

BRISBANE CITY COUNCIL

Review of National Competition Policy Arrangements

Productivity Commission Issues Paper

1. Introduction

The review of NCP arrangements is welcomed. Modern governments are complex and previous governance and organisational models have led to poor customer service, lack of accountability and a culture of throwing money at a problem, particularly if it has political ramifications. The result has been to obscure the true role of government, providing lack of clarity, secretive rule by the powerful and unaccountable, and concentration on legal plausibility as opposed to practical community benefits. The benefits of the NCP reforms has been a focus on the real costs and benefits to the community of particular activities, provision of more choice and concentration on the enormous sums of public monies often tied up in either under-performing and over-engineered assets.

Previous models of government service and business activities have disenfranchised the community. Policy objectives, their costs and implications were not made clear. The requirement for identification and specific funding of Community Service Obligations (CSOs) has assisted both governments and the community to determine the nature of, and implications for, policy objectives. It has allowed for better decision-making by making explicit issues such as cost of capital and the trade-off between capital and operating costs. Previous models have favoured secretive bureaucracies, deciding their version of the public good behind closed doors, the requirements of NCP have been such that accountability and transparency has been enhanced.

Separating policy objectives, setting and accountability from service providers is a significant advantage. It allows government policy decisions to be implemented without facing blockage from a sometimes faceless bureaucracy. It allows explicit budgets, outcomes and objectives to be established and funded. NCP reforms do increase accountability and transparency.

2. Water Reform

The advantages are particularly acute in the case of public water utilities that have been exposed to the policy requirements of NCP and where CoAG agreements have bolstered processes already underway. Part of the CoAG reforms has been a requirement to properly cost and account for the storage, treatment and transport costs of water. This has also led to scientific assessment of the resources available, after making provision, for instance, for environmental flows. Previous failures to make these assessments public was often due to structural blockages. The resultant debate was then clouded by uncertainty about the policy context and basis for scientific assessments. Debates were based on hyperbole rather than facts.

The water reform agenda in particular should be hastened. The proposals for market trading of water entitlements would reduce the extent of ad hoc policy decisions and lead to a more systematic and sustainable allocation of the resource. The underpricing of water has been significant in urban areas, and efforts have been made to address this policy failure. However rural water prices are typically far short of the true cost in financial, economic and environmental terms. This leads to substantial cross-subsidies from the environment to property owners. Time is critical. The longer this inequitable situation continues the worse are the impacts. There are also often disguised cross-subsidies from urban and other rural property owners to particular owners of rural properties in the case of irrigation dams and the like.

There is a lack of transparency for the public in where the often-substantial monetary benefits fall with a wealth transfer to the wealthy and often dysfunctional behaviour involving property

speculation. The amounts of money involved often swamp other public policy debates such as particular welfare payments, but are rarely analysed in terms of alternative uses.

The heavy, and often inefficient use of water in the rural sector (70%+) compared with the urban areas (industrial 20%+, domestic 5%) should be recognised with heavy emphasis on making all users of water bear the environmental costs of that use. The structural and other reforms inherent in the NCP package allows a systematic, robust and sustainable mechanism for addressing these issues.

Prices for water in all parts of Australia, rural and urban should be set at full financial cost as a minimum. Accounting for externalities, particularly environmental externalities should be systemised and included in pricing. Some of the major environmental costs associated with water such as the impact of dam construction and electricity required for treatment and transport of water or sewerage should be included in the costings and flow through to prices. The commencement of a market for greenhouse gases is crucial in assisting to determine the full economic cost to society of existing and proposed water-related items.

3. NCP - A benefited or conflicting world

Turning next to the claims of a benefited world subsequent to NCP reform, the world is actually one where 'regulatory failure' can occur. A recent specific, albeit minor example, of this failure may be found in the operation of Queensland's Integrated Development Assessment System.

