglines have been treated as equivalent to surface water extractions and others not, depending in part on the proximity of the dragline to the stream and the arbitrary distance applied to define the water as being congruent at the time. The upshot is that even where water metering records do exist, they may not fully capture the ‘environmental worth’ of modifying or halting a particular extractive activity. In addition, and unlike the streamflow tender conducted by Melbourne Water, there would appear to be even less scope for using subsidies for groundwater extraction to offset surface water extraction and thereby meet the objectives of the streamflow plan<sup>9</sup>. In this context DSE (2003, p. 42) noted that “the exact nature of the relationship between groundwater use and streamflows [...] may vary depending on the particular circumstances of the extraction site”. The costs of an agency gaining sufficient knowledge of this relationship in order to assess the merits of alternative buyback offers appear prohibitive.

Clearly, these circumstances produce major technical challenges to the use of buyback in its current form as a vehicle for achieving structural adjustment in the Upper Ovens. Nevertheless, these should not be insurmountable or taken to imply that buyback has no role in this context. Rather, we argue that

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<sup>9</sup> As noted earlier, the logic of this approach is itself dubious.

sharpening the focus of buyback schemes in a manner that takes account of information deficiencies holds considerable promise.

Most of the challenges described in this section derive from information asymmetries between the agency conducting the buyback program and potential participants. For example, farmers are generally well aware of the interrelationship between groundwater and surface water on their properties, even if the state agency is not. Similarly, farmers are more inclined to know the extent to which they hold 'sleeper' or 'dozer' licences than is the state, at least until sufficiently robust metering data is developed. In this contexts the potential seller has the ability to exploit the limited knowledge of the purchaser, as may have occurred in other instances of buyback highlighted in this paper.

The problems of the Upper Owens buyback can be addressed by focussing the tender at a scale that recognises the deficiencies in information and takes advantage of existing institutions capable of coordinating local action to meet the prescribed environmental outcome. In the case of the Owens Valley, many of the extractive users are affiliated with The Tobacco & Associated Farmers Co-operative Limited (TAFCO), a legacy of the former prominence of the industry in the region. Information asymmetries between members of TAFCO are likely to be less severe than those that exist between the state and individual farmers. Accordingly, a coordinated bilateral agreement struck between the state and TAFCO may yield superior results to tenders based on individual farmer participation. A critical element of such an agreement would be the necessity to tie financial incentives directly to the achievement of streamflow targets. This could include financial sanctions for non-compliance, as would be expected with most agreements in the private domain. In order to maintain the core elements associated with buyback, the program would need to be structured upon standard benefit cost analyses in order to avoid capture by political interests.

The intuitive appeal of this approach is also supported by a more rigorous analysis by Pincus and Shapiro (2008). Pincus and Shapiro (2008) argue that welfare gains can be achieved by reaching a collective agreement with farmers on the sale of their water rights relative to voluntary sales by individual irrigators. Notwithstanding that the model they propose embodies significant practical constraints<sup>10</sup> conceptualising buyback at an appropriate scale seems to be one of the simplest steps to improving its effectiveness.

### **Concluding Remarks**

Attitudes to water buyback have undergone a progressive transformation over the last decade and a half. The initial resistance to buyback derived primarily from the perceived political costs of this approach, notwithstanding the commitments given to reallocating water in favour of the environment as early as 1994. Buyback is now a key component of water policy, at least at the rhetorical level.

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<sup>10</sup> The approach partially relies on the threat of compulsory acquisition to help gain unanimous agreement amongst farmers re the total quantum of water to sell.

We have observed that the acceptance of buyback as a policy instrument has not come easily and the perceived political costs would appear to continue to have some influence over the sincerity with which it is being pursued. There are several prominent instances outlined in this paper which highlight the need for greater scrutiny since there is a strong incentive to publicly overstate the magnitude of buyback, in order to appease environmental interests whilst securing water products from agriculture that amount to a limited reallocation, at best. The costs of this approach may well prove severe even in the medium term, with limited progress on the environmental front and more intractable adjustment problems being created for a sector that continues to rely on largesse from the public purse, albeit in a different guise.

Buyback in the Murray-Darling Basin is also arguably fragmented and attention to planning would appear deficient. This has not only allowed for more political intervention than is desirable, it has also limited the potential gains from the mechanism. Increased transparency and planning to define and measure suitable water products and endeavours focussed on the management of those products to deliver measurable environmental benefits are required.

The case of the Upper Ovens Valley shows that instigating a buyback program capable of making genuine progress towards reallocation requires careful consideration of the scale and information components of the program. In that context we contend that additional work is urgently required to design buyback programs capable of dealing with these issues.

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