

**CITY OF TOWNSVILLE**

**Submission to the Productivity Commission Review of  
National Competition Policy Arrangements**

**June 2004**

**FINAL**

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## **Executive Summary**

### **Reform Implementation and Context**

Townsville City Council has implemented significant organisational reforms over the last decade (1994-2004) that have contributed to operational improvements.

These reforms include National Competition Policy (NCP)-specific reforms in terms of the introduction of competitive neutrality principles, full cost pricing and the creation of business units where applicable.

In addition to these reforms, Council independently initiated management and structural reforms via the Quality Directions Strategy (QDS), introduced accrual accounting and introduced new corporate planning procedures in response to requirements of the *Local Government Act 1993*. These three reform programs significantly contributed to business improvements.

As these initiatives pre-dated NCP, Council is of the view that they not only formed important preconditions for the NCP implementation but that they were responsible for the bulk of the benefits that have been achieved through reforms over the last decade.

### **Reform Benefits**

These reforms have together contributed to a range of benefits, including:

- Improved decision-making capacity and better decisions, particularly in relation to true service delivery costs and the relationship between program outcomes and costs
- Operational efficiencies reflected in cost reductions across Council's business units of between 6-18% over 4 years, and an across-the-board budget reduction of 5%
- Improved dividends payments from Council-owned business units to Council and a more robust and effective focus on achieving a return of assets
- Enhanced service delivery through process reforms, in large part achieved through QDS, with a more dynamic customer-oriented culture

- Improved accountability through more effective and robust reporting of Council operations not only within Council but to the general public

The extent to which NCP itself can be credited with these improvements is debatable.

### **Reform Costs**

Indeed, there have also been costs to Council in NCP implementation.

Council estimates that:

- One-off establishment costs in the order of \$700,000 were incurred
- The direct labour costs to Council of NCP-related activities are in the order of \$3.4m per year. This has been a direct result of increased administration requirements and the creation of purchaser-provider structures within Council that has led to reduced resource sharing/increased resource duplication
- Ongoing annual costs associated with business information systems to support NCP-driven activities are in the order of \$200,000

In addition to quantifiable costs to Council, a number of critical issues have adversely affected Council as a direct result of NCP and NCP-related reforms.

These are:

- Fragmentation of Council, as a direct result of the creation of business units and the introduction of an internal purchaser-provider structure
- Inconsistent interests and drivers, in that decisions made by Council's units in their narrowly defined interests are not necessarily consistent with the financial interests of the Council as a whole
- Resource duplication and asset under-utilisation, resulting from fragmentation of business activities and a reduction in resource sharing

As well, Council is concerned about a range of other issues associated with NCP that have adversely affected Council's competitive position, or which can potentially lead to adverse regional economic and social outcomes. Specifically, Council is concerned at the following:

- Anomalies in the application of competitive neutrality provisions disadvantage Council businesses and service providers. Such anomalies between Council and the private sector emerge in areas such as:
  - The differences in time horizon in the treatment of assets. Whereas Council is a custodian of assets in perpetuity for the community, and therefore invests in asset maintenance to a high level, private firms do not necessarily incur such costs due to a shorter time horizon position taken in relation to assets
  - Non-exist options. Unlike private firms, Council is not necessarily in a position to exit uneconomic or commercially unviable markets, which fundamentally affects the operating cost environment of competing businesses
  - Visibility and Community leadership. Policy decisions to maintain assets for non-business reasons result directly from Council's position as a community leader. Again, this places a greater cost impost on Council than would be the case for comparable private firms
  - Regulatory Compliance. Council businesses are not comparable to many smaller operators in terms of commitments to for example, Quality Assurance and Occupational Health and Safety, which can lead to significant cost disadvantages to Council
  - Overhead allocations. Council businesses are required to reflect in their full-costs a component of corporate overhead, which would not be comparable to many smaller private sector providers
- The failure of competitive neutrality requirements to adequately acknowledge and compensate for the additional costs and risks arising from Council's role and obligations as the provider of last resort
- Potential negative effects of external contracting on regional employment and social welfare
- Cost shifting by the Commonwealth through its community and environment grants that are auspiced by Council, in that such grants do not compensate for the true cost of providing the auspicing services

## **Water Reforms**

Council has implemented consumption based charging, with water meters installed on all properties. All commercial properties are charged by meter measurement. A water allowance is provided for residential properties.

Council's refusal to implement a two-part tariff for residential customers has been vindicated by the decision by the Commonwealth Treasurer to lift and pay the competition payment of \$270,000 to Queensland that was originally refused by the National Competition Council.

## **Future Directions**

Council does not believe that the potential gains of further competition reform are cost effective. The most significant gains have already been achieved, and further activity would be costly with limited benefits. Future actions should focus on:

- 1) Fine-tuning the application of competition and related reforms. These are principally matters of Council administration and management, rather than broader competition policy issues
- 2) Ensuring Council's obligations as a provider of last resort are more explicitly acknowledged and compensated for this obligation
- 3) Ensuring that tacit cost shifting that is occurring as a result of Commonwealth Grants (e.g. community services and environment projects) not including Council's full auspicings costs, does not continue, and
- 4) Continue a pragmatic approach to competitive tendering and contracting (CTC), which adequately reflects broader considerations of regional economic and social development priorities

## **1 INTRODUCTION**

This is a submission to the Productivity Commission Review of National Competition Policy Arrangements from the Townsville City Council.

