

COMMUNITY SERVICE OBLIGATIONS:

Policies and Practices of
Australian Governments

INFORMATION PAPER

February 1997

**INDUSTRY
COMMISSION**

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Forming the Productivity Commission

The Industry Commission, the former Bureau of Industry Economics and the Economic Planning Advisory Commission have amalgamated on an administrative basis to prepare for the formation of the Productivity Commission. Legislation formally establishing the new Commission is before Parliament.

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FOREWORD

This information paper is based on the submission by the Industry Commission to the House of Representatives Standing Committee on Financial Institutions and Public Administration Inquiry into Aspects of the National Competition Policy Reform Package (October 1996). The attachment to the paper is a related submission made by the Commission to the House of Representatives Standing Committee on Banking, Finance and Public Administration Inquiry into Aspects of the National Competition Policy Reform Package (December 1995).

The publications of these submissions is in response to what is perceived by the Commission as a need for greater public information and community debate about a range of issues concerning community service obligations.

The Industry Commission would like to thank staff of the relevant State and Territory agencies and the Commonwealth Department of Finance for their helpful comments and assistance on previous drafts of the paper.

OVERVIEW

Community Service Obligations (CSOs) - as non-commercial requirements of government business enterprises (GBEs) for identified social purposes - are a significant component of the social policies of all Australian governments. Governments and communities place considerable weight on the efficient and effective delivery of CSOs, which have a total annual cost exceeding \$3 billion.

The national competition policy reforms are not intended to reduce the commitment of governments to effective delivery of CSOs. On the contrary, they will facilitate a more careful and systematic consideration of the identification and implementation of these requirements.

In the past, CSO policies often lacked transparency, detracted from the efficiency and financial performance of GBEs and were frequently delivered inefficiently and ineffectively. All governments now have initiated programs to review CSO policies as part of broader GBE reform.

Significant changes have been made (see Table I):

- Australian governments have adopted a commonly agreed definition of CSOs;
- several governments have established programs to identify CSOs systematically;
- in principle, most governments accept that CSOs should be costed at avoidable cost and should be funded directly from consolidated revenue;
- several CSOs are now provided under contract, in some cases by private sector firms; and
- some jurisdictions have adopted, or are in the process of adopting, programs for monitoring their CSOs.

The extent of progress in reviewing and reforming CSO policies varies considerably across jurisdictions.

Some governments, such as NSW and Victoria, have made considerable progress in implementing comprehensive regimes incorporating specification, costing, funding, contracting and monitoring of CSOs. Many of these changes provide models for other jurisdictions in designing and implementing reforms. Governments in Queensland, Western Australia, Tasmania, the ACT and the NT are in the process of implementing CSO reform programs. The South Australian Government has only just begun the reform process.

At the Commonwealth level, the reform process seems to have stalled in several areas. Some CSOs remain uncoded, and there is scope to improve the specification of others. Several CSOs, including the major ones in telecommunications and postal services, are funded largely through cross-subsidies rather than directly from the budget.

The reform of CSO delivery is very much dependent on continued progress in certain aspects of GBE reform, such as developing improved management procedures, cost information systems, financial and non-financial performance monitoring and the removal of legislative barriers to competition. Budget constraints also will continue to affect the rate of progress in CSO reform.

Major priorities for the future review and reform of the CSO policies of Australian governments should be:

Identification of CSOs

- publication by all Australian governments of timetables for the review and implementation of policy changes in order to maintain the impetus for reform and provide greater accountability and public scrutiny of the reform process;
- identification programs which have regard to government requirements relating to inputs of GBEs as well as outputs;
- specification of CSOs for those governments just beginning the reform program and more detailed CSO specification in some jurisdictions, including the Commonwealth;

Costing of CSOs

- expansion of costing programs to include those CSOs which remain uncoded;
- improvement of the cost information systems of GBEs to permit greater use of the avoidable cost method of costing CSOs;
- achievement of greater consistency in costing methods, particularly in relation to departures from the avoidable cost method, between jurisdictions and within industries so as to improve the basis for national comparisons of GBE performance;
- incorporation of annual costings of CSOs in national reporting of GBE performance;

Funding of CSOs

- implementation of government policy statements regarding direct funding of CSOs and the establishment of timetables for the transition to direct funding;
- funding of CSOs on the basis of industry benchmarks rather than actual costs to provide greater incentives for the efficient delivery of services;
- assessment of combination methods of funding for particular CSOs in order to avoid over-funding of CSOs and distorting the reporting of GBEs' financial performance;

Contracting CSOs

- greater use of contracts between relevant portfolio departments and GBE or private providers to improve the efficiency and effectiveness of service delivery to targeted groups; and

Monitoring delivery of CSOs

- implementation of effective monitoring programs which are outcome-oriented.

The work of the Steering Committee on National Performance Monitoring of Government Trading Enterprises (SCNPMGTE) has facilitated reforms to improve the identification, costing, funding and monitoring of CSOs in Australia. Many of the reforms carried out in recent years have incorporated recommendations made by this group as demonstrated, for example, by the near uniform adoption of its definition of CSOs.

The SCNPMGTE still has an important contribution to make to further reform. It could provide a forum for further collaboration between governments to improve consistency in methods of costing CSOs. Its annual reports on the performance of government trading enterprises could incorporate information on the costs of CSOs. It could also facilitate the development of principles for designing monitoring systems for the delivery of CSOs.

Table 1 Australian government policies on CSOs

	Definition of CSOs	Identification procedure	Costing method	Funding method	Contracting of CSOs	Monitoring of CSOs
New South Wales	Yes	Yes	AC, FDC and FR ^b	DF and CS	Yes	Yes
Victoria	Yes	Yes ^a	AC ^c	DF and CS	Yes	Yes
Queensland	Yes	Yes ^a	AC, FDC and FR	DF, LRR and CS ^d	Yes	Yes
South Australia ^e	Yes	yes ^k	AC	IF and DF ^d	No	No
Western Australia	Yes	Yes ^a	AC and FR	DF ^f	No	Yes
Tasmania	Yes	Yes	AC ^c	CS and LRR ^{g,d}	No	Yes
ACT	Yes	Yes	AC, FDC and FR	DF ^{hd}	Yes	Yes
NT	Yes	Yes	AC, FDC and FR	DF and LRR ^{i,d}	na	Yes
Commonwealth	Yes	Yes ^l	AC and other	CS and DF	No	No ^j

Notes:

- a The identification procedure has been undertaken sector by sector as part of the commercialisation of government business operations.
- b The NSW Government has also advocated the use of the 'activity based costing' method.
- c Departures from the avoidable cost method are permitted in certain circumstances.
- d It is intended that identified CSOs be funded at efficient costs.
- e The information provided is based on the Community *Service Obligations Position Paper* (Draft).
- f This relates to WA's identified CSOs.
- g The policy of the Government is to move towards direct funding of CSOs in the medium term.
- h Other funding methods may be also be used.
- i This is the policy of the NT Government.
- j Although explicit CSOs (like those performed by Australia Post) are reviewed periodically, no overall monitoring program is in place.
- k SA GBEs are required to specify the nature and scope of non-commercial operations in their corporate charter.
- l Not all of the identified non-commercial activities performed by GBEs and Business Units are recognised by the Department of Finance as CSOs.

Abbreviations	AC	Avoidable cost	FDC	Fully distributed costs	IF	Internal funding
	CS	Cross-subsidies	FR	Forgone revenue		
	DF	Direct funding	LRR	(Accepting a) lower rate of return		

1. INTRODUCTION

The review of CSOs has been a significant component of efforts over recent years to improve the performance of GBEs. The impetus for the development of new policies and approaches on CSOs stems from several sources:

- poorly specified CSOs often resulted in confusion of commercial and non-commercial objectives which detracted from the financial performance of GBEs;
- the cost of implementing CSOs was often hidden or not measured appropriately;
- in many cases, CSOs were funded internally by GBEs through cross-subsidies which imposed higher costs on some users - directly through higher prices and indirectly through statutory barriers to competition;
- CSOs were not always delivered to those who were targeted to receive the benefits; and
- different approaches to defining, costing and funding CSOs made it difficult to measure accurately the performance of GBEs and make national comparisons of performance.

The national competition policy agreements between Australian governments has provided a further impetus for the review of CSO policies. These require governments to clarify objectives and specify the non-commercial obligations of GBEs to help achieve competitive neutrality between GBEs and private sector businesses. Prior to structural reform of public monopolies, governments must review, among other matters, the merits of any CSOs delivered by the enterprise. CSOs which are dependent on barriers to competition with government businesses will also be affected by the agreement to review all legislation restricting competition. Moreover, in assessing the merits of any particular course of action or policy under the Competition Principles Agreement, governments are required to take into account CSOs. A well constructed and clearly understood system of delivering CSOs is a key part of meeting the public interest objectives of competition policy reform,

Most governments in Australia now have adopted explicit policies on CSOs, usually as part of their GBE reform programs. Table 2 lists the principal government policy documents relating to CSOs.

This paper reviews progress made by governments in implementing new approaches to CSOs to: better specify the non-commercial objectives of GBEs; make the costs of CSOs more transparent; reduce the costs imposed on some

users; improve and monitor the delivery of CSOs to targeted recipients; and reduce inconsistencies in the national performance monitoring of GBEs.

