INFRASTRUCTURE PARTNERSHIPS AUSTRALIA

30 April 2026

The Productivity Commission

Via submission portal

LETTER TO THE PRODUCTIVITY COMMISSION ON ITS NATIONAL WATER REFORM 2026 INQUIRY

Infrastructure Partnerships Australia is pleased to provide this letter to the Productivity Commission on its National Water Reform Inquiry. We welcome the Inquiry's expanded Terms of Reference to include advice on approaches for a more sustainable water service industry and consider it a timely addition to the Commission's standard review of the National Water Initiative. Infrastructure Partnerships Australia looks forward to further engaging with the Commission throughout this Inquiry.

Infrastructure Partnerships Australia is an independent think tank and executive member network, providing research focused on excellence in social and economic infrastructure. We exist to shape public debate and drive reform for the national interest. As the national voice for the infrastructure sector in Australia, our membership reflects a diverse range of public and private sector entities, including infrastructure owners, operators, financiers, advisers, technology providers and policy makers.

The urban water sector is currently in the midst of a step-change. Emerging and escalating challenges are putting increasing pressure on the industry, which is attempting to adapt to a new and more costly operating environment. However, water utilities' ability to prepare for this step change has been constrained because, as the evidence demonstrates, regulators have prioritised short-term customer bill considerations over the long-term interests of customers.

While a cursory examination of the water sector shows that there has not yet been a significant deterioration in the quality of water services, dynamics present in recent regulatory processes have damaged the sustainability of the industry, and similar issues were precursors to substantially poor service outcomes internationally. It is crucial that a review of the national water sector examines the way that economic regulation has interacted with utilities over recent years, how outcomes from these processes have been pernicious for the long-term interests of customers, and the ways in which it should be reformed.

Economic regulation should protect the long-term interests of customers

The fundamental aim of economic regulation is to protect the long-term interests of customers. This means providing water services that reflect customers' expectations around reliability, quality and environmental outcomes on a sustainable basis over the long term.

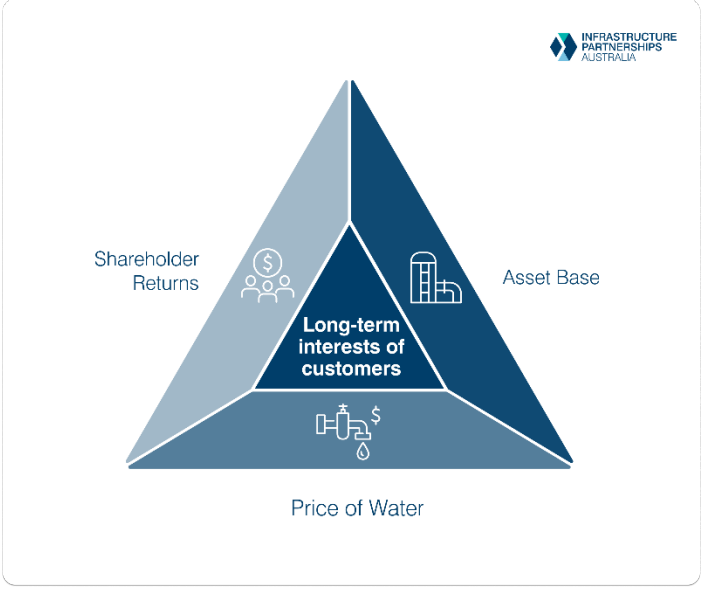
This objective is achieved by balancing three competing tensions:

- Ensuring the operational capacity of the asset base through adequate investment allowances,
- Managing the impact of bills so that customers are paying an amount reflective of efficient and sustainable service provision, and

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- Providing an appropriate return to shareholders to compensate their initial investment.