Townsville City Council is one of Queensland's largest regional local authorities, with a population base of in excess of 90,000 people. Its operating budget is approximately \$200m per year, and provides an extensive range of services to the City's residents.

Council has implemented National Competition Policy (NCP) and related reforms throughout its organisation, and has in the process, developed a strong appreciation of the financial and public benefit implications of the reform program.

This submission reflects this experience. The scope of this submission relates to matters that have directly impacted on Council's operations and provision of services.

The broader impacts of NCP were addressed in Council's 1998 *Submission to the Senate Select Committee on the Socio-Economic Consequences of the National Competition Policy*, attached at Appendix 1.

### **1.1 NATIONAL COMPETITION POLICY AND LOCAL GOVERNMENT**

National Competition Policy and related reforms was introduced in 1995 by agreement between the Commonwealth, State and Territory Governments to encourage better economic and social outcomes through micro-economic reforms that encouraged more effective use of national resources.

NCP was a package of related market and economic policy reforms that were designed to stimulate economic growth and job creation. It was believed that the disciplines imposed by competitive markets would drive reduced costs and prices, produce new innovative products/services and improve the efficiency in the use of resources.

Broadly speaking, NCP involved the following:

- 1) The extension of Trade Practices laws prohibiting anti-competitive activities (such as the abuse of market power and market-fixing) to all businesses, including government businesses

- 2) The introduction of competitive neutrality, so that privately owned businesses could compete on an equal footing with those owned by Government
- 3) The review and reform of all laws and regulations that restricted competition
- 4) The development of a national (third party) access regime to enable competing businesses to use nationally significant infrastructure
- 5) Price monitoring for all significant government businesses that have a market monopoly, and
- 6) Specific reforms to the gas, electricity, water and road transport industries.

The introduction of competitive neutrality into the local government arena was aimed at enabling fair competition between local government and private sector businesses, whereby any advantages or disadvantages that a government business experienced by virtue of its ownership status, must be neutralised.

Under NCP, competitive neutrality was to apply only to 'significant' government businesses, and where the benefits of competitive neutrality outweighed the costs. The extent to which a business was deemed to be 'significant' depended on the size of the business and its importance in the particular market in question.

NCP was to apply to all local governments throughout Australia. In Queensland, the State Government amended the *Local Government Act* to include provisions facilitating the implementation of NCP.

In practical terms, the application of NCP to the local government environment required the following:

- 5) Separation of the regulatory functions from the commercial activities of the businesses that are to be subjected to competition reform
- 6) Creating purchaser-provider accounting separation
- 7) Ensure that a business' structure is such that it can operate in a competitive environment and that business units operate on commercial terms
- 8) Independent determination of prices for activities that remain natural monopolies
- 9) Introduction of full-cost recovery to the prices charged by local government businesses, which are to include:



The direct cost of providing the goods or services and an appropriate proportion of indirect costs

- 1) All relevant taxes or tax equivalents
- 2) A commercial level of interest payments, and
- 3) A commercial rate of return

## **1.2 SUBMISSION STRUCTURE**

This submission proceeds as follows:

- **Section 2** describes Council's experiences in implementing NCP reforms
- **Section 3** provides an evaluation of Council's experiences in relation to NCP reforms
- **Section 4** provides an overview of Council's views in relation to water reforms and recent experiences, and
- **Section 5** outlines Council's view in relation to future issues for competition reforms

## 2 TOWNSVILLE CITY COUNCIL EXPERIENCE

This section of the submission describes Townsville City Council's experiences with implementing NCP and related reforms. The next section then evaluates the impacts and costs/benefits of this experience. The experiences of Water reform are dealt with separately (Section 4 below).

### 2.1 OVERVIEW

Council has successfully implemented NCP related requirements. The Table below summarises Council's actions in relation to NCP requirements. The extent to which Council has successfully implemented NCP reforms is substantiated annually by its Returns.

**Table: Overview of Townsville City Council's NCP Reform Implementation**

<b>Reform</b>	<b>Council Action</b>
Separation of the regulatory functions from the commercial activities of the businesses that are to be subjected to competition reform	Implemented separation where business units are able to focus solely on commercial activities and service delivery, and policy and regulatory functions are performed elsewhere.
Creating purchaser-provider accounting separation	Implemented successfully.
Ensure that a business' structure is such that it can operate in a competitive environment and that business units operate on commercial terms	Created Type 1, Type 2 and Type 3 (Code of Competitive Conduct) business units with corporate and operational plans, full-cost pricing and requirements to operate on commercial terms
Independent determination of prices for activities that remain natural monopolies	Independent price oversight regime in place
Introduction of full-cost recovery to the prices charged by local government businesses	Implemented across Council and business units

Introduction of competitive tendering and contracting	Implemented where benefits outweigh the costs, and consistent with the probity requirements of the Local Government Act
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## 2.2 SIGNIFICANT BUSINESS ACTIVITIES

NCP reforms are targeted especially at larger Councils where the bulk of the significant business activity is undertaken. This approach was driven by the idea of achieving the most overall gains through the involvement of relatively few Councils.

Significant business activities were divided into two types:

- 1) Type 1 business activities with a combined expenditure in excess of \$25m per year and other services with annual expenditure greater than \$15m, and
- 2) Type 2 business activities with a combined annual expenditure in excess of \$8.5m and other services with combined annual expenditure of more than \$5m.