Table 2: Principal government CSO policy documents

<i>Jurisdiction</i>	<i>Policy Document</i>	<i>Year</i>
Commonwealth	<i>Guide to Commercialisation in the Commonwealth Public Sector</i>	1996
NSW	<i>A Social Policy Program for NSW Government Trading Enterprises</i>	1994
Victoria	<i>Community Service Obligations: policy statement and background to policy.</i>	1994
Queensland ^a	<i>Corporatisation in Queensland - Policy Guidelines</i> <i>Commercialisation of Government Services Functions in Queensland. Policy Framework</i>	1992 1994
South Australia ^b	<i>Community Service Obligations Position Paper (Draft)</i>	1995
Western Australia	<i>Community Service Obligations Performed by Government Trading Enterprises</i>	1994
Tasmania ^c	<i>Guidelines: Community Service Obligations</i>	1996
ACT	<i>Community Service Obligations: Definition and Guidelines for Consideration within the ACT Public Sector</i>	1996
NT	<i>1996-97 Issues in Public Finance Budget Paper No. 5</i>	1996

Notes:

- a The *Government Owned Corporations Act* 1993 also relates to CSOs.
- b It should be noted that the South Australian Government is currently reviewing its *Community Service Obligations Position Paper*, with much of the current work by the Government directed towards developing detailed implementation procedures. Also, a broad CSO policy was endorsed by State Cabinet and is detailed in the March 1995 *Structure of Business Activities* paper.
- c In addition to the CSO policy document, Tasmania has a section on CSOs in its *Government Business Enterprises Act* 1995.

2. SPECIFICATION OF CSOs

The specification of CSOs involves the adoption of an accepted definition of CSOs and the identification of particular CSOs. Summary information on the approaches taken by Australian governments to the specification of CSOs is provided in Table 3.

2.1 Defining CSOs

The SCNPMGTE proposed the following definition of a CSO:

A Community Service Obligation arises when a government specifically requires a public enterprise to carry out activities relating to outputs or inputs which it would not elect to do on a commercial basis, and which the government does not require other businesses in the public or private sectors to generally undertake, or which it would only do commercially at higher prices. (SCNPMGTE 1994, p. xi)

This definition contains several key elements. First, it requires a CSO to be a government directive to a GBE on a specific service or function. This rules out initiation of CSOs by GBEs and prevents other loss-making activities being treated and funded as CSOs. It also means that government requirements contracted to third parties and general government requirements of an industry are not categorised as CSOs. Second, the definition requires that, under the same conditions, a CSO would not have been provided if the enterprise assessed the proposal on purely commercial grounds. Finally, to be regarded as a CSO, the specified service or function must provide an identified social benefit.

Most Australian governments accept the SCNPMGTE definition (see Box 1), although many have made alterations to it. For example:

- the NSW Government makes the distinction that the relevant government directive must identify a specific social objective;
- the Victorian Government explicitly acknowledges that both directives to carry out an uncommercial activity and directives to *cease* carrying out a commercial activity are CSOs; and
- the Tasmanian Government explicitly requires the CSO to be a net cost to the GBE.

The definition of CSOs adopted by the NSW and ACT Governments also depends on the method of funding. The NSW Government makes the distinction between non-commercial activities undertaken as a result of an explicit Government directive which are directly funded or funded internally with the approval of the Treasurer (CSOs), non-commercial activities for which

no funding arrangements have been made (quasi-CSOs) and non-commercial activities which do not rely on an explicit government directive (community services). Similarly, the ACT Government definition requires CSOs to be funded directly. Non-commercial activities funded by other means are referred to as 'quasi-CSOs'.

In principle, the Commonwealth central agencies also broadly accept the SCNPMGTE definition of CSOs.

Some governments have also specified a range of activities which are not to be included as CSOs. For example:

- in NSW, regulatory requirements, good corporate citizen activities, commercial price discrimination and demand management and 'head office' requirements (such as financial reporting to portfolio Ministers and the Treasurer) are not regarded as CSOs;
- the Victorian Government has stated that services that are part of 'good corporate citizenship' such as sponsorship or promotion of environmental awareness are not viewed as CSOs. The Government also explicitly ruled out loss-making activities intended to increase market share, losses incurred for administrative convenience, any activity performed by a non-GBE, activities provided as part of an industry-wide condition and instances where the CSO service claimed is the amount of loss incurred by the GBE;
- the Western Australian policy statement ruled out the possibility of good corporate citizen activities and commercial discounts to stimulate demand being considered CSOs; and
- the Tasmanian Government has stated that costs incurred in meeting regulatory requirements which are also incurred by private sector enterprises, market segmentation initiatives to maximise profit and good corporate citizen activities are not CSOs.
- Although CSOs are usually associated with outputs, government directives relating to specified inputs also impinge on the performance of GBEs. Consequently, it is appropriate to include input requirements specific to a GBE in the measurement of CSOs. Some governments, such as the Western Australian and Queensland Governments, have indicated that specific input requirements of GBEs are included as CSOs.¹ For example, the Queensland Government's current policy does not permit Queensland Rail to retrench or forcibly relocate staff. Most other jurisdictions do not explicitly include input requirements of GBEs as CSOs.

¹ At present, however, the Western Australian Government has not identified any CSOs that have arisen from input requirements.

Table 3 Specification of CSOs

	<i>Follow SCNPMGTE Definition</i>	<i>Identification program</i>	<i>Public timetable</i>	<i>Inputs included</i>	<i>Examples of non- CSOs specified</i>
New South Wales	Yes ^a	Yes	Yes	NS	Yes
Victoria	Yes ^a	Yes	No	NS	Yes
Queensland	Yes ^a	Yes	No	Yes	Yes
South Australia ^b	Yes	Yes ^c	No	NS	Yes
Western Australia	Yes	Yes	No	Yes	Yes
Tasmania	Yes ^a	Yes	Yes	NS	Yes
ACT	Yes ^a	Yes	No	NS	Yes
NT	Yes	Yes	No	na	na
Commonwealth	Yes ^a	Yes ^d	No	Yes	Yes

Notes:

a Minor variations apply.

b The information provided is based on the Community Service Obligations Position Paper (Draft).

c GBEs are required to specify the nature and scope of non-commercial operations in their corporate charter.

d The Department of Finance has identified services of GBEs and Business Units which do not earn commercial returns, although not all of these services are recognised as CSOs.

NS Not specified

Box 1 Australian governments' definitions of CSOs

NSW

To be proposed and approved as a CSO ... an activity must satisfy the following criteria:

- it would not be pursued by a GTE operating on a purely commercial basis.'
- it has a specified social objective;
- there is an explicit Government directive to the GTE that the activity should be pursued; and
- funding is from the Budget, or internal funding over the transitional period has been approved by the Treasurer' (NSW Government 1994).

Victoria

'A Community Service Obligation should be defined as arising when Parliament or the executive government expressly requires a government business enterprise to carry out an activity which it would not elect to provide on a commercial basis, or which would only be provided commercially at higher prices' (Office of State Owned Enterprises 1994).

Queensland

Queensland's *Government Owned Corporations Act 1993* broadly defines CSOs as activities that:

- (a) are not in the commercial interests of the GOC to perform; and
- (b) arise because of a direction, notification or duty to which this section applies; and
- (c) do not arise because of the following key principles of corporatisation (and their elements) -
 - (i) Principle 3 - Strict accountability for performance;
 - (ii) Principle 4 - Competitive neutrality.

South Australia

In its draft position paper, the SA Government adopted the SCNPMGTE definition (State Enterprises Branch Treasury and Finance 1995).

Western Australia

The WA Government has adopted the SCNPMGTE definition (Treasury 1994).

Tasmania

'A Community Service Obligation ... is a function, service or concession provided, allowed or performed by a GBE as a result of a direction under the GBE Act or any other Act of Parliament, or a specific requirement in any Act, and which would not have been performed, provided or allowed if that GBE were a business in the private sector operating in accordance with sound commercial practice' (Tasmanian Government 1996b).

ACT

'A Community Service Obligation arises when a government specifically requires a public enterprise to carry out activities relating to outputs or inputs, with identified public benefit objectives, which it would not elect to do on a commercial basis, and which the government does not require other businesses in the public or private sectors to generally undertake, or which it would only do commercially at higher prices' (OFM 1996, Attachment A).

Northern Territory

The NT Government has adopted the SCNPMGTE definition.

Commonwealth

'A community service obligation arises when the Government specifically requires a Commonwealth organisation to carry out activities relating to outputs or inputs:

- which the organisation would not elect to do on a commercial basis, or which it would only do at higher prices; and
- which the Government does not require other organisations in the public or private sectors to generally undertake' (Department of Finance 1996).

2.2 Identification of CSOs

Most governments have also embarked on programs to identify and review CSOs to be delivered by GBEs. However, there is considerable variation between governments in the progress made in implementing identification programs.

The New South Wales Government has made significant progress in developing a program for identifying CSOs.² The process began in July 1994 and consists of two stages:

- Stage 1 involved identification, preliminary costing and evaluation. All GBEs were required, by July 1995, to identify and analyse non-commercial activities and submit to their Minister those which they consider should be accepted as CSOs. Most GBEs in the electricity, water, transport and forestry industries have either partially or completely finalised Stage 1 submissions. After assessment, the Treasurer advised Ministers which proposals had been accepted for transitional funding in 1995-96.
- Stage 11, which commenced in January 1996, involves a detailed costing and evaluation of the social programs identified in Stage 1, approval for funding and negotiation of contracts with portfolio Ministers. The evaluations will identify the strengths and weaknesses in the existing arrangements and canvass the opinions of all the stakeholders. Stage 11 also involves the specification of program objectives, outputs and beneficiaries by the purchasing Minister.

In deciding whether to fund a CSO, the NSW Government will:

- define clearly the desired social objective;
- identify and evaluate the effectiveness of alternate program designs to meet the objective; and
- identify and evaluate the efficiency of delivery vehicles for the preferred program.

