

Productivity Commission

Draft Report: Impact of Competition Policy Reforms on Rural and Regional Australia

Municipal Association of Victoria

Response

1. *General comments about the impact of NCP*

Relevant recommendation:

All governments should review in the year 2000 the information they provide about National Competition Policy undertakings with a view to ensuring that it is:

- *accurate in terms of both its content and relationship to other policies*
- *is publicly available and is provided to those implementing National Competition Policy reforms in a readily accessible form.*

The Productivity Commission Draft Report provides an informative and comprehensive analysis of the downward economic trend experienced by some parts of country Australia. These trends are attributed to a confluence of economic factors and not to competition policy. The MAV supports the above recommendation. It recognises that NCP interfaces with other government reforms and therefore it is important to differentiate different elements of competition policies and to undertake an analysis of the overall impacts of those policies. To this extent, the recommendation seeking clarification of NCP policies is sound.

The MAV proposes that the Productivity Commission might also consider a recommendation made by the MAV in its submission (p.5) that in future:

- all levels of government undertake an impact analysis of the socio-economic consequences on rural communities prior to any policy initiative being introduced;
- that the socio-economic assessment include analysis of other reforms and rationalisation measures affecting a community;
- that the outcomes of an impact assessment of the socio-economic effects of a policy inform subsequent decisions about the implementation of a government policy.

If the Productivity Commission have identified that country Australia is affected and in some instances disadvantaged by a range of government policies then government policy-makers should ensure that they are aware of how a proposed policy might react with other, existing policies. The MAV urges the Productivity Commission to strengthen this aspect of its recommendations.

2. Application of public interest factors

Relevant recommendations:

All government should publish and publicise guidelines which:

- *outline the purpose and scope of the 'public interest' provisions of the Competition Principles Agreement; and*
- *provide guidance on how the provisions should be interpreted and applied.*

In the event that a common set of basic principles for application of the public interest test is developed jointly by governments, these also should be publicised and disseminated widely.

The MAV agrees that an important issue to emerge from the Productivity Commission inquiry is the lack of understanding that public interest considerations are inherent in the application of NCP. It is apparent to the MAV that this is not well understood either by the community or by governments as they apply NCP.

While NCP is intended to facilitate economic efficiencies at but also to accommodates situations where competition conflicts with other social and public policy objectives, in practice, economic and social polices may have competing and irreconcilable outcomes. It is the MAV's observation that Victorian councils are not clear or confident about the parameters of public interest criteria and the extent to which these might override the application of policies such as competitive neutrality. For example there are elements of any public interest analysis that will not necessarily translate into a 'cost - benefit' analysis. Not all elements of the policy can be expressed in this manner. Similarly councils have experienced difficulty in how to apply public interest questions when competition policy could be applied but a policy assessment is made by the council that it is not prepared to expose a service to either market testing or to competitive neutrality.

The MAV has recently commissioned a Guide to assist councils in how they should apply 'public interest' criteria as they develop their tendering program. The MAV view is that public interest factors should apply in broad sense. It is not confined to community service obligations only and is not a policy by which government bodies should seek to protect inefficient or costly services to the community. While these policy indicators are not easily contained in a rigid formula and must ultimately be assessed on a case-by case basis, the MAV advocates that there is a disciplined process that all council must engage in to determine two fundamental questions:

1. The services a council should provide to its communities

This question involves questions such as:

- what are the statutory obligations of the council?
- what are the unmet community needs?
- where does the council assess that it has an obligation to provide a service in the absence of a statutory obligation to provide a service?
- who are the other service providers?

2. How to deliver the services to ensure efficient and best value outcomes

This questions involves an assessment of:

- the different means by which a service can be provided - can it be out-sourced, is there an existing workforce, could the service be provided by a range of providers?
- is there a market from which to select providers?
- what are the costs of providing the service?
- what are the risks to council in tendering the service (if that is an option)?