### **2.2.1 Business Units**

For Townsville City Council this led to the creation of the following business units:

- 1) Type 1 Business Units for the delivery of Water and Wastewater services – known as CitiWater, and
- 2) Type 2 Business Unit for the delivery of refuse services – known as CityWaste, and
- 3) Type 3 (Code of Competitive Conduct) Business Units, namely for the provision of the following services:
  - a) Public Works through CityWorks
  - b) Vehicle services through Council Fleet Services
  - c) Building Certification
  - d) Civic Theatre
  - e) The Learning Centre
  - f) Property Business Unit
  - g) Parks Nursery, and
  - h) Off-Street Parking.

## **2.3 COMPETITIVE NEUTRALITY**

### **2.3.1 Full Cost Recovery and Structural Change**

Consistent with the competitive neutrality requirements of NCP, the Townsville City Council has implemented an organisation-wide program of full-cost pricing for the provision of internal and external services.

This was accompanied by a structural reform program that introduced an internal 'purchaser-provider' methodology within the operations of the Council itself (in addition to the Business Units). Where relevant, Council has developed key performance indicators and detailed corporate and operational plans to ensure ongoing compliance and performance evaluation.

Council has fully allocated to all its business units and all other operations those costs incurred by internal activities that provide support services to those business activities. These costs have been calculated on a full-cost pricing basis.

The following are the corporate overhead costs that are allocated via cost drivers:

- |                         |                                       |
|-------------------------|---------------------------------------|
| 1) Accounts payable     | 8) Financial accounting               |
| 2) Purchasing           | 9) Legal services                     |
| 3) Courier costs        | 10) Corporate information and support |
| 4) Financial operations | 11) Land information                  |
| 5) Cashiers             | 12) Human resources                   |
| 6) Accounts receivable  | 13) Information technology, and       |
| 7) Rates                | 14) Training.                         |

In addition to these, adjustments are made for tax equivalents and interest payments to reflect commercial rates. As well a rate of return is specified as an objective.

Full cost pricing is now a permanent feature of the Council's annual budget processes, where individual Council activities and business units are required to submit program budgets based on full-cost pricing principles.

### **2.3.2 Competitive Neutrality Complaints**

NCP required the establishment of a process for receiving and investigating competitive neutrality complaints. Council established such a process in June 1998 in compliance with these requirements.

Since then, one informal complaint was received and successfully resolved through the provision of commercial information and discussions with the complainant.

## **2.4 COMPETITIVE TENDERING AND OUTSIDE CONTRACTING**

Competitive tendering and contracting (CTC) involves the selection of preferred suppliers of goods and services from a range of bidders by seeking offers and evaluating these against predetermined selection criteria.

CTC is often associated with structural reforms within government in order to establish a distinction between the purchasing and providing arms – that is, the creation of a 'purchaser-provider' structure.

CTC is a means to achieve better performance through improved efficiency and effectiveness of government operations. When successfully implemented, competitive tendering and contracting is expected to deliver improved quality and/or quantity of services for each dollar of expenditure.

Townsville City Council notes that CTC has been a part of Council's operating environment for a substantial period predating the implementation of NCP. It is neither new nor specific to NCP.

Moreover, it is recognised that NCP does not require competitive tendering and contracting per se by government agencies. As noted by the Hawker Committee:

Neither the legislation nor the Agreements contain any obligation to impose outsourcing requirements on local government or to introduce competitive tendering.

However, Council notes that the Productivity Commission includes CTC within the ambit of NCP in that such practices "share the same underlying rationale – the use of competition to strengthen incentives for better economic, social and environmental outcomes".<sup>1</sup>

Notwithstanding the underlying rationale, the link between NCP and CTC is found in the requirement that in-house bids for competitive tenders will be subject to competitive neutrality provisions.

In implementing NCP reforms, Council has ensured that in-house bids are subject to competitive neutrality requirements, specifically the application of full-cost pricing principles and the removal of any advantages that accrue specifically as a result of the internal business' status as a Council-owned/operated entity.

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<sup>1</sup> Productivity Commission (2004) *Review of National Competition Policy Arrangements, Issues Paper* p. 2 Box 1.

### **3 EVALUATING COUNCIL'S EXPERIENCES**

This section provides an evaluation of Council's experiences in implementing NCP and related reforms, and places the benefits/costs into the broader context of reform activity undertaken by Council during the past decade (1994-2004).

#### **3.1 REFORM CONTEXT**

NCP was agreed by the Council of Australian Governments in 1995. For Council, the adoption and implementation of NCP and related reforms took place alongside a raft of other substantive reforms that predated and which were initiated independently of NCP.

Apart from NCP, Townsville City Council implemented a number of significant organisational improvements that contributed to many of the benefits that are often ascribed to NCP per se. These reforms were:

- 1) Accounting reforms, with the introduction of accrual accounting (to supplement and at times replace the previous practice of cash accounting) in 1994
- 2) Comprehensive public sector management reform through the Council's award-winning Quality Directions Strategy (QDS) in 1996, and
- 3) Corporate planning reforms brought about by requirements of the *Local Government Act 1993*

##### **3.1.1 Accrual Accounting Reforms**

Townsville City Council introduced accrual accounting on 1 July 1994 to improve accountability and facilitate improved performance.

It was recognised that the prevailing cash accounting approach was inadequate for a range of reasons. These included the fact that cash outlays did not recognise certain major costs such as the using up of fixed assets, stocks and inventories, and ignored accumulating liabilities. As such, cash

accounting did not provide any systematic information on assets and liabilities.