CSOs in Victoria are being identified as part of the commercialisation of GBEs, although there is no published timetable for the completion of the identification program. Implementation is occurring on an industry-by-industry basis. To date, it has included the contracting of CSOs with private electricity retailers

² As well as the policy document, *A Social Program Policy for NSW Government Trading Enterprises*, New South Wales Treasury released a costing manual, in December 1994, and an evaluation manual, in March 1996, to assist in the implementation of the policy. NSW Treasury is currently preparing a third manual dealing with the issue of contracting. The Government is also intending to publish a volume of papers concerning the whole administrative process for social programs, including contracting.

which are funded by the Government, management of community ports by local management committees under the scrutiny of the Department of Conservation of Natural Resources instead of port authorities, and agreement between State Trustees Limited and the Department of Health and Community Services to cover provision of trustee services on a non-commercial basis. For example, the review of electricity CSOs prior to the sale of electricity utilities in Victoria found some non-commercial activities which did not fulfil the criteria set by the Government.³ The activities considered to be CSOs were the administration of government funded electricity concessions and assistance schemes. They included the administration of the winter energy concession, the supply charge cap, a number of smaller concessions and the administration of the energy relief grant scheme.⁴ Pensioner rebates remain as a government-funded concession.

The Victorian Government also has reviewed CSOs in the gas industry and is currently reviewing CSOs provided by its water supply GBEs.

Queensland's CSO policy was formulated in 1992 as a result of the corporatisation of its GBEs. Since then, CSOs have been identified on a case by case basis as part of the corporatisation process for each GBE. The current Government in Queensland requires that 'CSOs (are) to be fully and transparently accountable' and 'all government enterprises (are) to adopt standard commercial accounting practices, explicitly accounting for CSOs, to facilitate public scrutiny of all government expenditures'.

The Queensland Government has identified CSOs performed by Queensland Rail, namely unprofitable passenger and freight services, provision of uneconomic branch lines and the previously mentioned staffing requirements for the organisation. There are also CSOs in the electricity industry (uniform electricity tariffs, free safety inspections of electricity installations and pensioner and seniors' concessions). No significant CSO activities have been identified for Queensland ports. The Government is currently in the process of

³ Activities found not to qualify as CSOs include uneconomical power lines and the uniform electricity tariff (see discussion below), funding of public lighting, electrical inspections and compliance with safety and environmental standards. The Victorian Department of Treasury and Finance states that many of the activities identified by the electricity industry as potential CSOs are now being designated as licence conditions imposed by the retail and distribution licences and are undertaken by non-CBE entities.

⁴ In addition, the re-locating of certain existing power lines underground (under the auspices of the Powerline Relocation Committee) was endorsed by Cabinet as a recognised CSO activity, and was allocated \$4 million in the 1995-96 financial year. This activity is distinct from the undergrounding of distribution power lines to new housing estates etc, which is now considered as an industry regulatory requirement.

identifying the CSOs provided by the rural water industry. There is no published timetable for the identification of CSOs in this area.⁵

In South Australia, the *Public Corporations Act 1993* requires that the nature and scope of any non-commercial operations, and the arrangements for their costing and funding, be identified in the corporation's charter. The South Australian Government is also considering undertaking some case studies of CSOs to provide a deeper understanding of the issues and how they should be dealt with. The Government hopes thereby to construct a 'systematic and objective process' across all GBEs for the identification of CSOs, their measurement and the determination of appropriate funding levels.

The Western Australian Government reviews and identifies CSOs sector-by-sector as part of the commercialisation/corporatisation of its GBEs. Currently, the Government has identified CSOs in the electricity, rail and water industries. The gas industry also has been reviewed, although no CSOs were identified. The identified CSOs required of Western Australian GBEs are: pensioner concessions for electricity and water services (provided by Western Power and the Water Corporation); and country rail passenger services and country inter-town coach services (Westrail).

The Tasmanian *Government Business Act 1995* required GBEs to identify all non-commercial activities and potential CSOs by 30 June 1996. The Government is now in the process of assessing which non-commercial activities qualify as CSOs. Applications for declarations of a CSO were to be submitted by GBEs to their portfolio Minister by 30 October 1996 and the review of all non-commercial activities is to be completed by 31 March 1997. A declaration of which non-commercial activities qualify as CSOs is to be made by 30 June 1997.⁶ It is intended that funding and performance criteria for CSOs will be established during the 1997-98 budget process.

In the ACT, an identification process is being implemented as part of the Government's financial reform agenda and to fulfil its obligations arising from the Competition Principles Agreement. Under guidelines issued in February 1996, the ACT Government is attempting to identify (and cost) CSOs on a uniform basis across all of its GBEs. CSOs are to be identified by the

⁵ Local government in Queensland also owns and operates several important GBEs and utilities, such as Brisbane Transport (operated by the Brisbane City Council Transport Division) and the Brisbane City Council Water Sewerage Department. Although local government CSOs are not directly subject to the Queensland Government's policy on CSOs, the Competition Principles Agreement applies to local government. Each State and Territory government is responsible for applying these principles to local government.

⁶ If, at any stage in the process, the Government assesses a non-commercial activity not to be a CSO, the GBE may continue to perform it, although it will not receive funding.

sponsoring or funding department in consultation with the GBE. First, the sponsoring Minister and the Office of Financial Management are required to agree on the specification and scope of CSOs. Second, the Government will consider the specification and scope of CSOs to ensure that the CSOs are priorities within the Government's programs. Third, after the initial list of CSOs is endorsed, it is expected that the process of specification and identification will form part of the GBE's business planning process and the sponsoring department's purchase agreement.

The 1996-97 ACT Budget Papers identify the CSOs performed by both ACTEW and ACTION. These CSOs include pensioner rebates for electricity, water and sewerage (ACTEW) and the provision of off-peak services, subsidised pricing levels and school services (ACTION).

In the NT, CSOs are to identified by GBEs as part of the reform of the Government's commercial and business operations.⁷ The value of CSOs is to be agreed with Treasury, and Treasury is to recommend the value and method of funding to Cabinet. Cabinet is to approve the proposed arrangements as part of the annual Budget process.

Commonwealth (Commonwealth Government 1993) directives require the responsible Minister to ensure that CSOs are specified and that the costs of the CSOs are transparent. Moreover, the directive to undertake a CSO activity should be in the form of a Cabinet Decision, Ministerial direction or a provision in legislation (Department of Finance 1996, p. 103). The Department of Finance has a record of all identified CSOs performed by Commonwealth GBEs.

However, not all non-commercial activities undertaken by Commonwealth GBEs have been explicitly recognised as CSOs. These include activities performed by the Defence Housing Authority, the Federal Airports Corporation, the Legal Practice Business Unit of Attorney-General's⁸ and the Australian National Railways Commission (AN). For example, in the case of AN, the passenger business has not been explicitly recognised as a CSO, but AN has in the past received revenue supplementation from the Commonwealth for this

⁷ The NT Government's policy on CSOs applies to all commercial and business operations, which are known as Government Business Divisions (GBDs). GBDs include GBEs as well as business units which supply goods or services solely to other arms of Government. The NT Government also requires government service obligations (GSOs) to be identified and treated in a similar manner as CSOs. GSOs arise when GBDs perform non-commercial functions, other than CSOs, that relate to their responsibilities within Government.

⁸ The non-commercial activities of the Legal Practice Business Unit do not fulfil any of the Government's social objectives. Rather, the non-commercial activities provide a special service for the Government.

service. A review is required to determine which of these non-commercial activities qualify as CSOs. Non-commercial activities that do not qualify as CSOs should be discontinued.⁹

Even where non-commercial activities have been made explicit, ambiguities as to the nature and scope of CSOs remain in some cases. An example of this is Australia Post's CSOs (see Box 2).

Box 2 Australia Post's CSOs

Australia Post is required under Section 27 of the *Australian Postal Act 1989* to make a 'letter service available at a single uniform rate of postage for the carriage within Australia, by ordinary post, of letters that are standard postal articles' and that 'the service is reasonably accessible to all people on an equitable basis'. The cost of delivering letters to remote areas exceeds the current uniform charge (\$0.45). It is the loss-making deliveries provided to meet the above requirements which can be regarded as CSOs. Australia Post, however, has considerable scope to determine the level of service provided as the Act does not specify the frequency of delivery required, nor does it define the term 'reasonably accessible'. This creates ambiguities as to the exact nature of the CSO to be performed by Australia Post.

2.3 Observations

Much progress has been made by governments in recent years in providing greater specification of CSOs to be undertaken by GBEs. This will help clarify the objectives of GBEs, improve the transparency of GBE activities, improve their financial performance and provide a more consistent basis for national comparisons of GBE performance.

A commonly agreed definition, with only minor differences, has been adopted by governments. Several governments have excluded specific loss-making activities of GBEs from the definition of CSOs. In some cases, these exclusions are categorised as 'quasi-CSOs' and 'community services'. While the distinction between CSOs required by governments and other non-commercial activities of GBEs is important, this form of categorisation has the potential to cause some public confusion about enterprise objectives and those activities which should receive government funding.

⁹ It should be noted that the Federal Airports Corporation and AN are subject to sale processes. The activities of the Defence Housing Authority are being reviewed, including the identification and costing of any CSOs.

Few governments explicitly state that input requirements are included in the definition of CSOs. Such differences of practice have the potential to lead to inconsistencies between governments which may affect comparability of GBE performance monitoring. Consistent with the recommendations of the SCNPMGTE (1994), a case exists for governments to include specific input requirements explicitly as part of the definition of CSOs.

Most governments have made progress in identifying their CSOs, although the extent to which programs have been implemented has been quite variable. While some governments (such as NSW) are nearing completion of the process, others (such as South Australia) are only just beginning. The review systems developed by the NSW and Tasmanian Governments have much to offer to other jurisdictions.