The issues paper on page two talks of "an extensive program to review and, where appropriate, reform legislation restricting competition in areas such as (inter alia) planning and development services". One reality of the result of the reform here is that regulatory assessment of building construction is performed by the certifiers engaged to provide the certification service to the developers who constructed such buildings; and, to use a proverb, those certifiers do not act to bite the hand that feeds them. This is 'conflict of interest' in its purest form. Council does not believe it to be sufficient to argue that the residual local government power to also take enforcement action constitutes a sufficient protection for the community, and is somehow of less weight than the "freeing up" of services which has allegedly resulted.

4. Economic Impacts for Brisbane

Brisbane City Council (BCC) endorses the broad intention of NCP to promote competition in the economy by extending the reach of competition law to previously exempt activities and improving the delivery of economic infrastructure services.

4.1. Extending NCP Reform

The Issues Paper mentions scope to extend reform into other areas of the NCP agenda and gives examples of potential new areas as government procurement, export marketing assistance and R & D support.

Since the Economic Development agenda of many local and state governments deal in these matters, it is important that good practice is widely understood and implemented.

It would be appropriate that advice and guidance came from the Productivity Commission following a review of world-best-practice and consultation with all levels of government and industry. Brisbane City Council supports such an extension of NCP reform.

4.2. Impact of NCP and Related Reforms to Date

The issues paper lists the introduction of third party access arrangements for infrastructure services to promote competition in related markets as one of the main

elements of the NCP reform package. It notes that “prices paid by most consumers and business users for certain infrastructure-based services.....have generally declined in real terms” as a result of NCP reforms.

BCC’s view is that while improvements over the previous situation may have occurred, the more pertinent question is “how do we rate against world’s-best-practice in terms of price and the quality of service?”.

BCC notes that, in the case of telecommunications, the reforms to date have failed to deliver facilities approaching “world-best” in terms of price and quality of service. Australia ranks 20 out of 30 OECD countries in the proportion of the population connected to broadband, and Australia has slipped each year since 2001 in the Economist-IBM e-readiness rankings. These failings are due to lagging connectivity and technology infrastructure.

Brisbane City Council believes that current policies are inadequate in relation to telecommunications. Greater attention to models that deal with the following propositions is necessary:

- The “last-mile” connection is the critical link.
- Very high bandwidth in last-mile links will be necessary to provide for the functionality that will be demanded by businesses and households in the near future.
- Current last-mile links are obsolete and new very-high-bandwidth links are required.
- With informed technology choice, a single next-generation-broadband last-mile link to each premises is capable of providing “future proof” access to and from that premises for the occupant and all telecommunications content and service providers.
- In general, assuming that correct technology and governance choices are made in the next-generation-broadband last-mile rollout, there is unlikely to be a need or desire for duplication of such last-mile links by the public or private sector.

The above propositions are consistent with the following observations of Brisbane City Council:

- The inherent desire by all telecommunications users for lower costs and maximum functionality.
- Telecommunications network convergence on packet-switching technologies and Ethernet network standards.
- A reducing number of networks and the move towards very high bandwidths so as to provide seamless services.
- Optical networks operating on genuinely open technical standards are necessary to provide the high bandwidth demands implied by future functionality requirements.

These characteristics confirm the nature of telecommunications infrastructure as a “Natural Monopoly” with the attendant requirements to safeguard the public interest. In particular, fair, open and non-discriminatory terms of access and generic, non-proprietary technical standards need to be mandated and implemented.

Given the growing importance of telecommunications to the nation’s economy, BCC believes that appropriate NCP reform along the above lines is essential and overdue.

5. Tax impacts

Future capacity to implement further reforms is clouded when proposed tax regulations or government policy comes into conflict with NCP activities (eg Div 250) .

The Commonwealth continues to penalise the delivery of community services through its income tax policies on asset financing. The concept of NCP is to create a level playing field between the private and public sectors. However, as the Review of Business Taxation¹ pointed out "The ability of tax exempt bodies to engage in leasing and similar arrangements is restricted by section 51AD and Division 16D (of the Income Tax Assessment Act). The 1999 Review report recommended reform.