In light of these deficiencies, and the broader movement within the accounting profession and public sector accounting towards accrual accounting methods, Townsville City Council introduced accrual accounting to its operations.

The benefits gained by Council through this experience include the following:

- 1) Accrual accounting provided information on total costs of operations, particularly at a program level, so that costs were related to program outputs
- 2) Measuring costs became an important part of overall performance, including the management and control of costs and where relevant the recovery of these costs through charges, and
- 3) Information on longer-term emerging liabilities or commitments arising through the carrying out of certain activities also was made available. Council was as a result aware of the rate at which future liabilities were building up and of the full cost of providing services and was able to fund these appropriately.

Council also adopted a policy decision to fully fund depreciation, which has ensured Council is able to fund its future replacement of infrastructure requirements without seeking additional external financial support.

Accrual accounting was therefore a precondition to Council's approach to fully costing the provision of services.

### **3.1.2 Quality Directions Strategy**

Aligned with the progressive introduction of accrual accounting, Council implemented a comprehensive program of organisational and management practice reform in 1996. The program was known as the Quality Directions Strategy and involved, among other things:

- 1) Detailed process mapping of Council's operating environment, which revealed the precise operating environment of the Council's broad range of interrelated activities and functions



- 2) A detailed understanding of cost centres, which together with accrual accounting, formed the precondition to the effective application of full-cost pricing methodologies and NCP-driven internal purchaser-provider separation, and
- 3) Process and structural reorganisation, which enabled process efficiencies to be achieved through streamlining of activities and better organisation of related competencies and capabilities.

### **3.2 CORPORATE PLANNING REFORMS**

The *Local Government Act 1993* made requirements for Councils to introduce new corporate planning procedures. These procedures involved the following:

- 1) A corporate plan for Council covering a 3-5 year time horizon
- 2) Annual operational plans that were aligned to the corporate plan
- 3) Key performance indicators to evaluate outcomes, and
- 4) Quarterly reports against the key performance indicators.

These reform programs were to have a significant effect on Council's ability to enhance service delivery, improve accountability and transparency and achieve better work practices. In other words, through QDS and accounting reforms, Council was able to 'work smarter' and improve operating effectiveness and efficiency.

It is Council's experience that within this context, NCP-specific reforms were largely restricted to the creation of business units and introduction of competitive neutrality principles.

### **3.3 REFORM BENEFITS**

This section considers the benefits to Council as a result of implementation of NCP and related reforms. It should be noted that this section is focused solely on those gains directly relevant to Council, rather than possible benefits achieved by organisations or groups outside of the Council.

### **3.3.1 Operational Improvements**

The most significant type of benefit experienced by Council through the implementation of NCP and other reforms (3.1 above) is the enhancement of Council's ability to make informed decisions about its activities, and therefore drive operational improvements. Such improvements are manifest in the form of cost reductions, improved service delivery, innovation and more effective opportunity-cost decision-making.

Reforms implemented throughout the 1990s and 2000s have enabled Council to gain a deeper and more detailed understanding of its activities and businesses, and thereby make more reasoned decisions about the ongoing provision of these services, improvement and efficiency enhancement programs and opportunity-costs.

Specifically, improved information and decision-making capacity related to:

- 1) Better identification of full costs
- 2) Adoption of full cost pricing budgets
- 3) Continual review of operating costs
- 4) Continued review of charging policies, and
- 5) Awareness of the need to be aware of the markets in which business units operate.

The extent of benefits that have accrued as a result of better decision-making, in terms of avoided or reduced costs, better products and improved service delivery is difficult to measure for the simple reason that limited data exists for the pre-reform environment against which subsequent performance can be evaluated.

However, business unit experience since NCP indicates that cost reductions ranging from 5% to 18% have been achieved over 4 years. Furthermore, this is consistent with the success of Council in achieving across-the-board cost reductions of 5%, required through budgeting mandates. Improved knowledge of business and activity cost and revenue centres has enabled effective decision making that has reduced costs without adversely affecting service standards and levels.

On these measures, Council has experienced real productivity improvements as a result of business improvement reforms implemented in the last decade.

Council is also more aware of the true extent of cross-subsidies, in the form of Community Service Obligations (CSOs), and is therefore able to make ongoing reasoned decisions about its ongoing commitment to these. From time to time, evaluations of opportunity-cost issues related to Council's ongoing funding of particular activities are undertaken, with benefits to ratepayers and residents resulting directly from a constant desire to deliver improved value for money. Full cost details make it possible for robust and comprehensive analyses of opportunity-costs.

### 3.3.2 Dividends

Dividend payments from Council-owned business units have increased appreciably since the creation of business units. There has been an associated improvement in focus and performance in relation to the return on assets achieved, a summarised in the Table below.

**Table: Rate of Return, Return on Assets & Profit Performance**

	<b>CitiWater (RoR)</b>	<b>CitiWorks (Profit)</b>	<b>Fleet Services (RoA)</b>
2000-01	8.6%	6.6%	32%
2001-02	8.7%	4.4%	15%
2002-03	10.6%	4.2%	14%
2003-04	8.8%*	5.2%	9%

\*As at May 2004

### 3.3.3 Service Delivery

Council has achieved significant improvements in service delivery over the last decade. Council services are more responsive to the various needs of ratepayers and residents, and a corporate culture of service delivery excellence has been encouraged and consolidated over the last decade.