To date, only the NSW and Tasmanian Governments have published a timetable for completing the identification and review of CSOs. A publicly announced timetable provides an incentive for governments to complete the review process.

Governments also differ markedly in the nature of the CSOs required of GBEs. For example, there are significant differences between the CSOs required by the Victorian, Queensland and Western Australian Governments in the electricity industry. Such differences are to be expected because the nature of CSOs to be delivered is a matter of government policy and there is no reason to expect that governments should arrive at similar policy objectives. However, the extent of the differences in the CSOs specified by different governments points to problems which can arise in comparing the financial performance of GBEs in different jurisdictions.

Despite the progress made in the specification of CSOs, it is apparent that some ambiguities remain. There is scope to improve the specification of the CSOs of Australia Post. Moreover, several Commonwealth GBEs undertake other non-commercial activities which have not been explicitly required by a Government directive. A review is needed to determine which of these non-commercial activities the Government wishes to continue.

3. COSTING OF CSOs

The objective of costing CSOs is to determine the economic cost to the GBE of providing the required service or product. It should measure the opportunity cost, or real resource cost, of the CSO. It is also an essential element of making CSOs explicit.

The SCNPMGTE (1994) recommended that CSOs be costed at their avoidable cost.¹⁰ The avoidable cost method measures the extra cost (net of extra revenue) incurred by the GBE from providing the CSO (or alternatively, the net cost that would be avoided if the service was not provided). Thus, fixed costs which the GBE would have incurred without the CSO, even if that input is also used to provide the CSO, are not included in the avoidable cost.

Fully distributed costs and stand-alone costs are not appropriate ways of measuring the economic cost of CSO provision. Fully distributed costs measure the variable costs of provision plus a proportion of the fixed costs which are not directly attributable to any particular activity. As such, a portion of any fixed cost necessary to provide a CSO is included as part of the fully distributed cost, even if the expenditure would have been required without the CSO. Consequently, fully distributed costs do not reflect accurately the costs attributable to CSOs.

Stand-alone costs measure the cost of providing a product or service in isolation from other products. Stand-alone costs tend to overestimate the cost of provision as they ignore the potential for economies of scale and scope which are often present for activities carried out by GBEs.

The SCNPMGTE (1994) acknowledged that, in the case of decreasing cost industries, there may be reason to cost CSOs that are generally supplied to a large proportion of users according to avoidable cost plus a mark-up, or by average cost. Otherwise, the GBE may not be able to fully recover its costs.

3.1 Costing methods

All governments have accepted the principle that the costs of CSOs need to be made transparent for reasons of public accountability and scrutiny and in order to better assess the financial performance of GBEs. Most governments have

¹⁰ The Industry Commission also recommended in *Competitive Tendering and Contracting by Public Sector Agencies* that net avoidable cost be used to cost in-house bids for competitive contracts. Where this method would be too costly to use, the Commission suggested that other methods, such as activity-based costing, may be more appropriate.

also accepted avoidable cost as the preferable method in principle for measuring the real resource or opportunity costs of CSOs (see Table 4). In practice, however, many governments still use methods other than avoidable cost to cost their CSOs.

Table 4 Method of costing CSOs advocated by Australian governments

<i>Jurisdiction</i>	<i>Method advocated</i>
NSW	Fully distributed cost or forgone revenue (for subsidised price concessions) Avoidable cost (for subsidised operations)
Victoria	Avoidable cost (inclusive of capital costs)
Queensland	Long-run avoidable cost
South Australia	Avoidable cost
Western Australia	Long-run avoidable cost
Tasmania	Avoidable cost
ACT	Fully distributed cost or forgone revenue (for subsidised price concessions) Avoidable cost
Northern Territory	Fully distributed cost or forgone revenue (for subsidised price concessions) Avoidable cost
Commonwealth	Avoidable costs (although this method is only explicitly required in several cases)

The NSW Government social program policy requires subsidised price concessions to be costed at fully distributed costs and that subsidised operations be costed using avoidable costs.¹¹ The policy allows for some variety in the costing approaches used given the different situations and constraints that will be encountered. In practice, forgone revenue is being used as the basis for costing price concession CSOs in the short term because of the practical difficulty associated with estimating efficient costs (that is, costs based on

¹¹ Price concessions are defined as the reduction in price charged to certain consumers of a core service provided by a GBE. Subsidised operations are particular activities which CBEs are directed by governments to perform, which they would not otherwise undertake as a commercial decision. The NSW Government policy documents also refer to general operating subsidies of GBEs which cover residual losses of enterprises or support the reduction of externalities (such as road congestion) through the activities of enterprises.

efficient production by industry standards) and inadequate information about actual demand.

The ACT Government's approach is similar to that of NSW. It has proposed that price concession CSOs be costed by the fully distributed cost method and that the avoidable cost method be used for the subsidised operations of GBEs. However, in the latter case, it also suggests that forgone revenue may be the best approach because the compliance burden on GBEs is less.

The ACT Government's approach is based on the judgement that joint costs, which it defines as the costs of resources utilised in the production of more than one product or service, should not be included in the costing of CSOs for subsidised operations but should be included for price concession CSOs. It states that the avoidable cost method cannot be used to cost price concession CSOs because this method relies on the assumption that the joint input would be provided in any case. The ACT Government also argues that if the avoidable cost method were used for price concession CSOs: the profitability of a GBE would rise and fall with the introduction or discontinuation of a CSO; and that GBEs with a smaller client base will appear to perform better than those which have a larger CSO client base.

CSOs delivered by Northern Territory GBEs are costed using a similar method to that adopted by the NSW and ACT Governments. That is, fully distributed costs or forgone revenue are used for subsidised price concessions and avoidable costs for other CSOs.

The Victorian Government has adopted the avoidable cost approach (Inclusive of capital costs) for costing CSO services. However, the policy statement allows departures from the avoidable cost approach in situations where CSO provision is large in relation to the overall activity. This approach is based on the belief that avoidable cost is less meaningful where there are significant joint or common costs.

The Queensland Government's general policy is to use long run avoidable costs, inclusive of capital and overheads. For example, Queensland Rail's CSOs were costed using actual long run avoidable costs in 1995-96. However, there are instances where the fully distributed cost method continues to be used, particularly where this method approximates the result achieved under the long run avoidable cost method. Under the fully distributed cost method, the Queensland Transmission and Supply Corporation received \$80 million in 1995-96 to maintain its uniform tariff CSO. This CSO will be reviewed in the context of Queensland's commitment to adopt national electricity market reforms. In addition, price concessions are costed using forgone revenue.

It is stated in the South Australian draft policy that, as a general rule, only the avoidable cost method will be acceptable.

The Western Australian Government's policy is to cost CSOs at long run avoidable cost. All identified CSOs in Western Australia will be budget funded from 1996-97 according to their long run avoidable cost, except for pensioner concessions which are costed at forgone revenue.

The avoidable cost method is the preferred method of costing CSOs in Tasmania, although alternative methods may be used in certain circumstances. Under the *Government Business Enterprises Act 1995*, both the stakeholder and portfolio Ministers determine the method of costing to be used. A GBE may seek the agreement of both these Ministers for a departure from the avoidable cost method.

The Commonwealth Government has directed that the CSOs performed by Australia Post and Telstra be costed at avoidable cost. There appears to be little published information on the methodology used for these costings, nor is there any published information about the basis on which other Commonwealth CSOs are costed.

3.2 Estimates of CSO costs

Comprehensive information on the overall cost of CSOs undertaken throughout Australia is not available because of inconsistencies in the methods of costing and because some CSOs have not been identified adequately and costed. However, some governments have published estimates of the costs of CSOs in their Jurisdiction and for particular GBEs. In addition, many GBEs publish in their annual report estimates of the costs of CSOs they are required to provide. Examples of estimates of the cost of CSOs are provided in Box 3. The information suggests that the cost of CSOs throughout Australia is likely to be in excess of \$3 billion annually when other CSOs in the transport, water and energy industries are taken into account.

While little information is available on the impact of different costing methods on the estimates of CSO costs, large differences can occur. For example, early estimates of the cost of telecommunications CSOs indicated very substantial differences between estimates based on the avoidable cost method and those derived from the fully distributed cost method. The Bureau of Transport and Communications Economics (BTCE) estimated the cost to Telecom at \$270 million based on avoidable costs and an opportunity cost of capital of 13.6 per cent. In contrast, Telcom's estimate based on the fully distributed cost method was \$800 million (BTCE 1989).

3.3 Observations

Significant progress has been made by several governments in the costing of CSOs. However, there are still widespread differences in the methodologies used and many CSOs remain uncOSTed.

Forgone revenue or average costs seem to be the basis for many estimates of the cost of CSOs. As a result, the economic cost of resources used in the delivery of these services is not being assessed accurately (see SCNPMGTE 1994). Use of different costing methods also impairs assessment of the performance of GBEs and national comparisons of performance. Funding CSOs on the basis of inadequate assessments of the real costs of CSOs also may lead to higher than necessary charges for some users of GBE services and under-funding or over-funding of GBEs by taxpayers (SCNPMGTE 1994).

Box 3 The cost of CSOs

It is difficult to ascertain the cost of CSOs in Australia as many CSOs are still poorly defined and remain uncOSTed. Moreover, different costing methods are still used, rendering comparisons of costs between GBEs and jurisdictions problematic. The figures below are by no means comprehensive. They merely provide an indication of the substantial size of CSOs in Australia,

Total funding provided for social programs (CSOs) in NSW in 1995-96 was estimated to be over \$910 million, of which \$34 million was internal funding, the remainder being funded from the budget. CSOs provided by transport GBEs accounted for 82 per cent of the total, water CSOs for 10 per cent and electricity 4 per cent.

