



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

Submitted by the Australian Local
Government Association

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Introduction

In 1995 the Australian, state and territory governments agreed to a program of competition policy reform. Whilst local government was involved in the negotiations, it was not a signatory to the resulting agreement. The states and the Northern Territory governments signed the agreement on behalf of local government and were responsible for local government's implementation of National Competition Policy. Consequently, the experience of local government in each state and the Northern Territory has been different¹.

While local government recognises the benefits of improving the efficiency of its activities, the National Competition Policy process has been problematic particularly during the early stages of the reform program. Local government had difficulty accessing accurate information on the National Competition Policy reform requirements and the obligations of local government. Many local government bodies, particularly small councils in rural and remote areas, had difficulty accessing the skills needed to review restrictions on competition and implement competitive neutrality reforms.

More significantly, however, many of the councils that bore the adjustment costs associated with reform did not receive any funds from their respective state or territory governments to assist in the implementation process or share in the benefits of the reform process.

ALGA therefore welcomes this opportunity to make a submission to the Productivity Commission Review of National Competition Policy Arrangements.

This submission provides an outline of the impact of the current arrangements on local government as well as a general overview of local government's obligations under the Competition Policy Agreement (CPA) and the resulting issues. There is some discussion regarding the application of the public interest test and areas of further expansion. The submission includes a conclusion and several recommendations. ALGA trusts that the Commission will consider its recommendations as part of the final report.

Terms of Reference

ALGA notes the scope of the inquiry (Attachment 1), however comments in this submission are limited to specific matters of direct relevant to local government.

¹ There are no local governments in the Australian Capital Territory. The government in the Australian Capital Territory operates as both state and local government.

The Impact of Current Arrangements on Local Government

Clause 7 of the Competition Policy Agreement (CPA) requires that local government should be party to the principles set out in the CPA. Under the CPA, states and territories took responsibility for applying these principles to local governments within their jurisdiction. As such, the impact of the current arrangements on local governments has been different in each state and the Northern Territory.

An Overview of Local Government's Obligations under National Competition Policy

The most common competition policy principles applied to local government activities are competitive neutrality (CN), structural reform, the review of legislative restrictions on competition and water reform.

Competitive neutrality (CN)

The overall objective of CN is that government businesses (whether they are corporatised or not) do not enjoy any net competitive advantage simply because of their public sector ownership. This principle does not apply to all non-business, non-profit activities of publicly owned entities and it has been up to each state and territory to determine its own definition of non-business, non-profit activities.

More specifically, the Competition Policy Agreement (CPA) provides that each state and territory is free to determine its own agenda for the implementation of competitive neutrality principles. These include:

- corporatisation of significant government business enterprises;
- payment of full Commonwealth, state and territory taxes or tax equivalents and debt guarantee fees directed towards offsetting the competitive advantages provided by government guarantees;
- imposition of those regulations to which private sector businesses are normally subject; and
- pricing of goods and services to take account of these CN costs and to reflect full cost attribution.

The application of the public interest test that assesses whether the benefits of the change exceed the costs is also relevant to the implementation of CN.

Structural and legislative reform

Structural reform involves introducing competition or, at a minimum, removing barriers to new businesses competing in the market. It also often involves splitting a public monopoly (or parts of it) into smaller, separate entities or separating defined business activities (e.g. water and sewerage) from the main activities of the council. Privatising public monopolies raises several structural reform issues including introducing measures to avoid creating a private monopoly.

Legislative reform involves all levels of government reviewing and changing legislation that restricts competition. However, the application of the public interest test may allow local government to retain restrictions on competition if those restrictions are in the best interest of the community.

Water reform

In 1994, CoAG agreed to a package of water reforms that would lead to the better management of Australia's water supply. The key areas of water reform include:

- water pricing based on full cost recovery and the amount of water used;
- the establishment of clearly specified water entitlements and the arrangements to enable trade in those entitlements;
- the allocation of water to the environment;
- the establishment of regulatory and water service institutions that have clear roles and responsibilities; and
- public education and consultation.

Local government has an important role in Australia's water reform agenda. In particular, local government is responsible for the provision of water and sewerage services in a number of states. Accordingly, in these states local government has worked closely with respective state governments to meet NPC requirements.

ALGA, as a member of the Council of Australian Governments (CoAG) actively participated in development of the National Water Initiative.

Issues

Competitive neutrality

The issues for local government surrounding the principle of competitive neutrality include:

- full-cost reflective pricing for services and compulsory competitive tendering;
- the inconsistent approach to exemptions; and
- the refusal of state governments to pay local government any of the revenue raised by taxing government owned bodies.