Client satisfaction research points consistently to high levels of satisfaction from Townsville residents towards Council activities and services. There also are positive perceptions about the value for money provided by the Townsville City Council in terms of the relationship between services provided and rates charges.

Operational efficiencies, brought about by improved knowledge and focus on business activities (3.2.1 above), have been important in driving service delivery excellence. However, many of these improvements have also been driven by Council management commitment to process improvement and quality directions (3.1.2 above).

#### **3.3.4 Accountability**

Better information has also contributed to improved transparency and accountability in the form of improved reporting both within Council and to the public.

The nature of financial reporting made available to Council and the residents of Townsville is of a qualitatively superior standard than was the case a decade ago, prior to the implementation of accounting reform, QDS and NCP.

Additionally, Council is further accountable to the Queensland taxpayers through compliance reporting to the Queensland Competition Authority and its Ministers.

#### **3.3.5 Competitive tendering and outside contracting**

Council has implemented CTC from a pragmatic, rather than ideological, perspective. This is consistent with the view expressed by the Industry Commission in its report on *Competitive Tendering and Contracting by Public Sector Agencies* (1996) that CTC “is not an end in itself” (p. 1).

Due consideration has been given to Council’s role within the regional economy as a direct employer and provider of essential services and as a provider of last resort, when determining which activities are most suitable for competitive tendering and external contracting.

Within this strategic framework, competitive tendering has been used where it can provide Council and ratepayers with value for money services, access to

capabilities that exist outside of Council and where risks are appropriately allocated to the parties most able to manage those risks.

### **3.4 REFORM COSTS**

This section considers the direct and indirect costs to Council as a result of implementation of NCP and related reforms. It should be noted that this section is focused solely on cost issues directly relevant to Council, rather than possible costs carried by organisations or groups outside of the Council.

#### **3.4.1 Direct Costs**

Council has incurred significant one-off and recurrent costs as a direct result of NCP implementation and compliance. These relate predominantly to the personnel resources and information technology requirements needed to administer NCP-related activities, namely:

- 1) Identification of full-costs and cost drivers, and annual budgeting activities related to cost adjustments arising from the application of full-cost recovery principles and resolving disputes about cost drivers and attributed values to these drivers
- 2) Internal transactions between Council purchasers and providers – issuing of invoices and internal payments – which required the implementation of a dedicated internal charging system to support and account for the transactions. Between 01-July-2003 and 31-March-2004, a total of 5,674 internal transactions were made for the provision of services.
  - a) This involves recurrent costs associated with software licensing, software updates, information technology support and financial expertise within business units and departments of Council
- 3) NCP reporting and compliance administration, and
- 4) Contract development, evaluation, management and supplier performance monitoring (associated with effective implementation of CTC).

Council estimates that to date, costs associated with these activities have been in the order of \$3.6m per year, of which \$200,000 relates to information systems and support, together with a one-off investment of \$700,000 in

developing full-cost pricing methodologies, acquiring and installing software and initial staff training.

### **3.4.2 Indirect Costs**

Apart from the direct costs associated with administering NCP related processes and requirements, the implementation of NCP and NCP-related reforms has exacted considerable indirect costs to the Council. These indirect costs include:

- 1) **Fragmentation of Council.** The introduction of purchaser-provider structures and processes has led to the watering down of a strong unified corporate culture, replaced by a more fragmented organisation. This fragmented corporate culture gives rise to the need for management intervention to resolve disputes and manage differences of interests and approaches. Associated costs are difficult to separately identify and quantify, but the divisive impact on corporate culture as a result of NCP is beyond question.
- 2) **Inconsistent interests and drivers.** Associated with the watering down of a strong unified corporate culture, NCP reforms (i.e., purchaser-provider and creation of business units) have led to the disintegration of organisational interests whereby the narrowly defined interests of a sub-unit of Council is not necessarily consistent with the interests of the corporate whole. This had led to decisions that could have potential long-term implications for Council's resources and assets as individual unit decisions to outsource services for short-term financial gain can contribute to resource under-utilisation within Council and therefore, inefficiencies and long-run degradation of Council's capabilities. This issue is of particular concern in the context of Council needing to ensure that it has the capacity and capability to act as the provider of 'last resort' (see 3.5.3 below).
- 3) **Resource duplication and asset under-utilisation.** Structural fragmentation has led to reduced resource sharing and the associated growth in duplication across Council. This is especially evident in the employment of unit-specific financial personnel rather than the sharing of

corporate financial management resources. Anecdotal evidence suggests that duplication has also contributed to heightened under-utilisation of assets. This gives rise to Council-wide inefficiencies in the use of resources.

### **3.5 OTHER ISSUES**

So far, this section has outlined Council's assessment of the benefits and costs of NCP and related reforms in a fairly narrow Council-focused frame of reference. However, in evaluating the overall merits or otherwise of NCP, it is important to consider a broader range of issues. This is consistent with the NCP regime, which acknowledged the importance of public good considerations, and the obligation to provide community services.

#### **3.5.1 Competitive Neutrality**

Competitive neutrality was designed to ensure Council businesses were neither advantaged nor disadvantaged by virtue of its public ownership. For some, it was about ensuring that private sector businesses could compete on equal terms against Council providers.

Council believes that its ownership of various businesses does not confer benefits that would be to the detriment of competitive neutrality. The fact that since 1998 there has only been one informal complaint related to competitive neutrality of Council's businesses is clear evidence of this.