The recabling of certain existing power lines underground in Victoria (under the auspices of the powerline Relocation Committee) was allocated \$4 million in the 1995-96 financial year from the Budget. The forgone revenue cost of non-commercial activities performed by the Port of Melbourne Authority in 1994-95 was approximately \$300 000 (SCNPMGTE 1996).

In Queensland, total payments from the Government to Queensland Rail for providing CSOs in 1995-96 were \$595.2 million. In the same year, Queensland Transmission and Supply Corporation received \$80 million to maintain a uniform tariff, \$25 million for pensioner rebates and \$6 million for the provision of free inspections of installations and regulatory functions.

In Western Australia, the expected payments for CSOs in 1996-97 are \$29.2 million to Western Power, \$191.2 million to the Water Corporation and \$17.9 million to Westrail. These CSOs were costed according to their long run avoidable cost, except for pensioner concessions which were costed at forgone revenue.

The Department of Finance has collected published information concerning the estimated cost of Commonwealth CSOs and other non-commercial services. These totalled \$516.4 million in 1994-95. Of this total, \$287 million was funded internally. The largest CSOs were Telstra's portion of the telecommunications Universal Service Obligation (\$222 million), Australia Post's universal letter service and uniform price requirement (\$65 million), Australian National Railways Commission passenger business (\$50 million) and services to the Attorney-General from the Legal Practice Business Unit (\$50.6 million). Notably, the last two of these non-commercial activities are not recognised by the Government as CSOs.

In the NT, approved budget funding for CSOs and government service obligations in 1996-97 was \$34.8m.

In many cases the use of forgone revenue or average costs to measure the costs of CSOs has been forced on governments because of inadequate information systems in many GBEs and the time required to establish systems that will enable the calculation of avoidable costs. However, most governments have indicated their intention to adopt the avoidable cost method in the long term,

Several governments have recognised that the avoidable cost method may not be appropriate in all circumstances. For example, the NSW, ACT and NT Governments have adopted the fully distributed cost method for price concession CSOs and the policies of the Victorian and Queensland Governments allow for departures from avoidable cost where CSO provision is large in relation to the overall activity. The common basis for these exceptions is that avoidable cost method may underestimate the cost of CSOs in the presence of significant joint or common costs. This is a particular issue in conditions of declining costs, a feature of several industries in which GBEs operate.

The fully distributed cost method may represent the most practical response to these industry cost conditions, particularly where there is little difference between long run average cost and long run marginal cost. However, this method is not without its own problems. For example, it may underestimate or overestimate the costs of CSOs in the presence of declining costs, depending on the elasticity of demand for the service in question (see SCNPMGTE 1994). If the difference between average and marginal costs is significant, there may be advantages in using approximate price elasticity's of demand to determine the mark-up above avoidable cost to value CSOs.

Where governments permit departure from the avoidable cost method without clear specification of the circumstances in which this is justifiable, there is some potential for disparate approaches, despite similar industry cost characteristics. This makes it difficult to assess GBE performance accurately and to compile consistent national performance indicators. In order to minimise such problems, further collaboration between governments is needed to develop greater consistency in costing methods for CSOs. This task could be carried out under the auspices of the SCNPMGTE and the respective industry associations.

There is much scope to improve public reporting on the cost of CSOs. One initiative would be to develop a national register of the CSOs of GBEs and compile regular annual costings. This could be undertaken as part of the annual reporting framework of the SCNPMGTE.

4. FUNDING MECHANISMS

CSOs can be funded in a variety of ways. They include:

- cross-subsidies between different users;
- direct funding (including contracting out); and
- acceptance of lower rates of return on capital.

Each method has its own costs and benefits. The methods are not mutually exclusive; a GBE may have its CSOs funded by different methods. For example, the CSOs of Australia Post are funded by a combination of cross-subsidies and adjustments to its rate of return, while the Port of Melbourne Authority's non-commercial activities have been funded by a combination of cross-subsidisation and direct funding.¹²

Cross-subsidisation requires a GBE to charge higher prices to some users to recover the losses incurred by supplying the CSO to other users. This distortion of relative prices is likely to result in production and consumption inefficiencies (SCNPMGTE 1994). Cross-subsidisation also requires barriers to entry to prevent competitors entering the high margin markets and undercutting the GBE. The restriction of competition may lead to further inefficiencies such as cost-padding, failure to adjust to changes in demand and delayed introduction of more efficient techniques of production and management.

Alternatively, governments can directly fund GBEs, or private firms, to provide CSOs. The choice involves judgements as to their relative impact on allocative efficiency. Unlike cross-subsidisation, direct funding avoids the resource allocation effects from increased prices in the high margin markets and the need for barriers to entry. It also offers greater transparency through annual budget review and it allows for the possibility of competition in the provision of CSOs through a tender process. On the other hand, direct funding has a real resource cost, as it is financed through the tax system.

Instead of directly funding the losses from providing CSOs, the government could accept a lower rate of return from the GBE. As this is similar to direct funding, it has many of the same advantages. However, indirect funding may not subject CSOs to the same level of scrutiny as that applied during annual budget processes to CSOs that are funded directly.

¹² The Port of Melbourne Authority's non-commercial activities are not formally recognised by the Government as CSOs. It should also be noted that the Authority has been significantly restructured, and that part of the Authority is to be privatised.

4.1 Government funding methods

Most governments have stated an in principle preference for direct funding of CSOs. However, some governments have acknowledged that it is not always a practical alternative and other measures have been retained (see Table 5). Budget constraints, in particular, have restricted implementation of direct funding in many cases.

Table 5 Methods of funding CSOs used by Australian governments

<i>Jurisdiction</i>	<i>Method advocated</i>
NSW	Direct funding Internal funding (to continue during the transitional period)
Victoria	Direct funding Cross-subsidisation
Queensland	Direct funding Cross-subsidisation Accepting a lower rate of return
South Australia	Internal funding
Western Australia	Direct funding
Tasmania	Cross-subsidisation Accepting a lower rate of return
ACT	Direct funding
Northern Territory	Direct funding Accepting a lower rate of return
Commonwealth	Cross-subsidisation Direct funding Accepting a lower rate of return

Also, governments differ in their approaches as to whether CSOs should be funded on actual costs or efficient costs as measured by industry benchmarks.

Funding for social policies (CSOs) in 1995-96 in NSW was either through the State budget or internally via cross-subsidies. Most CSOs are funded directly. As noted above, of the \$910 million provided to fund social programs in 1995-96, \$34 million was funded internally, with the remainder being funded from

the Budget. By 1998-99, all CSOs must be either budget funded and provided under contract, or discontinued.¹³

In Victoria, several different funding methods are used, including direct funding and cross - subsidies. Although direct funding of CSOs is the preferred method, the 1994 CSO policy statement indicated that direct funding of CSOs might have to be implemented over time. Since the finalisation of the policy statement the Victorian Government has direct funded CSOs in the electricity industry and for State Trust Ltd. The *State Owned Enterprises Act 1992* provides a mechanism for direct funding of CSOs undertaken by designated State business corporations and State-owned companies.

The Victorian Government also has allowed cross-subsidies to continue in its electricity supply industry. Victorian policy is to cross-subsidise rural areas by undervaluing assets located in rural areas and by levies on urban distributors. For instance, the assets of electricity distribution businesses have been revalued to achieve lower rural asset costs and higher urban asset costs than would have otherwise been the case.¹⁴ These revaluations allow the distribution businesses to earn the required rates of return on their assets while maintaining a uniform tariff across the State. In addition, a transfer of \$23.95 million, called the grid equalisation fee, from the urban distribution businesses to the rural businesses will subsidise rural network charges (TPC 1995).

The Queensland Government's policy is to use direct funding for CSOs. All CSOs currently identified through the corporatisation process are funded through direct funding. In principle, the Queensland Government intends to

¹³ Although CSOs which are not budget funded are to be discontinued, 'good corporate citizen' activities may be continued at management's discretion. CSOs given for externalities must also be specifically targeted by the end of this review process. It is intended that, at the end of the process, there will no longer be any general operating subsidies for the financial losses of GBEs.

¹⁴ The assets of the rural distribution businesses were written down by \$379 million to equate with the current and expected rural maximum uniform tariffs. Conversely, the assets of the urban distributors were written up by \$326 million (TPC 1995, p. 86).

The Victorian Department of Treasury and Finance disputes the contention that the revaluation of assets to maintain uniform tariffs constitutes cross-subsidisation. Rather, the Department argues that the uniform tariff has been maintained (until the year 2000 when residential customers are meant to have access to competitive purchasing of electricity) by means of a one-off subsidy. The Department also argues that, as it is achieved through the means of an assets write down, the uniform tariff should not be classified as a CSO.

However, the asset write down is an alternative means of funding the CSO to rural consumers. As such, it amounts to a cross-subsidy. It is, in a sense, akin to charging urban consumers prices above marginal costs to subsidise rural consumers (who pay prices below marginal costs), except in this instance the means of transferring finances to the rural sector is by adjusting asset values.

fund its CSOs on the basis of efficient (rather than actual costs). For example, in 1995-96, Queensland Rail's CSOs were funded at actual costs and it is intended in the future to base CSO payments on efficient long run avoidable costs. Where it is difficult to estimate an efficient price, the level of funding will be determined by negotiation. It is intended that this level of funding will be low enough to place sufficient discipline on the GBE to provide the CSO efficiently.

Currently, the Queensland Government is funding CSOs from consolidated revenue. For example, CSOs provided in the electricity industry are funded from consolidated revenue, although it is understood that there is some cross-subsidisation inherent in the electricity tariff equalisation CSO.¹⁵ Pensioner and other concessions provided by Queensland Rail are funded from the budget, with additional CSO payments to cover the full cost of the service provision, including capital costs (inclusive of the return on assets), so that the total payment is equivalent to the amount that would be paid to the private sector for the same service. The State Government subsidises both Brisbane Transport and the private sector urban bus service providers for CSOs, while Brisbane Transport also receives explicit funding for other CSOs from the Brisbane City Council.