Application of competitive neutrality has required a substantial overhaul of how councils operate, including full-cost reflective pricing for competitive services.

Full-cost pricing has ensured that local government does not provide subsidised services in competition with private providers. For example, Victorian local councils received complaints from private providers who accused local councils of cross-subsiding recreation services such as gyms and swimming pools. The Municipal Association of Victoria, by developing a model framework to determine the full-cost reflective pricing of these services, enabled councils to provide services in a competitive environment and fulfil its CPA obligations.

In the absence of national rules, the application of the competitive neutrality principle to local government has been inconsistent across the states and the Northern Territory.

For example, South Australia, Western Australia and Northern Territory government owned enterprises pay the equivalent of local government rates to their respective state treasuries but local governments do not receive any of this revenue.

In New South Wales, a corporatised state owned corporation specified under the *State Owned Corporations Act 1989* pays rates on commercial properties. Further, there has been some suggestion that the application of competitive neutrality may, in the future, extend to government owned organisations not specified under the Act.

In Queensland, all non-exempt government organisations pay rates and in Victoria and New South Wales, properties that are public, educational, religious or charitable in use or ownership, are exempt from council rates.

In Tasmania, the state government and the Tasmanian councils have signed a Partnership Agreement on financial reform that includes:

- the payment by state government of council rates on crown land, apart from certain types of reserves, roads, bridges and Hydro land;
- the payment by councils of all state government taxes including payroll tax and land tax, with the exception of parks, reserves and conservation areas; and
- the abolition of up to \$10 million in state government levies on councils.

The definition of exempt and non-exempt organisations and activities is also inconsistent between the states and the Northern Territory. In some states, it is costing local government vast amounts of revenue. The Western Australia Local Government Managers Association has calculated that local government bodies lose between \$50,000 and \$500,000 in revenue per annum.

Additionally, to avoid paying rates, property holders in some states are transferring responsibility for rental properties to exempt government bodies (e.g. the Western Australian State Housing Commission).

Structural and legislative reform

Local government has played an important role in the implementation of structural reform and legislative review in all states and the Northern Territory. As such, a strengthening of the relationship between productivity and payments from the states is required in those states that have not passed on the financial benefits of NCP.

As part of the implementation of the CPA, the states and territories agreed to undertake reforms in return for additional funding (i.e. NCP payments). As stated previously, local government is not party to the agreement but is obliged to undertake structural reforms and review its legislation.

When local government bodies have identified by-laws that restrict competition, it has initiated reform of these by-laws.

In its submission to the Hawker inquiry, the National Competition Council (NCC) accepted that there were numerous circumstances where local governments had incurred significant reform costs without receiving any fiscal resources to assist in accomplishing this task. In New South Wales, Tasmania, South Australia and the Northern Territory, the state governments have not passed on any proportion of the NCP payments, despite local government's key role in achieving NCP goals and requirements.

The NCC submission also noted that local governments in some states received competition payments as an incentive for local government to undertake the necessary NCP reforms. The jurisdictions concerned have found local government initiatives to be of value, assisting the reform process.

In Queensland, the State government provided local government with \$150 million in NCP dividends.

In Victoria, local government received 9 per cent of the state government's allocation over 5 years. The allocation for the next four years is \$65 million.

Originally, the Western Australian Local Government Association negotiated an agreement with the state government for local government to receive \$4 million in NCP payments. The state government discontinued the arrangements after the first three years.

Water reforms

Local government has met all its obligations under the CPA with respect of the 1994 agreement on water.

Two important issues for local government have emerged from the recently announced CoAG arrangements. These include:

- the separation of water entitlements from property title will have an impact on land values thus effecting the property rates base for local councils; and
- the significant trade of water between locations may result in substantially uneven socio-economic impacts.

The terms of reference for the review state that the inquiry will

“...take into account but not replicate significant current and recent review activity in areas such as the CoAG work on energy and water and the review of the competition provision of the Trade Practices Act.”

ALGA notes that local government across all states and territories has fulfilled its water reform obligations. These obligations were determined on a state-by-state basis and included reviewing all water supplies managed by local government. Prior to the recent COAG agreement to accelerate these reforms, consultation included local government and state authorities agreed to work with local government to meet further obligations.

Two important issues for local government have emerged as part of the new arrangements. These include:

- the impact of separation of water entitlements from property title on council rates; and
- the impacts of significant trade of water between locations.

The separation of water entitlements from property title will have a significant impact on land values within council boundaries. In many areas, the impact may be to reduce property values and therefore erode the property rates base for local councils. In other areas, addressing the adverse impact of this process administratively (e.g. using differential rating) may be difficult.

