



Municipal Association of Victoria

MAV Submission to the Productivity
Commission Review of National
Competition Policy

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1 INTRODUCTION

This submission will comment on the National Competition Policy (NCP) as it has (a) impacted on local government in Victoria, (b) in areas where its application has been ambiguous, and (c) where NCP is likely to impact on local government in the future. It is the view of the Municipal Association of Victoria (MAV) that it is important to examine NCP together with the microeconomic reforms of the 1990s and the impact of the reforms to local government in Victoria.

In general, the impact of NCP has been most acutely experienced through the application of the competitive neutrality principle to service provision for local government. There remain some services where this principle is applied without necessary clarity, resulting in inefficiency. Additionally, there are several services where competitive neutrality is applied without a full appreciation of the political imperatives placed on local government.

The MAV is the statutory peak body in Victoria with a legislative responsibility to represent the 79 councils in Victoria. The purpose of the Association is to promote and support the interests of local government throughout Victoria as defined in the *Municipal Association of Victoria Act 1907*. All Victorian councils are financial members of the MAV.

Local government in Victoria underwent a period of reform beginning in 1994 which saw the reduction in local government authorities through amalgamation from 216 to 78 (subsequently 79 with the de-amalgamation of Delatite Shire Council), an immediate capping of rates, an immediate reduction in total rates collected by local government by 20%, and the introduction of Compulsory Competitive Tendering (CCT). Although these reforms were introduced before NCP they nevertheless fundamentally changed the operational environment of local government. Given these multiple reforms, it is difficult to disaggregate the benefits derived from the earlier reforms and the NCP reforms with any clarity.

2 THE IMPACT OF NCP

2.1 THE APPLICATION OF COMPETITIVE NEUTRALITY

The most substantial impact of NCP on local government has been through the application of competitive neutrality. The premise of competitive neutrality is that a government business should not have any advantages – for example, immunity to bankruptcy, cross subsidisation, predatory pricing, misuse of regulatory power – that would distort a market. As a direct means of applying this principle in Victoria, the State Government has introduced a policy to guide the application of competitive neutrality for councils. This policy dictates that where a local government operates a significant business it must:

1. corporatise the business
2. commercialise the business, or
3. introduce full-cost reflective pricing for services provided.

In practice, the introduction of full-cost reflective pricing for services by local government in Victoria has been the most frequently used option to ensure that councils' businesses operate in a competitive environment.

On the whole, the application of these principles on local government has resulted in local government erring on the side of caution in applying competitive neutrality. It has been noted that the application of competitive neutrality to the substantial businesses of local government is subjective. In particular, it is not always clear what a 'substantial' business is.

While local government in Victoria has been subject to competitive tendering (albeit a reformed model of competitive tendering under the best value principles) for a decade, the MAV accepts that tendering does not, in isolation, fulfil the competitive neutrality principles underpinning NCP. However, it does provide a basis on which accountability for service provision can be applied clearly and consistently, and can therefore facilitate the application of competitive neutrality.¹

An example of the application of competitive neutrality for local government can be seen in the provision of recreation services such as gyms and swimming pools, which was subject to a number of complaints by private providers. The complaints alleged local government was cross subsidising these services.² In an effort to overcome these accusations, local government through the MAV were able to implement a model framework to determine the full-cost reflective pricing of these services.

2.2 ADDITIONAL RESPONSIBILITY OF LOCAL GOVERNMENT IN SERVICE PROVISION AND SERVICE MANAGEMENT

One tenet of NCP is that, where possible, the service provision functions of a government enterprise should be separated from the planning and management functions as a means to impart private sector managerial techniques into the public sector to increase efficiency. While the MAV does not contest the intent of this aim, it has resulted in local government increasingly undertaking the role of service manager without substantive additional funding.

This has resulted in financial pressure on local government through increased responsibility. The impact of this is ultimately on ratepayers who have to bear a greater rate burden or reduced service provision. One possible result of this is a reduction in infrastructure spending. An evaluation of this outcome should examine the appropriateness of funding these services out of a property-based tax (rates) in funding service management.

Conversely, councils' role as a service provider is also changing. For example, local government is, *prima facie*, a substantial service provider of HACC in Victoria.³ Responsibility for HACC funding rests with the Commonwealth and state governments (60/40% split), and states are responsible for administering HACC

¹ There is a possibility that local government, through the provision of extensive contracting, is increasing the transaction costs of service provision. The extent of these costs, and the net benefit of any productivity gains through increased contracting, is unclear.

² It should be noted that many of these complaints were identically worded and were sent from a single source.

³ This program provides home care, respite care, personal care and meals services in-home for the elderly and people with disabilities who would otherwise be at risk of entering residential facilities.

services, including the output prices paid to service providers. (The Victorian Department for Human Services (DHS) sets the output prices in Victoria).

A recent report by the Victorian Auditor General indicated that local government in Victoria receives around 37% (\$117.1 million) of Victorian Commonwealth and state HACC funding.⁴ Additional to this, local government also contributes a minimum \$48 million of its own source revenue.