It applies an analysis that should assist councils to determine where it has a community service obligation and where there is a risk or potential disadvantage to the community if a service is not subjected to a competitive tendering process. This kind of analysis is necessary in Victoria local government as all services are, prima facie capable and likely to be subject to a competitive process. This requires councils to develop a rationale and procedure by which they can assess what service they are in the business of providing and how best to provide them. While this Guide is directed to a council's competitive tendering program, it equally applicable to the application of other elements of NCP, such as competitive neutrality..

3. Impact of competitive neutrality on local government

The Draft Report does not make any recommendations about the application of competitive neutrality. This is no doubt based on the impression gained by the Productivity Commission that the overall impact of competitive neutrality on local governments' business activities is relatively small.

The Commission notes that while there is flexibility in the application of the policy this is not the case where competitive tendering is in place as competitive neutral policies must be operational. The Commission has already noted that in Victoria, this has led to a greater application of competitive neutrality in local government. There have been some developments in Victoria that the MAV seeks to make the Productivity Commission aware of. These developments take shape around the definition of "business activity" and the interpretation of competitively neutral pricing policy by State Government bodies. The fact that these issues have emerged recently highlights the extent to which NCP is a policy that is evolving and the need for an ongoing monitoring mechanism of the changing implications of NCP.

Competitive Neutrality in Victorian local government

Competitive neutrality applies only to the business activities of local government. However, as the Draft Report notes, in all States a business activity will automatically apply to a service or function that is competitively tendered. As the Draft Report notes, in Victoria this has led to a higher application of competitive neutrality as 50% of a council's total annual expenditure is to be subject to a 'competitive arrangement'. However, Competition Principles Agreement signed by all councils and recent Guidelines published by the Department of Infrastructure will result in an even higher application of competitive neutrality in Victorian local government.

In 1998 the Victorian Government agreed to share 9% of its competition payments received from the Commonwealth with local government. The condition on which competition payments are to be paid to local government, is satisfactory compliance with NCP.

Specifically councils are required to:

- maintain Trade Practices Act compliance;
- achieve 50% CCT targets (or less if a council's explanation for lesser achievement has been accepted by the Minister);

- review the structural options for the delivery of services (model 1 or model 2);
- apply competitively neutral pricing principles;
- review local laws for compliance with competition principles;
- report annually on NCP compliance.

These conditions are enshrined in Competition Principles Agreement signed by individual councils and the Minister for Local Government. All agreements were signed and payments made between December 1998 and February 1999. The agreements mirror the CoAG Competition Principles Agreement and the *National Competition Policy and Local Government: A Statement of Victoria Government Policy* (published in 1996). However, they have one significant inclusion, a definition of “business activity” which is now contained in recently published NCP Reporting Guidelines by the Department of Infrastructure.

The definition contained in the Competition Principles Agreement is:

Business activity means the supply of goods or services or the undertaking of works by the council (whether for the benefit of the council, the community or an external party) and includes any activity that:

- a) has been subjected to competitive tendering; or
- b) has not been subjected to competitive tendering but is a significant business activities.

A significant business activity is a business activity of the council which has the potential to compete with the private sector as indicated by;

- a) the councils expenditure on the business active during the financial year exceeds one per cent of the councils total operating expenditure (as set out in the operating statement for that year but excluding the amount allowed for depreciation); or
- b) the councils revenue from user charges generated by the business activity during the financial year exceeds one per cent of the council total operating revenue (as set out in the operating statement for that year); or
- c) the business activity is significant with respect to the relevant market for that activity.

This definition has three potential outcomes:

1. The widening application of competitive neutrality to council operations - the definition is structured in such a manner that even if the service does not fall within the costing formulae, it will invariably fall with the final criteria of “significant with respect to the relevant market”.
2. The creation of an overly inflexible definition of “business activity” that councils must comply with to achieve competition payments, but may be contrary to the understanding of “business activity” applied under State Government Policy by the Competitive Neutrality Complaints Unit.