Consequently, ALGA, as a member of CoAG, has requested all jurisdictions to address specifically this problem and to develop solutions in conjunction with their respective state or territory local government association.

Significant trade of water between locations may result in substantially uneven socio-economic impacts. All jurisdictions have indicated an awareness of this issue and have agreed to the provision of structural adjustment under the NWI. ALGA considers that there is further work required on this matter to guide governments and communities on assessing and addressing adverse impacts on communities resulting from the implementation of the NWI.

Public Interest Test

NCP recognises that there can be exceptions to the general presumption that competition is of benefit to the community. Consequently, the NCP developed the public interest test framework as a means of determining whether particular restrictions are justified, and whether their costs outweigh their benefits.

The public interest test has had a significant impact on local government. During the introduction of competition reforms, inadequate explanations of the public interest test and its method of application lead to negative public perceptions. The introduction of compulsory competitive tendering further compounded these perceptions. In any future reform process, better communication regarding the role of the public interest test is necessary.

Local government considers the public interest test broad enough to enable consideration of all relevant issues during the assessment of a particular restriction of competition against the public interest. Local governments have benefited from the application of the public interest test by being able to maintain certain services delivered better by local government rather than private businesses.

Areas of Further Expansion

Before new areas of reform are established, new financial agreements should involve consultation with local government and include financial recognition of the work undertaken by local government. A suggested approach is undertaking local government impact statements.

Conclusion

Local government has an important role in the implementation of the National Competition Policy despite not being party to the Competition Policy Agreement. Given the activities undertaken by the local government, the four competition principles most commonly applied to local government include competitive neutrality, structural reform and review of legislation, and water reform.

Because of the application of the competitive neutrality principle, local government has experienced:

- full-cost reflective pricing for services and compulsory competitive tendering;
- an inconsistent approach to rate exemptions, and

- reluctance on behalf of state governments to pay local government any of the revenue raised through government owned corporations paying rates.

In many states, local government has made very difficult adjustments to meet its obligations without compensation from its respective state governments.

In regard to water reform, local government has met all its CPA obligations and looks forward to working with state and territory governments to ensure the seamless implementation of the next stage of reforms.

The public interest test has been of benefit to local government as it has given local government a choice of whether to maintain services. Communication of the role of the public interest test has in the past, been poor and will need to be improved for the next stage of reforms.

Local government looks forward to better consultation during the development and implementation of further reforms. Local government impact statements will ensure the full assessment of the impacts of reforms on local councils.

Recommendations

ALGA offers the following recommendations:

- Maintain the public interest test as it has assisted many councils.
- Encourage the other states to follow the example of Victoria, Queensland and South Australia in passing on competition payments to local government.
- Encourage state and territory governments to pass-on any rates raised by the application of competitive neutrality.
- Maintain National Competition Policy but ensure a more consistent implementation framework across the country.
- Improve consultation with local government by introducing the requirement for the completion of a local government impact statement before further expansion can be undertaken.

ATTACHMENT 1

Scope of Inquiry

4. The Commission is to report on:

a. the impact of NCP and related reforms undertaken to date by Australian, State and Territory Governments on the Australian economy and the Australian community more broadly. To the extent possible, such assessment is to include:

i) impacts on significant economic indicators such as growth and productivity, and to include significant distributional impacts, including on rural and regional Australia; and

ii) its contribution to achieving other policy goals.

b. at the Australian, State and Territory level, areas offering opportunities for significant gains to the Australian economy from removing impediments to efficiency and enhancing competition, including through a possible further legislation review and reform program, together with the scope and expected impact of these competition related reforms.

Considerations

5. In conducting this review, and in recommending changes, the Commission should take into account the desire of the Government:

c. to focus new review and reform activity on areas where there is clear evidence of significant potential gains, in particular where clear gains are possible in Australia's international competitiveness, in the efficiency of domestic markets or for Australian consumers; to ensure possible reform activity considers appropriately the adjustment and distributional implications and its contribution to achieving other policy goals.

d. to take into account but not replicate significant current and recent review activity in areas such as the CoAG work on energy and water and the review of the competition provisions of the Trade Practices Act.

6. In undertaking the review, the Commission is to advertise nationally inviting submissions, hold public hearings, consult with relevant Australian Government, State and Territory agencies and other key interest groups and affected parties, and produce a report.

7. The Government will consider the Commission's recommendations, and the Government's response will be announced as soon as possible after the receipt of the Commission's report. The report will inform the CoAG review due to be completed by September 2005.