There are, however, anomalies in the comparable operating environments that actually disadvantage Council operations and businesses vis-à-vis especially smaller service providers. These include the following:

- 1) A longer-term outlook on assets. Council is a custodian of public assets that are in effect 'perpetual' assets. As such, Council's financial commitment to asset management and maintenance is considerably greater than would be the case for organisations whose asset life strategy is viewed over a shorter time horizon. Further, Council's policy decision to fully fund depreciation benefits future ratepayers but is a cost impost that is often avoided by private sector operators.

- 2) Non-exit option. Unlike private businesses, Council is not always able or willing to exercise a suitable 'exit' strategy. This fundamentally affects the operating cost environment of competing businesses. For example, a private firm that intends on exiting the market within say 3-5 years has greater incentive to run-down assets and reduce maintenance expenses to improve immediate bottom-line performance. In contrast, a competing Council provider is required to fully fund depreciation and ensure that its assets are maintained to a standard befitting a community leader and a perpetual service provider or 'provider of last resort' (see 3.5.3 below). The full-cost for a Council business is, therefore, greater than for a comparable private provider.
- 3) Visibility and Community leadership. Policy decisions to maintain assets for non-business reasons result directly from Council's position as a community leader. Council is a community leader and is highly visible. It is often necessary for non-commercial reasons for Council to ensure that its assets 'set a high community standard' to ensure Council is 'leading by example'. Again, this places a greater cost impost on Council and its businesses than would be the case for private sector organisations that are not as visible or which do not need to conduct themselves as leading community citizens.
- 4) Regulatory Compliance. Council businesses are not comparable to many smaller operators in terms of commitments to for example, Quality Assurance and Occupational Health and Safety. As a highly visible community leader, Council is required to ensure high level compliance with quality standards and OH&S. Quality systems, documentation and auditing are costs that Council carries (and therefore reflected in full-cost prices), which are not carried by many (smaller) providers. This disadvantage is not a simple result of the differences in size of operations (a factor that is not relevant in terms of competitive neutrality), but is a direct function of the differences in community expectations associated with publicly and privately owned/operated businesses.
- 5) Overhead allocations. Council businesses are required to reflect in their full-costs a component of corporate overhead, which would not be



comparable to many smaller private sector providers. The costs associated with regulatory compliance are one example. Another relates to Council's approach to professional liability insurance. Whereas Council is insured to a value of \$20m, with the costs of such allocated proportionately to all business units, comparable private sector providers do not carry the cost disadvantage of being associated with a larger, more visible organisation.

While Council has sought to make adjustments to account for these competitive neutrality anomalies, it must be recognised that the ascription of values is imprecise. In this context, the adjustments are more likely to not fully compensate Council businesses for the disadvantages associated with these factors.

### **3.5.2 Provider of Last Resort**

The change from an environment where universal supply was unquestioned to competitive supply is a fundamental one. Proponents of market reform reconcile universal service and the competitive markets through the adoption of CSOs that explicitly shift 'social' responsibility from the utilities to government. If Council wants service providers to serve 'uneconomic' customers, then it must be prepared to subsidise the customer.

Local Governments are service 'providers of last resort'. This is largely a function of an historic 'social compact' between local authorities and residents. The obligation to be the provider of last resort takes two forms:

- 1) Council does not have the ability to withdraw services from existing customers, and
- 2) Council has an obligation to 'be ready' i.e., to maintain the ability to provide services in the event of the withdrawal of alternative service providers.

This obligation applies to essential or basic services provided by local authorities, such as water, sewerage and waste, which are fundamental to a high quality of life for residents.

As the provider of last resort Council is both a) the 'default' supplier in the event of unplanned market exit of alternative provider(s) or (b) when alternative providers refuse or are unable to provide a universal service.

### **Default Supplier**

Council is by its nature the default supplier of essential services should alternatives not be available or prevail. The true cost of maintaining a capability to fulfill this role is not adequately accounted for within NCP concepts of full-cost recovery and competitive neutrality. Council does not have the commercial luxury of 'exiting' a service provision requirement, and must therefore retain and maintain a capability to ensure that it can meet community expectations of service continuity.

It is important in this context to recognise that the risk to ratepayers of service failure is conversely related to the proximity a market is to capital cities. In other words, the further a community is from capital cities and to a secondary extent from regional centres (and therefore, the smaller it is), the greater the risk of service failure.

In competitive multi-supplier markets, when one supplier exits the market another potentially fills the breach. Service continuity is typically not affected, except perhaps during a short transitional period. However, in markets where the market size does not support the viable existence of multiple competitive suppliers – as is often the case in smaller, regional environments – local authorities are by nature a provider of last resort.

### **Economic Discrimination**

Service providers seeking a profit or market share can potentially discriminate between classes or groups of customers by either 'cherry picking' or 'redlining' practices.

Markets tend to segment their customer bases, and as information technology and data mining become more prolific the opportunity for competing providers to target specific customers or customer groups grows and intensifies.

Competing providers want to attract and retain the customers that are most valuable to them, and rid themselves of the customers that are unprofitable or of comparatively low value.

These market drivers sit uneasily with notions of universal service provision.

Council, however, is required to provide a universal service in a range of essential or basic services. It cannot discriminate between classes of customers based on financial value, as Council is fundamentally about service provision not profit (or shareholder value) maximisation.