The major area where CSO identification and costing is not yet complete is the rural water supply industry. In this instance, CSOs continue to be indirectly funded through a reduced rate of return. However, the Queensland Government is currently in the process of identifying and costing these CSOs.¹⁶

The South Australian Government has suggested that CSOs 'be funded on a best practice cost basis and identified in the normal budget process'. However, this may be difficult in the short run due to budget constraints. The *Community Service Obligations Position Paper* (Draft) also suggests that, although CSOs should be funded on a 'best practice' cost basis, this does not preclude transitional arrangements whereby the CSO contract requires annual improvements in costs to be achieved.

At present, a majority of South Australia's CSOs are internally funded, although a small minority are subject to direct funding from the Budget.

¹⁵ The level of this cross-subsidisation is likely to have been reduced since large commercial users were allowed to negotiate reduced tariff rates on a commercial basis.

¹⁶ Queensland's ports do not provide a commercial rate of return. The Queensland Government claims this is not related to the provision of CSOs, but rather that it is the result of 'grandfathering' existing contracts which have less than fully commercial terms and conditions.

The Western Australian Government funds its identified CSOs (performed by Westrail, the Water Corporation and Western Power) directly from the budget.

The preferred method of funding CSOs in Tasmania is directly from the budget. At present, CSOs in Tasmania are funded through cross-subsidisation or accepting a lower rate of return. The Government has stated that the funding of CSOs is to have a minimal impact on the budget. Consequently, direct funding is a medium-term goal and will be considered only in cases where GBEs have been fully commercialised (that is, where the GBE is subject to dividends and is paying tax equivalents). It is intended that all CSOs will be funded directly by the 1998-99 budget.¹⁷ The policy statement of the Government also states that CSOs will be funded at an efficient level, as judged from national and international performance benchmarks. The *Government Business Enterprises Act 1995* also refers to funding CSOs 'in whole or in part'.

The policy of the ACT Government is that '[w]here there is agreement to scope and cost of the CSO it will be funded from the budget' (Australian Capital Territory Government 1996, p. 5). The CSOs performed by both ACTEW and ACTION are direct funded. Prior to the 1996-97 Budget, ACTEW's pensioner rebates were funded from consolidated revenue, however, ACTEW's other CSOs were funded by the Government accepting a lower rate of return.

The ACT Government has stated that, in principle, all CSOs should be priced at efficient costs. However, recognising that GBEs may not have efficient operations, the Government will allow transitional funding above the efficient level to allow the service to continue to be provided. At the end of the transition period, these subsidies are to be eliminated. Where industry benchmarks are not available, CSOs will be funded at actual costs.

In the NT, it is preferred that CSOs are funded via direct funding, however, because of budget constraints, in some cases funding is provided by accepting lower rates of return. Currently, funding is being provided on the basis of actual costs, although with the collection of further information it is intended that funding be provided in the future on the basis of 'best practice' costs.

Some of the Commonwealth's CSOs are funded directly.¹⁸ However, the Commonwealth still allows its principal CSOs to be funded through cross-

¹⁷ The policy document of the Tasmanian Government states that direct funding may be phased in by 1997-98, at least for some CSOs.

¹⁸ Some CSOs required by the Commonwealth are performed by Business Units, such as the Australian Surveying and Land Information Group (AUSLIG), the Centre for Environmental Management, the Australian Government Analytical Laboratories and the Australian Government Publishing Service. These CSOs are budget-funded. In addition, AUSLIG's CSOs are to be market tested for outsourcing, with AUSLIG undertaking the expert buyer function.

subsidies. In particular, the CSOs provided by Australia Post and Telstra are funded by cross-subsidies. (CSO funding arrangements for Telstra are detailed in Box 4) The Joint Committee on Public Accounts (Parliament of Australia 1995) made the following observation on these Commonwealth arrangements:

Although appropriation from the Budget is the method of funding CSOs that is preferred by central agencies, it is the exception rather than the rule and, in the opinion of the PSA, is likely to remain so. (p. 87)

The Commonwealth also allows for funding of CSOs by acceptance of a lower rate of return. The *Accountability and Ministerial Oversight Arrangements for Commonwealth Government Business Enterprises* requires that:

... appropriate adjustments to the target to be made for any non-commercial Government requirements (including CSOs), where these are not separately funded. (1993, p. 2)

As noted above, the Commonwealth also uses a combination of funding methods for some CSOs. This practice can lead to problems of transparency and over-funding. For example, the BIE (1995) found that the revenue pool generated by cross-subsidisation, uniform pricing and reserved letter services protection arrangements has of itself been at least sufficient to offset the avoidable capital and operating losses which Australia Post incurs in delivering its CSO. The BIE estimated that the rate of return adjustments for the CSO have the effect of increasing Australia Post's rate of return from around 14.5 per cent to 17 per cent, substantially above a reasonable target rate of return of about 12 per cent. The BIE concluded that the combination of methods of funding has led to a form of double counting and an overly favourable assessment of Australia Post's performance.

4.2 Observations

Despite the stated preference for direct funding of CSOs by nearly every Australian government, there is a considerable way to go to turn this policy preference into reality. While the NSW, Victorian, Queensland and Western Australian Governments have progressed significantly, other governments have much to do.

The necessity to establish information systems to permit accurate costing of CSOs and the presence of budget constraints suggest that direct funding will take time to complete. The practice established by the NSW and Tasmanian Governments of publishing a timetable for completion of direct funding of CSOs provides a model for other governments as a way of ensuring that incentives remain to make the transition.

Box 4 Telstra's Universal Service Obligation

The *Telecommunications Act 1991* outlines the Commonwealth Government's current CSO initiatives in the telecommunications industry. These CSOs are referred to collectively as the universal service obligation (USO). While Telstra is currently the carrier that delivers the Government's USO, the costs of providing unprofitable services are shared between the carriers.

The Act defines the USO as the obligation to:

- ensure the standard telephone service is reasonably accessible to all people in Australia on an equitable basis, wherever they reside or carry on business;
- supply the standard telephone service to people in Australia;
- ensure pay phones are reasonably accessible to all people in Australia on an equitable basis, wherever they reside or carry out business; and
- supply, install and maintain pay phones in Australia.

These services are to be carried out as efficiently as possible.

AUSTEL has the role of monitoring the performance of the USO carrier and assessing the cost of providing the USO.

The Act requires the avoidable cost method be used to assess the cost of providing the USO. The estimation must include an economic measure of the operating costs, depreciation and the opportunity cost of capital on the assets employed to provide the USO. The measure calculates the costs that would be avoided and the revenues that would be lost if a particular group of customers were not serviced. The forgone revenues are subtracted from the avoidable costs to determine the net losses, called the Net Universal Service Cost (NUSC). As a result, this method is essentially a cross-subsidy between areas rather than services (Ergas 1994).

The mechanism adopted to allocate costs between the carriers is the 'timed traffic' measure of market share. Timed traffic essentially measures the sum of all timed connections in minutes of use. Each carrier's obligation is the total NUSC multiplied by the carrier's number of minutes of timed traffic as a fraction of the total number of minutes of timed traffic.

The process to determine the USO levy has several stages. First, at the beginning of the financial year Telstra indicates the areas where it believes it will make a loss. Following scrutiny and acceptance by AUSTEL, these areas are declared Net Cost Areas (NCAs). After the financial year has finished, Telstra calculates the losses made in these areas, and submits its levy claim. At the end of the period, some NCAs may show up to be profitable (and some areas anticipated to be profitable may make a loss). Only the *ex post* losses in the NCA areas contribute to the NUSC. AUSTEL argues that this process tends to cap the total amount of the NUSC available to Telstra (AUSTEL 1994a, p. 12).

The 1992-93 financial year was the first year in which a competing network to Telstra (Optus) had a timed traffic share of greater than zero. Since 1993-94, the assessment also has included Vodafone.

Several governments including Queensland, Tasmania and the ACT fund, or intend to fund, CSOs at efficient costs rather than actual costs. This method provides an incentive for GBEs to reduce the cost of CSOs rather than to load more costs on to their CSO activities. It is a practice to be commended to other jurisdictions.

In principle, there is no reason why a combination of methods could not be used to fund CSOs, particularly as a transition measure to direct funding. In practice, however, this approach has been found wanting. The Australia Post example highlights the difficulties and confusion that can arise in assessing performance and the potential for over-compensation which, in turn, would impose unnecessary costs on some users and/or taxpayers.

5. CONTRACTING CSOs

The contracting of CSOs between the relevant policy department and the GBE provider offers several advantages:

- it has the potential to reduce the resources required to cost the provision of CSOs. If there is a sufficient number of potential providers, contracting out should reveal the appropriate price for the service requested. Competition for the provision of CSOs through contracting should also help determine the 'best practice' cost;
- it allows governments to make explicit requirements of the provider. By specifying the exact requirements, contracting CSOs should enhance the accountability of the provider and make it easier to identify whether the government's social objectives are being met; and
- it can be used to specify which party bears the risk of unexpected changes in costs.

Moreover, if CSOs are funded directly, it is not necessary that they be provided by a GBE. Rather, they can be provided by private firms under contract to the relevant portfolio or, indeed, by other government agencies.¹⁹

It should be noted, however, that contracting out is not an end in itself. Nor is it appropriate in all situations. To maximise its potential it must be applied intelligently.

Overall, there has been relatively little contracting of CSOs in Australia.