There is no argument on the part of councils that it is appropriate and a matter of good policy to address questions about the best structural options for service delivery and to fully cost council services. A positive outcome of competitive neutrality has been the implementation of costing systems to identify all the costs of a service and any subsidisation of the service. However, many council services have not necessarily operated on a full cost recovery basis particularly services such as Leisure Centres (swimming pools in particular) and child care centres. These questions must be addressed, along with the “threshold” issue of whether the activity is a “business activity”.

Issues arising from the definition of “business activity”:

- The extent to which a service can be exempted from the application of competitive neutrality because it is a not-for-profit activity. This question is particularly relevant to council services such as child care or other community based services that do not seek to recover a profit and in some instances may be subsidised by councils because they operate at a loss.
- The extent to which a council can legitimately disaggregate the budget for a service area and obviate the application of the definition of “significant business”. For example a council may conclude that it wants to subsidise community child care facilities. The total cost of all council run child care facilities may exceed 1% of council expenditure, but if the individual centres were to be assessed separately then they would not fall with the definition. Even if this approach to the definition were accepted, a question remains as to how the council should assess whether the child care centres are significant with respect to the relevant market.
- When determining whether a service is significant with respect to the relevant market should the council consider this question on a neighbourhood basis or is it obliged to consider the market from the perspective of the whole municipality or even on a regional basis?
- Will an approach accepted by the Minister for Local Government also be acceptable to the Competitive Neutrality Complaints Unit? The MAV notes that the Complaints Unit apply the principles of competitive neutrality as set out in *Competitive Neutrality - A Statement of Victoria Government Policy*. It does not contain a definition of “business activity” and the Complaints Unit have indicated that it is not bound by the definition contained in the Competition Principles Agreements entered into between the Minister for Local Government and councils. This means that a council may potentially comply with the parameters of the Competition Principles Agreement in order to secure competition payments but may still be exposed to a complaint and finding by the Complaints Unit that the councils application of competitive neutrality may be in breach of the State Government Policy. A council may technically be in compliance with the Competition Principles Agreement definition, but may nevertheless be generally regarded as a business activity by the Complaints Unit.

Issues arising from the application of competitive neutrality policy:

- the full costing of a service particularly the calculation of a rate of return to non commercial activities;
- how to apply subsidies to a pricing policy should it be universal or targeted;
- the parameters of a council policy stating a community service obligation in respect to particular service and the impact this has on pricing places;

The MAV is currently working with the Competitive Neutrality Complaints Unit to develop a better understanding throughout local government of the Victorian Government Policy, as applied by the Complaints Unit to competitive neutrality. The Complaints Unit are undertaking a number of case studies with councils to identify best practice application of competitive neutrality. The case studies have targeted a number of service areas that have experienced difficulty in the application of competitive neutrality. The aim is to highlight the difficult issues and to work them through in the case studies. A copy of the Case Studies and the Progress Report is enclosed for the information of the Productivity Commission. The Case Studies will provide a practical Guide for councils as to competitive neutrality. The advantage is that they are based on existing council services and address issues that have been confronted in practice.

Local government accepts the authority of the Complaints Unit as the “interpreters” of competitive neutrality policy. The Complaints Unit have indicated that they will have regard to the policy commitments a council has made along with the consideration it has given to how competitive neutrality could be applied and the different approaches that might be taken to subsidising a service. It does not regard a council subsidising a service as, ipso facto constituting a non compliance with the competitive neutrality pricing principles. However, it would certainly require a demonstration by the council of how the benefit to the public overrides the cost of not seeking full cost recovery in the pricing structure of the service. This raises questions for councils as to whether subsidises can be available on a universal basis or whether they must be targeted to particular users of a service.