After limited consultation, the Commonwealth Government has drafted tax legislation, Tax Laws Amendment (2004 Measures No. 4 Bill 2004) which is understood to be put to the June sitting of Parliament. The Bill, in the form of Division 250 deals with assets put to a tax preferred use (ie where the assets are used by a tax exempt body such as local government). The new division is intended to remedy the problems caused by s51AD and Division 16D. However, the new provisions catch many more transactions than the current legislation does and results in higher tax being paid by the taxpaying asset owner. Preliminary modelling suggests that the price of garbage collections would need to go up by around 5% to compensate the asset owner for the increase in tax.

The new provisions will lead to separate price regimes being quoted to the private sector and to the public sector for the same use of an asset. Under NCP, the advantages and disadvantages of public sector ownership are to be removed and this is normally done through the Tax Equivalents Regime (TER). However, it is not possible to replicate Division 250 within a TER.

The higher cost and NCP issues were pointed out to Commonwealth Treasury officers responsible for drafting the new legislation.

6. Other impacts

6.1. Is NCP useful in delivering social outcomes and does a focus on pricing efficiency deliver longer term planning outcomes?

BCC would argue that economic rationalism is often in conflict with social outcomes and it is governments' role to deliver these outcomes because it does not make economic sense for the private sector to do so. BCC would also argue that in the case of infrastructure a focus on pricing efficiency does not necessarily deliver longer term planning outcomes.

NCP, together with regulation of water services based on NCP, has given economic efficiency an extreme dominance over existing water reform agenda and relative legislative requirements.

The water reform agenda is largely driven by the Council of Australian Governments agreement on water resource policy and a strategic reform framework. Whilst the agreement shares the economic efficiency objectives of the NCP, it focuses on an integrated approach that gives equal weighting to environmental and social issues as well as economic efficiency. The agreement also recognises the need for institutional reforms that remove potential conflicts of interest between regulation and service provision.

The provision of water infrastructure in Queensland is carried out predominantly under two acts – the *Water Act 2000*, premised on efficient resource management and ecological sustainability, and the *Integrated Planning Act 1997*, premised on sustainable development and ecological sustainability.

Hence whilst water reform is taking place to address environmental and social concerns, and economic efficiency; and infrastructure is being provided under the broad banner of sustainability; the outcome in regulated water businesses is ultimately being assessed on the basis of economic efficiency under NCP concepts.

¹ A Platform for Consultation, Discussion paper 2, volume 1, page 222.

Since the optimal provision of water infrastructure under legislation, addressing sustainability and the environment, may have little to do with economic efficiency, there is a potential conflict between providing a water service to the community and the assessment of the regulated business providing that service. The dominance of economic efficiency generated under NCP means that the least-cost-planning concepts (under NCP) drift towards lowest-cost-valuation for pricing under regulation and social issues are then assessed outside the regulatory framework. This “drift” is not conducive to good long-term outcomes for the community.

This NCP review needs to take into account the social and political obligations involved in providing community infrastructure, that has component cost that can not be incorporated into CSO's. It also need to consider how social issues become a “before the fact” consideration rather than a post assessment.

6.2. Further reforms may be achievable, but only with re-alignment of Federal/State and local government functions and activities. Local government continues to feel that it is being asked to deliver more without additional resources; a cost shift from the other levels of government.

6.3. A move to a less regulatory environment may permit greater reform:

- deregulation of the telecommunication industry has seen new entrants, which stimulates price benefits.
- looking at some other industries, such as the aviation sector, price benefits from encouraging competition is offset in other ways with differentiating levels of service (eg no foods on planes, boarding at smaller airports, no seat allocation etc).

7. Conclusion

BCC is of the view that NCP for Local Government was appropriate for its time, as it was one of many enablers for reform to take place in our organisation. The BCC of today is a substantially different organisation from the BCC of 10 years ago. Since then we have come a long way and have embedded this way of thinking into our governance structures, management, operations and processes. We have done more than NCP required and continue to evolve as circumstances change. Consequently we are of the view that further external invention at the local government level is unnecessary and possibly undesirable with the exception of water reform.