By its very nature, Council is required to provide services to customers that would, in a narrow commercial frame of reference, be considered uneconomic. While full-cost pricing has improved the transparency of the cost of this inherent subsidy, it does not lead to genuine competitive neutrality for the reason that while a private provider may decide to not service uneconomic customers (or introduce charges to recover the additional costs of servicing such customers), Council does not have this 'luxury'. In an environment where private providers were allowed to cherry pick or redline, Council would have to fill the service gap, at an even greater cost overall.

For example, Council has to fulfill this role in the building certification market in which private providers are unwilling to undertake building certification work on Magnetic Island due to those jobs being considered uneconomic. Private providers have effectively redlined Magnetic Island projects. Certification must, however, be undertaken and Council provides the service to Magnetic Island projects.

To comply with the obligation to be ready, Council can and does adopt a number of strategies, including:

- 1) Maintaining existing infrastructure and intellectual property so that they can be used or activated when required
- 2) Develop alternative or emergency or short-term responses to ensure that service capacity is in place quickly
- 3) Hold in reserve materials and equipment that can be installed when or where required, and
- 4) Add reserve capacity to new infrastructure.

By adopting these strategies, the full cost of providing a service by Council is likely to be higher than is the case for a competitive provider that does not

have to provide for the obligations associated with being the provider of 'last resort'.

As well, a number of additional uncompensated costs and risks arise. These are reflected in Council's true cost of service provision but are not necessarily present for alternative service providers. Such costs and risks include:

- 1) The risk of stranded assets (resulting from technology change), which affects depreciation provisions, and
- 2) Revenue risks due to the introduction of competition and contestability, manifesting in the form of increase revenue forecasting error and revenue volatility.

### **3.5.3 Regional Development**

Council notes the potential adverse effects of NCP and CTC in relation to regional economic development, including:

- 1) Potential loss of employment and income from the region, and
- 2) Transfer out of the region of equipment, workers and families.

As an employer of almost 1,300 people with an annual payroll of approximately \$44m, Townsville City Council is one of the region's most significant employers and contributors to economic welfare.

A dilution of this, resulting from CTC whereby service delivery is performed by organisations headquartered elsewhere (e.g. in southern capital cities) would lead to the repatriation of significant revenues and profits from the region, with consequent multiplier effects on local economic activity. This situation would be exacerbated should service delivery be provided by firms without a genuine local presence, whereby personnel and resources are deployed on a fly-in/fly-out basis.

### **3.5.4 Full Cost Pricing and Cost Shifting**

A key element of NCP reform was the introduction of full-cost pricing. Council has implemented this principle throughout the organisation.

However, Council is concerned that full costing pricing is not recognised by Commonwealth Government grants in areas such as community service and

environmental programs. In these situations, grants provided to community organisations – and auspiced by Council – do not make provisions for the full-costs involved in the delivery of auspicings services that make it possible for community organisations to implement funded programs.

To date, Council has provided auspicings services, and carried the costs of doing so, to ensure service continuity. However, it is concerned that the inconsistency between grant funding arrangements (which do not provide for Council's costs) and the NCP requirements of full-cost pricing is leading to tacit cost shifting from the Commonwealth to local authorities.

### **3.6 SUMMARY**

It is difficult to ascribe all the operational enhancements achieved in the last decade by Townsville City Council to the implementation of NCP without acknowledging the centrality of contemporaneous but unrelated reforms in accrual accounting and business and management practices and organisational reform.

Council's submission is that many of the improvements in business practice and performance would have taken place without the implementation of NCP-specific aspects of the reform experience, namely competitive neutrality and the structural creation of business units.

A keener and rigorous focus on the operating environment of Council's activities was being created and effected as a result of QDS and introduction of accrual accounting, with NCP often playing a secondary role.

Council's explicit policy commitment to fully funding depreciation is consistent with achieving intergenerational equity but disadvantages Council's businesses when compared to the business time horizon of many small operators within the market place. These disadvantages and anomalous outcomes are exacerbated by a competitive neutrality regime that does not adequately acknowledge and compensate for Council's role and obligation as the service provider of last resort.

Council also is concerned that NCP full cost pricing principles are not consistently applied to other Commonwealth Government activities, and

specific reference was made to the provision of community service and environmental project grants that are auspiced by Townsville City Council. In these cases, Council's auspicings services are fully costed by Council, but these costs are not compensated by the grants provided.

At the same time, however, the relevance of NCP should not be understated. At times, NCP provided a powerful rationale to drive through organisational reforms when cultural resistance and inertia may have slowed the reform process. Additionally, the focus on competitive neutrality honed the importance of fully costing activities and benchmarking them to market prices, which provided a useful tool to facilitate ongoing or continual improvement.

Taking these considerations into account, it is Council's considered position that on balance NCP *by itself* was at best of marginal net benefit to Council and at worst was a 'cost neutral' reform program. Contemporaneous reforms were of greater significance to operational improvements, which continues to deliver a stable, and financially robust local government service provider to Townsville residents.

Furthermore, Council notes that NCP does and will continue to incur costs into the future, which may negate some of the benefits achieved in the short term.

## **4 WATER REFORMS**

This section briefly addresses issues related to the implementation of water reforms, as much of the literature associated with debate on this issue is publicly available via the National Competition Council website ([www.ncc.gov.au](http://www.ncc.gov.au)).

Water reforms were a specific area identified by COAG for NCP, and as such are dealt with separately from other more general areas of NCP application to Council activities.

### **4.1 COUNCIL ACTIONS**

Council has implemented consumption based charging, with water meters installed on all properties. All commercial properties are charged by meter measurement. A water allowance is provided for residential properties.