In summary, the MAV contests the conclusion reached by the Productivity Commission that competitive neutrality has had a benign effect on local government. In Victorian this is certainly not the case. Considerable resources have been applied by councils, the MAV and the State Government to ensure that competitive neutrality polices are applied appropriately and do not undermine a councils capacity to subsidise community services. There is still considerable confusion on the part of councils as to the extent and the parameters of the pricing policy, in particular and how to apply the public interest test. While some councils have experienced difficulty in the interpretation of the accounting elements of the policy, it is expected that these will be resolved through the case study process with the Complaints Unit. The question about how “business activity” is appropriately defined and the circumstances in which a council can determine that it is appropriate to subsidise council run services, where there are competition private sector providers, are unclear and require resolution.

4. Water reforms

Relevant recommendation

CoAG should give consideration to the formal extension of the rural water reform timetable for implementation of the water property rights and water allocation requirements.

The MAV supports this recommendation. It is evident from information given to the MAV by its rural membership that access to water is fundamental to rural industries. Equally it is important that water is available on an equitable basis. The issues surrounding debate on water reforms are complex and controversial. It is appropriate that the timetable for water reforms and the implementation of the water property rights and water allocation be sufficient to enable adequate debate and anticipation of consequences.

5. Adjustment measures

Relevant recommendations:

If governments consider that specific adjustment assistance is warranted to address any large regionally concentrated costs, such assistance should:

- *facilitate, rather than hinder, the necessary change;*
- *be targeted to those groups where adjustment pressures are most accurately felt;*
- *be transparent, simple and of limited duration; and*
- *be compatible with general safety net arrangements.*

Governments should rely principally on generally available assistance measures to help people adversely affected by NCP reforms.

The MAV recommendations encouraged an early assessment of the impact of NCP before the introduction of reforms. These are indirectly included in above recommendation, which implies an impact assessment of NCP reforms. However, while this recommendation presumes instances in which assistance is required, the level of assistance is under estimated. Concern is expressed about the recommendations which suggests that generally available assistance measures are sufficient to address negative impacts of NCP.

If elements of rural and country Australia have been identified as bearing a disproportionate burden of various reforms including NCP then resources should be allocated to ensure those impacts are neutralised. The MAV advocates that:

- assistance for negative impacts of NCP should be adequately funded and not only provided only from generally available assistance measures;
- given the findings of the Commission regarding the downward economic trend in rural Australia it is appropriate for the Commission to recommend a major commitment by all levels of government to implement policies and initiatives to address those trends.

The above recommendations are insufficient to fully address the issues raised and accepted in the draft Report.

**CASE STUDIES ON LOCAL GOVERNMENT
IMPLEMENTATION OF COMPETITIVE NEUTRALITY**

**Competitive Neutrality Complaints Unit
Update on progress**

**Meeting of Competitive Neutrality Compliance Working Group
Municipal Association of Victoria
Friday 18 June 1999**

Agreement to conduct case studies

1. On 21 April 1999, the Complaints Unit met with the MAV and council representatives from the Competitive Neutrality Compliance Working Group to discuss the proposal to conduct a series of case studies examining the implementation of competitive neutrality by local government.
2. Councils agreed to provide information to the Complaints Unit related to their tendered services and significant business activities that could be used to form the basis of the case studies.
3. The Complaints Unit is pleased with the council's enthusiasm and commitment to the project. Ten potential case studies examining the application of competitive neutrality have been proposed which relate to the following services and business activities:
 - Meals on Wheels (Moonee Valley)
 - Saleyards (Wodonga)
 - Minor construction works (Knox)
 - Family Day Care (Swan Hill)
 - Childcare (Moonee Valley)
 - Saleyards (Swan Hill)
 - Paddle steamer tourist operations (Campaspe)
 - Road construction (Moyne)
 - Accounting services (Moyne)
 - Leisure services (Melton)

10

Case studies in progress

4. The Complaints Unit has made good progress on the case studies.
5. The case studies discuss the Victorian Government's Competitive Neutrality Policy requirements and how they have been applied to each of these services. The case studies also examine a number of issues related to the implementation of competitive neutrality.
6. The case studies examine a number of common themes and issues:
 - notional tax adjustments (eg. payroll tax)
 - the calculation of an appropriate rate of return;
 - consideration of notional accounting entries (cash cost to council of selecting an external tender);
 - treatment of redundancy costs;
 - subsidies and CSO's;
 - public policy objectives of councils;
 - administrative and managerial practices which affect competitive neutrality (eg. ringfencing, bundling of services, 'gainsharing')