It is the NSW Government policy that by 1998-99 all CSOs will be performed under contract. Contracts are to include:

- specification of services to be provided, including sale, quality, etc;
- financial arrangements, including contract price and agreed provision for variations;
- roles and responsibilities of client and service provider; contract period and timing of deliverables, contract milestones, etc;
- arrangements for performance monitoring and evaluation, including measures of efficiency (output/income) and effectiveness (outcomes). and
- accounting, reporting and communication arrangements.

¹⁹ By definition a CSO is a social program delivered by a GBE. Consequently, when a CSO is contracted to the private sector it is no longer a CSO as such. A similar point could also be made about CSOs that are competitively tendered to GBEs, since the activities would then be voluntarily undertaken and earning commercial returns.

For existing CSOs, arrangements for the contracting of CSOs will commence in Stage 11 of the Government's reform program, once Budget funding has been confirmed.

Central to NSW policy (and incorporated to some extent in the policies of the Victorian, Queensland, South Australian and Tasmanian governments) is the separation of the role of the producer and the purchaser of a service. Once the relevant social policies behind CSOs are identified, responsibility for them is lodged with the relevant portfolio Ministry together with the funds to purchase these CSO services. They can choose to purchase these services from another GBE or private firm, or to purchase alternative services that may better meet the needs of the identified clients.

In Victoria, some services previously supplied as CSOs by GBEs, are now provided under contract by the private sector following privatisation of GBEs. For example, contractual arrangements have been made recently with the five Victorian electricity distribution businesses for the delivery of the concessions and assistance schemes and the funding of the related administration costs. These contracts were made prior to their privatisation. Electricity concession discounts are now supplied by distributors under contract with the Department of Human Services.

The Tasmanian Government will examine, the possibility of contracting CSO provision to private providers, including voluntary organisations, after the first year of direct funding (1998-99).

In summary, very little contracting of CSOs has occurred in the past. However, several jurisdictions are moving towards contracting a significant number of CSOs between the relevant policy department and the GBE provider. NSW has advanced furthest along this path and provides a model for other jurisdictions.

6. ACCOUNTABILITY AND MONITORING OF CSOs

In the past, there has been very limited monitoring of the delivery of CSOs. In some cases, the services have not been well targeted. For example, the Industry Commission found that subsidies for urban transport CSOs often leak to those who are relatively well-off and the most disadvantaged often receive relatively little assistance (IC 1994).

Inadequate monitoring of the delivery of CSOs was frequently due to the fact that they were poorly defined with, at best, sketchy objectives. Clearly defined objectives however, facilitate assessment of the outcomes of CSO programs.

6.1 Government reforms

The monitoring of CSO provision is currently in a development stage for most Australian governments, although several have designed special monitoring regimes and administrative arrangements to promote greater accountability for the delivery of CSOs.

The NSW Government's accountability framework, to be implemented as part of Stage 11 of the review of CSOs, centres around separating the roles of the purchaser/funder and the CSO provider:

Establishing an appropriate accountability framework depends on separation of the policy/funder and service provider interests so that they are exercised independently (NSW Treasury 1996b, p. 19).

Once this has been achieved, outcomes of CSOs in NSW are to be monitored by the policy/funder agency independently of the service provider (although the provider may be required to collect and supply relevant information).

In addition, the reform process in NSW includes consolidating the responsibility for similar CSOs in the same Department to assist the co-ordination of social policy and avoid duplication.²⁰ For example, the Minister of Community Services is currently conducting an overarching evaluation of all pensioner concessions. The review commenced in July 1996. It is hoped that

²⁰ The New South Wales Cabinet Office found that the fundamental weaknesses affecting virtually all price concession CSOs were the lack of an overarching framework describing the rational (target groups and needs); policy outcomes to alleviate needs; and a strategy (consisting of appropriately designed programs) for achieving outcomes.

centralisation will help develop a more comprehensive approach to strategic planning, including the establishment of priorities between services and the needs of target groups, as well as allowing for better valuation of the total complement of benefits going to particular target groups (NSW Treasury 1996b, p. 23).

The NSW Governments intends to involve community groups in the process of reviewing and monitoring CSOs.

In Victoria, monitoring of CSOs will be undertaken by the Department of Treasury and Finance, in conjunction with both the GBE's portfolio department and the department which funds the CSO. The Victorian policy statement also specifies other methods of monitoring CSOs. For example, GBEs regulated under the *State Owned Enterprises Act 1992* are required to prepare a corporate plan (which would include details of CSO provision) on an annual basis for Government approval.

As in NSW, the Queensland Government is allocating prime purchasing responsibility for CSOs to the Department responsible for the targeted social policy. For example, the responsibility for price concessions has been transferred from the delivery agencies to the Department of Families, Youth and Community Care.

In Western Australia, both Western Power and the Water Corporation are required by legislation to specify in their annual Statement of Corporate Intent: the nature and extent of CSOs that are to be performed; the costings of, funding for, or other arrangements to make adjustments relating to CSOs; and the ways in which, and the extent to which, compensation will be made for performing CSOs. In the case of CSOs performed by WestRail, similar reporting requirements apply as part of the principles of commercialisation.

The role of Treasury in Western Australia relating to CSOs includes monitoring expenditure on CSO payments at the end of each year and determining any differences that have occurred between actual and estimated expenditures for the year.

The Tasmanian Government intends to implement a form of the purchaser/provider model by making the purchasing Minister responsible for the social outcomes of a CSO (Tasmanian Government 1996a, p. 6). It is intended that the purchasing Minister undertake annual reviews to ensure that CSOs are being delivered in accordance with the contract specifications. However, in some cases, the Tasmanian Government may allow the purchasing Minister to be also the Minister responsible for the GBE.

The ACT Government intends to measure the performance of CSOs in terms of..

- the (cost) price of the outputs - for example, cost per unit and total cost;
- the quantity of the outputs - for example, volume and level of supply;
- the quality of the outputs compared with the pre-negotiated standard; and
- the timeliness of the outputs.

The NT Government has also adopted the purchaser/provider framework as the basis for the delivery monitoring of its CSOs. Funding will come from a 'purchasing' agency which has policy responsibility for the particular activity in question. In a limited number of cases where a CSO represents broader Government-wide interests rather than portfolio responsibilities, Treasury will be the responsible agency for providing funding. As part of the annual Budget process, 'purchasing agencies' will review the level of CSO funding and its effectiveness.

The Commonwealth Accountability and Ministerial Oversight Arrangements (1993) require that the corporate plans of GBEs should include CSO details and costs, including strategies for minimising costs. At present, these corporate plans are confidential and there are no other requirements for public information about the nature and costs of Commonwealth CSOs. There is no requirement to specify and report on CSOs in annual reports, although some Commonwealth GBEs have taken the initiative to publish the cost of their CSOs in their annual reports.

6.2 Observations

It is apparent that the implementation of monitoring regimes and administrative arrangements to provide greater accountability for the delivery of CSOs is at an early stage for most governments. The system which has been put in place by the NSW Government provides a model for other governments which are beginning the process. There is much scope, for example, to improve public monitoring of Commonwealth CSOs.

All jurisdictions should implement (if they have not done so already) compulsory annual reporting of CSOs detailing the objectives of the program (including the target group), the method of determining the cost, the total cost of the CSO, the funding arrangements and the outcomes achieved (particularly relating to the target group).

The annual reports of the SCNPMGTE should incorporate information on the costs of CSOs performed by government businesses. Monitoring the delivery of CSOs will require the development of appropriate outcomes indicators.

Monitoring of the delivery of CSOs should not be left to the provider of the CSO. It may be helpful for the SCNPMGTE to assist in the development of principles or criteria for the design of monitoring systems.

Contracting of CSOs could enhance the monitoring process. By explicitly outlining the objectives of the program, contracts provide an opportunity to assess the outcome of the program against specific criteria. Greater use of the purchaser/provider model, as being adopted in some jurisdictions, has the potential to improve the monitoring of CSOs.

ATTACHMENT

IMPACTS OF COMPETITION POLICY REFORM ON COMMUNITY SERVICE OBLIGATIONS

This attachment is the submission made by the Industry Commission to the House of Representatives Standing Committee on Banking, Finance and Public Administration Inquiry into Aspects of the National Competition Policy Reform Package (December 1995).

This submission addresses the Terms of Reference requiring the Committee to have "particular regard to the impact of competition policy reform on the efficient delivery of community service obligations" (CSOs). It summarises insights about GBE reform and CSOs drawn from the Industry Commission's public inquiries, as well as its secretariat role for the SCNPMGTE (Steering Committee on National Performance Monitoring of Government Trading Enterprises).

1. Competition Policy and Social Policy

According to the Assistant Treasurer, one of the reasons for this inquiry is to provide guidance on how the economically and socially disadvantaged can be assured of access to basic services such as electricity and water. Until now, virtually all CSOs have been supplied by government business enterprises (GBEs) through various forms of cross-subsidy. To enable them to fund CSOs, most GBEs have had legislative protection from competition. Some groups fear that exposing GBEs to competitive pressures will adversely affect their ability to supply CSOs.

The purpose of competition policy reform is to put greater pressure on monopoly elements of private and public businesses and to achieve greater efficiency in the provision of infrastructure services. Competition policy aims to improve economic efficiency by increasing the supply of goods and services available to the community and holding prices in check. More efficient provision of services by GBEs is likely to lead to reduced costs for commercial customers and increased business activity and employment across the economy. For example, the Industry Commission (1995, p. 50) estimated that reforms to GBEs alone could increase the overall size of the economy by 2.5 per cent. It also found that there are large revenue gains to government from competition reform policy.