MAV analysis shows that the output prices determined by DHS do not fully compensate local government for the service provided.

Table 1 shows the output prices determined by DHS as a percentage of the estimated average unit cost.⁵

Table 1: Output prices as a percentage of estimated average unit costs

| Output Prices | 1997-98 | 1998-99 | 1999-00 | 2000-01 | 2001-02 | 2002-03 |
|-------------------------------------|----------------|----------------|------------------|----------------|----------------|----------------|
| Home Care | 21.5 | 21.7 | 21.7 | 22.13 | 22.75 | 23.84 |
| Personal Care | 24.6 | 24.8 | 24.8 | 25.3 | 26.01 | 27.26 |
| Respite Care | 22.4 | 22.6 | 22.6 | 23.05 | 23.51 | 24.64 |
| Property Maintenance | 33.66 | 34 | 34 | 34 | 34 | 34.68 |
| Planned Activity Group (Core) | 8.4 | 8.48 | 8.48 | 9.12 | 9.35 | 9.69 |
| Planned Activity Group (High) | 12.52 | 12.65 | 12.65 | 12.85 | 13.17 | 13.66 |
| Meals | 1.1 | 1.1 | 1.1 | 1.1 | 1.1 | 1.2 |
| Estimated Average Unit Costs | 1997-98 | 1998-99 | 1999-2000 | 2000-01 | 2001-02 | 2002-03 |
| Home Care | 22.22 | 22.66 | 23.08 | 24.01 | 24.73 | 25.55 |
| Personal Care | 23.7 | 25.65 | 27.59 | 28.78 | 29.65 | 30.65 |
| Respite Care | 26.02 | 28.16 | 30.29 | 31.44 | 32.38 | 33.46 |
| Property Maintenance | 42.53 | 38.77 | 35 | 35.86 | 36.93 | 38.13 |
| PAG Core | 9.56 | 9.13 | 8.72 | 8.9 | 9.17 | 9.44 |
| PAG High | 11.86 | 12.93 | 14 | 14.42 | 14.85 | 15.28 |
| Meals | 7.19 | 7.65 | 8.06 | 8.28 | 8.53 | 8.71 |
| Unit Price as % Unit Cost | 1997-98 | 1998-99 | 1999-2000 | 2000-01 | 2001-02 | 2002-03 |
| Home Care | 97% | 96% | 94% | 92% | 92% | 93% |
| Personal Care | 107% | 97% | 90% | 88% | 88% | 89% |
| Respite Care | 88% | 80% | 75% | 73% | 73% | 74% |
| Property Maintenance | 93% | 88% | 97% | 95% | 92% | 91% |
| PAG Core | 106% | 98% | 103% | 102% | 102% | 103% |
| PAG High | 79% | 98% | 90% | 89% | 89% | 89% |
| Meals | 15% | 14% | 14% | 13% | 13% | 14% |

Notes:

1997-98 & 1998-99 based on shadow prices. Italicised figures proposed.

Whilst it could be argued that this is reflective of inherent inefficiencies in the provision of community care services by local government, the Victorian Auditor General's report overwhelmingly argues that the local government provision of HACC services are high-quality and efficient.⁶ Recommendations made by the Auditor General focus on incremental improvements to service planning and provision.

Local government is increasingly being identified as responsible for community care, and there can be direct political and social consequences for local government if they do not increasingly subsidise the service. This is contrary to the role of a service provider and can be viewed as a consequence of competitive neutrality.

⁴ Auditor General Victoria (2004) *Delivery of home and community services by local government*, No. 69, Session 2003-04, government printer for the State of Victoria.

⁵ The MAV will shortly update these figures

⁶ Auditor General Victoria (2004)

There are new and complex paradigms of service provision for local government in Victoria. The responsibilities of local government are evolving, and it is now a core provider of community infrastructure. This suggests that the transfer of service provision onto local government has also brought a transfer of political responsibility, which substantially muddies the waters surrounding competitive neutrality. When local government acts as a service provider for other levels of government, there appears to be evidence that they may also take on political responsibility for the service provision.

2.3 LOCAL GOVERNMENT IMPROVEMENT INCENTIVE PROGRAM

The Victorian State Government provides to local government 9% of the Commonwealth competition dividends paid directly to states under the Local Government Improvement Incentive Program based on three criteria:

1. national competition compliance;
2. best value compliance; and
3. asset management compliance

Whilst the MAV is strongly supportive of the Victorian State Government's commitment to recognising local government's responsibility to NCP through a financial dividend, the nexus between productivity and competition payments could be strengthened by more clearly linking payments to criteria directly related to compliance to NCP.

It should also be recognised that the MAV strongly believes that the reform period of the mid 1990s (as outlined above), although difficult, resulted in a restructure of councils. These reforms have also ensured that Victorian local government authorities (LGAs) are efficient vis-à-vis LGAs from other states.