Figure 1: Tripartite Tension



Source: Infrastructure Partnerships Australia

Managing these tensions since the Millennium Drought

The rationale for an uplift in capital expenditure during the Millennium Drought was clear – substantial investment was required to deliver desalination plants at most major cities to ensure water security. As the drought-related risk subsided, the industry returned to its status quo, with jurisdictional regulatory systems enabling both a moderate uplift in capital expenditure and, up until recently, relatively sustained dividends to shareholders. Over the 15 years since the Millennium Drought, the average price of water bills across the industry declined in real terms.

At a surface level, this dynamic of modestly increasing capital investment and relatively sustained dividends, alongside decreasing bills, may appear like a regulatory system operating effectively, passing on efficiency gains to customers and shareholders. However, this dynamic was in part enabled by two factors. First, the cost of capital decreased during this period, which had a substantial impact on the revenue requirements of capital-intensive water utilities and allowed savings to be passed through to customers. Secondly, in response to a regulatory framework limiting price increases, utilities increasingly relied on debt to finance their capital programs. Several utilities began to compromise their financial health to maintain service standards over the short-term.

The urban water sector is amid a step-change in investment

The trends and dynamics since the Millennium Drought have set the context for water utilities and their respective regulatory frameworks, as the sector enters its next, more perilous phase. Urban water utilities are now in the midst of a step-change, dealing with intertwined and escalating challenges, including:

- Growing populations
- Increasing service expectations
- More unpredictable climatic conditions

- Ageing asset bases
- More environmental and regulatory obligations
- Higher costs of capital

This has put pressure on the existing economic regulatory framework to accommodate high levels of capital expenditure through raising water bills. Early indications demonstrate that the framework in its current form has ill-adapted to dealing with this new phase of water management. With the step-change beginning in earnest in 2021, effective and sustainable balancing of the tripartite tension has not been achieved.

Recent regulatory dynamics present a concerning trajectory

Infrastructure Partnerships Australia has witnessed the following dynamics over the past three years:

1. Regulators have allowed historically large levels of capital investment, while simultaneously deferring or disallowing unprecedented amounts of expenditure from utilities' proposed capital programs
    - This illustrates a major and deepening divergence in the perceived investment needs between utilities and regulators.
2. Many utilities have become financially stressed or technically insolvent, with more trending in that direction
    - Some are now reliant on a 'Letter of Comfort' from their respective state government to continue operations.
3. Regulatory commercial principles have been eroded
    - Several regulatory determinations have departed from best practice or consistent processes, with one jurisdiction committing to de-corporatisation.

The regulatory framework has suppressed water prices in the short-term at the expense of the long-term interests of customers. Aggregate water bills for urban utilities since this step-change have remained stagnant, below levels charged over a decade ago (in $2024-25 prices).

The tripartite tension has not been balanced in the urban water sector for some time. This has not yet resulted in poor service outcomes for most customers. However, these regulatory dynamics were present in our international case study of Ofwat-regulated water utilities in England and Wales and were precursors to poor outcomes.

The United Kingdom is a cautionary tale

Ofwat-regulated water utilities in England and Wales experienced a divergence between increasing capital expenditure and stagnant bills over an extended period. At a regulatory level, the same dynamics unfolding in Australia were also present – large capital expenditure deferrals, utilities became financially stressed, and commercial principles deteriorated.

The consequence of these regulatory shortcomings eventually translated to poor customer service and environmental outcomes. This case study should serve as a cautionary tale for policymakers in Australia.

Principles to rebalance the tripartite tension

Infrastructure Partnerships Australia recommends re-embracing the corporatised utility model and implementing best-practise regulatory principles to effectively manage the tripartite tension in the long-term interests of customers. This should include ensuring effective settings across the following:

- Pricing and Water Bills

- Governance Arrangements
- Planning and Strategy
- Financeability
- Engagement and Transparency
- Consistency and Clarity
- Adaptability
- Asset Monitoring

Infrastructure Partnerships Australia looks forward to further assisting the Productivity Commission on this inquiry. If you require additional detail or information, please do not hesitate to contact Katie Dempsey at katie.dempsey@infrastructure.org.au.

Yours sincerely,



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