In this respect, Council has not introduced a two-part tariff pricing regime for residential consumers, as was originally required under NCP. Council's concerns about the relevance of two-part tariff reforms to the Townsville environment have been justified, and agreed to by the Commonwealth.

### **4.2 GREENING TOWNSVILLE**

The core of Council's concerns regarding the impacts of two-part tariff reforms is driven by:

- 1) The seasonal nature of rainfall patterns in the area
- 2) A concern that costs were unlikely to change due to consumption decreases because of high fixed costs in the business, and
- 3) Council's policy commitment to 'Greening Townsville'.

It should be noted that the reduction of water use is not a major driver for Townsville as there are limited benefits from reduced water consumption in terms of both price and community lifestyle.

This is because in the dry tropics, annual rainfall is concentrated within short time period and it is necessary to ensure that water pricing does not act as a disincentive to achieving the Greening Townsville policy.

This policy is driven by the need for Council to address its 'hot dry image' and provide a 'counter' to the City's strong 'industrial' image, which tended to overshadow efforts made to promote Townsville as a holiday destination.<sup>2</sup>

This policy supports the supply of enough water to each user in the City to ensure:

- 1) Quality of life through green lawns and lush gardens
- 2) Swimming pool maintenance at a reasonable cost, and
- 3) Lush green public parks and gardens.

This policy is achieved through the provision of water used by the following groups at less than full cost price:

- 1) Commercial gardening where a specific garden meter has been installed and used only for irrigation reticulation
- 2) Charitable organisations, sporting and welfare groups, and
- 3) Domestic users.

A Community Service Obligation payment is made to CitiWater for the difference between the full cost price of supplying water to these groups and the revenue received from these groups. This CSO is provided from the general rate revenue of Council.

Council has always believed that the introduction of a two-part tariff would adversely impact the Greening Townsville policy. Conversely, the current water pricing policy has played an important role in providing the community with affordable water and allows residents to actively beautify their gardens and footpaths.

### **4.3 EVALUATION AND OUTCOMES**

Council has steadfastly argued that the costs of introducing two-part (consumption based) tariff for residential customers outweigh the benefits, and would adversely affect Council's Greening Townsville policy.

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<sup>2</sup> Kinhill Cameron McNamara, 1991, 'Regional Tourism Development Concept Plan for Townsville and Environs'



The National Competition Council had recommended in 2001 that competition payments to Queensland in 2001-02 be permanently reduced by \$270,000 and further recommended that this reduction continue in 2002-03 in its 2002 assessment of Townsville City Council's refusal to implement consumption-based pricing for residential customers.

However, in response to various submissions and evaluations conducted by Council and by the National Competition Council over the period, the Commonwealth Treasurer agreed on 25 July 2003 to lift the penalty imposed on Queensland in 2002-03 in relation to Townsville City Council's water pricing and reimburse \$270,000 in competition payments to Queensland.

The Treasurer agreed on 25 July 2003 to lift and reimburse a \$270 000 competition payments penalty imposed on Queensland in 2002-03 in relation to water pricing by the Townsville City Council. In taking this decision, the Treasurer released the National Competition Council's supplementary 2002 assessment report considering the performance of Townsville against the water reform obligation to introduce consumption-based pricing for water services where cost-effective. This decision was based on a review undertaken by the Queensland Competition Authority of evidence provided by Townsville City Council, in which the National Competition Council concluded that the QCA report was sufficiently robust in its support of Townsville's case.

Council believes this decision is right, and vindicates its long-held concerns about the cost-effectiveness of blindly implementing consumption-based tariffs for residential water.

However, it should be noted that Council must review its position via a public benefit test next year under the NCP requirements of the *Local Government Act 1993*.

## 5 FUTURE DIRECTIONS

The Productivity Commission has been asked to “report on areas offering additional opportunities for significant gains to the Australian economy from removing further impediments to efficiency and enhancing competition”.

Townsville City Council is of the view that any significant gains to be achieved through the implementation of competition and related reforms have already been realised. Council has actively implemented the reform program and in conjunction with independently initiated improvement strategies (accrual accounting and management and structural reforms), operational benefits in the form of improved decision-making, efficiency gains and accountability have been achieved.

Given that the biggest gains have already been achieved, the potential benefits of further reform and extension of reforms are likely to be quite small and would not be cost-effective to implement.

Future focus should be directed towards the following:

- 1) Future challenges for local governments like Townsville City Council are to fine-tune the application of competition and related reforms to ensure ongoing relevance to Council operations and service obligations. These are principally matters of Council administration and management, rather than broader competition policy issues
- 2) Council is concerned about the adverse impacts of existing competitive neutrality provisions in relation to Council’s obligations as a provider of last resort and believes that NCP and competition-related activities and reforms in the future need to more explicitly acknowledge and compensate for this obligation
  - a) In particular this relates to the financial costs associated with Council’s long-term approach to asset management and maintenance, and
  - b) The costs and risks directly incurred as result of Council’s obligations resulting from it being the provider of last resort
- 3) Council is concerned at the tacit cost shifting that is occurring as a result of Commonwealth Grants (e.g. community services and environment

projects) that do not acknowledge or compensate for the full costs of Council auspicing services

- 4) A pragmatic approach to CTC must be continued, which adequately reflects broader considerations of regional economic and social development priorities

## **APPENDIX 1**

*Submission to the Senate Select Committee on the Socio-Economic  
Consequences of the National Competition Policy.*