This is supported by an analysis conducted by the MAV that indicated rates levied by local government increased in real terms by only \$7 per head of population between 1991/92 and 2001/02 despite the changed role of local government described above.

3 FUTURE ISSUES

This section examines key areas of NCP that are likely to influence local government in the near future.

3.1 CHILDCARE

Local government provides childcare through two mechanisms: (a) as a direct service provider; and (b) as a facility owner leased to a community or private provider. Many local government-owned facilities built on local government land were seeded by construction grants from the Federal Government in the 1970s and 1980s. These grants include conditions inhibiting local government from using the building for other uses and selling or transferring the land and building to others.

The MAV contends that a mixed market of public and private providers for childcare is beneficial due to the inelasticity of supply of childcare facilities. In particular, it is

beneficial for local government to continue to provide childcare services in areas where no private providers would operate, especially in lower socioeconomic areas due to insufficient demand or fluctuation in demand.

Financial pressure on councils' provision of childcare has followed an amendment to the award governing childcare workers by Australian Industrial Relations Commission (AIRC) in 2003.

Whilst a substantial amount of work has already been undertaken to analyse the most appropriate response councils should make to fulfil competitive neutrality requirements in childcare, there remains some ambiguity in how local government should provide these services. It is the view of the MAV that an efficient method of ensuring private and public providers supplies the optimal level of childcare is for the Commonwealth to immediately increase the level of childcare benefit to increase the competitiveness of the sector.

3.2 PUBLIC LIGHTING

Councils have a statutory obligation to provide street lighting within their municipalities. Tariffs payable by local government for public lighting are composed of three charges: (a) a charge for electricity; (b) a tariff payable to the national network; and (c) a charge for the operating, maintenance and replacement (OMR) of public lighting (ostensibly a fee to lease and maintain public lighting infrastructure). Given that public lighting constitutes a substantial annual expenditure of \$50 million statewide, of which charges of excluded services represent approximately 30-50% (including OMR of public lighting), local government can be regarded as a major street lighting customer.

After the State Electricity Commission (SEC) was privatised in 1995, five distribution businesses became electricity retailers. These retailers operated under contracts subject to commercial confidentiality so the legislative requirements placed on the electricity distributors remains unknown. In 2002, full retail contestability (FRC) was introduced which enabled electricity to be supplied competitively by any distribution business.

However, the OMR charge is not subject to competition under this distribution model, and research commissioned by the MAV indicated that there is no mechanism to determine whether the OMR charge is being supplied at market rates. Anecdotally, the research indicated the distribution businesses probably obtain economic rent through the OMR charge through a cross-subsidisation of the supply of electricity.

Proposed new charges by distributors in most cases represent significant increases, sometimes up to about 70-80% more than 2001 charges (including CPI) and on average approximately 20%.

Councils are concerned about the monopolistic nature of the current marketplace where customers have little control over the price setting process and have called for a transparent mechanism for determining and approving charges.

3.3 WATER REFORM

The Victorian State Government will shortly release a white paper on water reform aimed at ensuring sustainable water use. A number of reforms mooted in this paper

may have an impact on local government and are worthy of comment in the context of the NCP review.

Rural irrigation-based councils have raised concerns over the possibility that water entitlement will be separated from property title and reduce the rate base of the municipality. These councils have requested that the State Government negotiate directly with local government through the MAV on the impact of this measure. It remains possible that property valuations in these councils will be unable to differentiate between properties with access to irrigation (or potential to access irrigation) and properties unable to access irrigation – thereby reducing the overall rating base of a municipality. This would result in an inequitable reduction of the rates burden on properties without realised or unrealised water entitlements. This is essentially an issue caused by the introduction of a market-based system of water entitlement.

An increase in the price of water so it more precisely reflects its scarcity has also been raised as a possible policy response to constrain water use. While the MAV has given in-principle support to this, it is unclear whether local government will have access to commercial rates of water supply under a tiered pricing schedule. Councils manage a wide range of community facilities using water, such as parks and gardens, sporting ovals, and swimming pools. Price increases for water will impact on the cost of providing these services. This could lead to increased user charges or pressure on rates to offset increased water costs. Conversely higher prices for water will lead to increased use of water conservation measures by councils. In either case, the price of water accessed by local government in Victoria needs to acknowledge the role of local government in the direct provision of community facilities.

4 CONCLUSION

NCP has impacted greatly on the operations of local government in Victoria for a considerable period of time. The introduction of NCP in Victoria came during a turbulent time for local government and it is impossible to disaggregate the effect this policy has had when considering the full range of reforms introduced from the mid 1990s.

There is strong evidence that the impact of the competitive neutrality principle has altered the service provision practices of local government considerably. In the last decade, local government has changed governance practices to ensure there is greater transparency surrounding service provision. However, it is very difficult to gauge the exact financial impact of this on individual service markets given local government's often marginal role in service provision.

Despite the perceived clarity that NCP has provided for defining service delivery functions of local government, some of the major political decisions made by the Commonwealth and state governments impacts upon core services that have ostensibly been devolved to local government, such as HACC services.