7. Some examples of best practice are emerging. For example, at least one council has developed its own competitive neutrality policy that draws on the Victorian Government's policy statement and outlines the application of CN to its own services and significant business activities.
8. Work on four of the case studies is well advanced in relation to Meals on Wheels services (Moonee Valley), Management of minor road construction works (Knox), Saleyards (Wodonga) and Family Day Care (Swan Hill). The Complaints Unit has met with each of these councils to discuss the issues and information requirements of the case studies. A summary of the main issues examined in these case studies is attached.

Case studies to be commenced shortly

9. Over the next couple of weeks, the Complaints Unit expects to be able to circulate a draft copy of the first set of case studies to each of the relevant councils for their comment.
10. The Complaints Unit will commence work on the remaining case studies as drafts are completed for the set of case studies.
11. The case studies are expected to be complete by the end of July.

**CASE STUDIES ON LOCAL GOVERNMENT
IMPLEMENTATION OF COMPETITIVE NEUTRALITY
Summary of Case Studies**

CASE STUDY 1 MEALS ON WHEELS

This case study looks at the application of competitive neutrality to a Meals on Wheels service. The service was competitively tendered by a council in the metropolitan area. The contract was awarded to the in-house team.

The case study examines four main issues related to competitive neutrality:

- whether the council has offered access to council facilities to all tenderers on the same basis.
- whether the approach taken by the council to calculate a return on assets is consistent with competitively neutral pricing principles.
- whether consideration of notional accounting entries is appropriate under the phase 2 tender evaluation process.
- how redundancy costs should be treated under competitive neutrality policy.

CASE STUDY 2 FAMILY DAY CARE

This case study examines a range of family day care services provided by a rural council to families in the municipality. Families pay a standard hourly fee for these services and the council subsidises the cost of these services. Grants from the State and Federal Governments are also used to subsidise the services. The service is currently provided directly by council employees and has not been competitively tendered. However, the council indicated that it is considering the possibility of competitively tendering the service.

The case study examines the following issues:

- is the provision of subsidies consistent with competitive neutrality policy? How should grants from other governments be treated?
- how should a rate of return on assets be calculated for this service?
- how should depreciation of assets and office rental be treated?
- what should the council do if the in-house bid is higher than private sector bids as a result of notional tax adjustments?

CASE STUDY 3 CATTLE SALEYARDS

This case study examines the application of competitive neutrality to a cattle saleyards service. The service was competitively tendered by a council in a rural municipality. The contract was awarded to the in-house team.

The case study examines the following issues related to the application of competitive neutrality:

- whether the appropriate notional tax adjustments have been estimated in accordance with the competitive neutrality pricing principles;
- whether the calculation method used to adjust for a return on assets is consistent with competitively neutral pricing principles, in particular:
 - has a suitable asset base been used; and
 - under what circumstances can an alternative rate be used to estimate an appropriate return on assets.

CASE STUDY 4 CONSTRUCTION WORKS

This case study looks at the application of competitive neutrality to a minor construction works business unit of a council in the outer metropolitan area. The unit operates with a small workforce of full time employees engaged in a supervisory role and engages subcontractors and suppliers. The unit tenders for construction works both for the council and for other organisations.

The council tendered out its construction work recently. The three-year contract was awarded to the in-house unit with an option to renew for another two years.

The case study examines four main issues related to competitive neutrality:

- how should redundancy payments be treated under competitive neutrality policy;
- to what extent does Council ownership of assets used by the business unit affect the estimation of a rate of return;
- is the practice of 'gainsharing' consistent with competitive neutrality;
- can in-house business units be treated on a stand alone basis for the purpose of claiming the payroll tax exemption