Competition policy reform is compatible with social policy goals. By boosting the nation's output and the rate at which it grows, it is possible for governments to do more about social justice and poverty issues. Higher growth and employment reduces the pressure on government social welfare programs. It may enable governments to spend more on social programs without raising taxes. By allowing other providers, competition also provides choice for consumers who would otherwise be subject to price rises or service cuts by government monopolies. As an example, the Commission (IC 1992b, p. 147) found that:

... lack of direct competition reduces the pressure on Australia Post to minimise prices and costs and to provide high quality services to its customers. It has also generated concern among participants about the ability of Australia Post ... to exert unfair pressure on its customers.

The implementation of competition policy reform is not intended to be at the expense of social policy. There is no requirement or expectation under the Competition Policy Agreement that governments will abandon or reduce CSOs. The Assistant Treasurer, in the second reading speech to the Bill, stated that these competition reforms are:

... not about competition for competition's sake ... [they] do not compel, or even encourage, governments to privatise government business enterprises or abandon or reduce community service obligations.

But the Agreement will facilitate a more careful and systematic consideration of the delivery of CSOs by State and Territory governments where they decide to undertake structural reform of GBEs.

Under the Agreement, governments have agreed that before competition is introduced into a market traditionally supplied by a public monopoly, or before a public monopoly is privatised, they will review:

... the best means of funding and delivering any mandated community service obligation (section 4 (3) f).

BOX A1 National Approach to CSO's

SCNPMGTE (made up of representatives of all Australian governments, chaired by the Chairman of the Industry Commission and supported by staff of the Commission) was established to develop and publish measures of the financial and non-financial performance of major GBEs in a range of core industries. The accuracy and comparability of these indicators depends in part on how consistent governments are in their approach to the definition, costing and funding of CSOs. To this end, the Steering Committee (1994) developed a preferred definition of a CSO and arrived at a preferred method of costing CSOs. These have been widely used by governments in the formulation of CSO policies.

2. Opportunities to Improve CSOs

Far from cutting back CSOs, competition policy reform should enable them to meet social needs better. Under the uncompetitive regime of the past, many CSOs were inefficient, ineffective, inequitable and lacked transparency. Conflicting objectives, cross subsidies and legislative restrictions on competition reduced efficiency of GBEs. Lack of review allowed poor targeting, which in turn led to ineffective and inequitable delivery of CSOs. A lack of transparency and poor reporting permitted the existence of CSOs that were not sanctioned by parliament.

Conflicting Objectives

Conflicting objectives contributed to GBE inefficiency. On the one hand, GBEs were required to provide non-commercial services; on the other, they were also required to achieve commercial rates of return. For example, in its report on *Mail, Courier and Parcel Services* (IC 1992b), the Commission found that the confusion had led to a conflict between commercial and non-commercial objectives of the enterprise.

In some cases this conflict may have caused, or been used to excuse, poor CSO delivery or poor overall performance by GBEs. For example, the Commission (IC 199 1 a, p. 5 9) reported of the Gas and Fuel Corporation of Victoria that:

In comparing its performance with AGL the corporation used as an excuse for its poor performance its need to provide community service obligations.

Similarly, the Commission (IC 1992b) found that pressure for commercial returns may have caused Australia Post to reduce CSO performance by withdrawing from some high cost remote mail runs and reducing the frequency of delivery to other areas.

Cross Subsidies

GBE efficiency was also reduced by the use of cross subsidies to fund CSOs. Cross subsidies operate by overcharging some customers so as to subsidise others. Customers who are overcharged consume less of a service than they would like to if it was priced to reflect the actual cost of provision. Those who are subsidised will tend to expand their consumption beyond that which would otherwise occur. The over-consumption of the subsidised service may require GBEs to invest in unnecessary additional capacity. For example, the Commission (1992a, p. 158) found that the introduction of pay-for-use pricing in the Hunter Valley "reduced average water consumption by around 30 per cent" which delayed the "need for a new dam with a capital cost of over \$50 million by at least 10 years".

BOX A2 Industry Commission experiences of CSOs

The Commission's report on *Government (Non-Tax) Charges* (IAC 1989) was one of the first documents to uncover the extent and cost of CSOs in Australia. This report was followed by further inquiries into individual sectors dominated by government businesses, such as *Energy Transmission and Distribution* and *Rail Transport* in 1991 and *Water Resources and Water Waste Disposal*, and *Mail, Courier and Parcel Services* in 1992. In each of these reports, the Commission assessed major CSOs with regard to how efficiently they were being delivered and how effective they were in fulfilling social policies. In addition to these major CSOs, there is a great number of lesser CSOs that the Commission has identified in other inquiries (for example, *Availability of Capital* in 1991 and *Taxation and Financial Policy Impacts on Urban Settlement and Port Authority Services and Activities* in 1993).

Legislative Barriers to Competition

Legislative restrictions on competition that were used to enable these cross subsidies to be provided also contributed to inefficiency in GBEs. Protection reduces efficiency in a number of ways. The absence of competitors allows protected businesses to increase their costs and over-price their services. Being indentified from bankruptcy or hostile take-over reduces incentives for GBEs to perform efficiently. Further, in the presence of protection from competition public firms will often seek to maximise output and employment, which draws resources away from more productive uses.

Inadequate Monitoring of Costs

Lack of effective monitoring has been symptomatic of the GBEs uncompetitive environment. Many GBEs did not know what their CSOs cost, let alone what the benefits were. For example, the Industry Commission (1991a, p. 61) reported that energy CSOs were:

... continuing without periodic evaluation of their worth ... utilities themselves have little information on the cost of providing the major CSOs.

An absence of parliamentary review allowed the provision of CSOs that were not sanctioned by parliaments (and thus, implicitly, by the community itself). A number of GBEs provided "quasi-CSOs" without being required to do so under their Acts. Examples of unsanctioned CSOs the Commission has found in its inquiries include Australia Post's registered mail service, the uniform electricity

tariffs of the State Electricity Commission of WA and cross-subsidised water for residences in Victoria.¹² Some CSOs may have had government sanction once, but had never been reviewed. Other CSOs created beneficiaries quite unintended by parliaments. As the NSW Government (1994, p.3) notes, some CSOs:

... permitted special interest groups to benefit at the expense of the community at large. These special interest groups include some GTE customers, employees and management. (These latter two groups benefit from an expansion of their organisation's activities.)

Poor Targeting

Many CSOs were ineffective in their targeting and delivery. Many CSOs have been delivered to those not in need. For example, with subsidised fares, an aged person may have received a subsidy where another person on the same income did not. Similarly, with subsidised services, rich patrons often received the same subsidy as poor ones. Also, the cost of cross-subsidies has to be borne by a limited group who happen to consume the same product. For example, the Commission (IC 1994, p. 191) arrived at the following conclusion regarding urban transport CSOs:

Current policies aimed at fulfilling social objectives in transport have not been effective in meeting the needs of many in the community. The most disadvantaged often receive relatively little assistance, and subsidies often leak to those who are relatively well-off.

Funding CSOs - Alternatives to Cross Subsidies

The introduction of greater competition for GBEs will create pressures to re-examine the way CSOs have impacted on GBE efficiency. Cross subsidies will be difficult to maintain once legislative barriers are removed. If a GBE attempts to fund a CSO by overcharging its customers in a competitive, or potentially competitive market, they can simply turn to another supplier.

There is a range of alternative ways CSOs can be provided under a regime of greater competition for GBEs. They include funding CSOs directly from consolidated revenue, indirect budget funding (where governments accept lower rates of return from GBEs in lieu of direct funding), user levies, contracts with private suppliers and vouchers or direct cash-payments to users.

Most governments have a policy preference for direct funding of CSOs, but permit alternative arrangements for particular CSOs. For example, the Commonwealth (Commonwealth Government 1993) has stated that CSOs

¹ See respectively (IC 1992b, p. 98), (IC 1991a, Vol. 3 p. 47) and (IC 1992a, p. 26).

should be "normally financed from the Budget". However, the Commonwealth still requires Australia Post and Telstra CSOs to be funded by cross subsidies. Some governments, most notably the NSW Government, have made considerable progress towards direct funding of CSOs.

Direct funding of CSOs provides a means of overcoming the reductions in efficiency associated with cross-subsidies and their concomitant barriers to entry. Also, it ensures that the costs of the non-commercial objectives of government enterprises are subject to closer annual budget scrutiny and thereby creates incentives for governments to identify clearly the service to be provided. In order to apply for direct funding, GBEs will have to identify what CSOs they have and how much they cost. Governments would then either have to fund the CSOs or release the GBEs from their obligations to achieve specific rates of return. As the Victorian Government (Office of State Owned Enterprises 1994, p. 5) states, the information thus gathered will mean that:

... for the first time, through the adoption of a clear CSO policy, the nature, scope, cost and effectiveness of CSOs will become apparent, facilitating informed community assessment of CSO provision.

Direct funding will also encourage agencies to take greater responsibility for the nature and quality of services delivered to client groups. While protected by barriers to entry, there was little incentive for many GBEs to concern themselves with the service provided to recipients of CSOs and their was limited accountability for CSO performance. For example, the IC (1992b, p. 72) reported that, in cutting back on rural deliveries, Australia Post:

... did not seem to take the people that would be affected into its confidence. Insufficient explanation was provided as to why the reduction was necessary and the reaction of the people as to whether their needs would still be met with the reduced frequency was not sought. Any consultation that did occur was at the initiative and request of the residents.

Under a regime of actual or potential competition for GBEs and the direct funding of CSOs, the funds and responsibility for service delivery will mostly lie with the relevant government agency dealing with welfare and community needs. Relevant ministers will have an incentive to establish which CSOs are most appropriate for community needs, and what are the most effective and efficient means of delivering them. As the NSW Government (NSW Treasury 1994b, p. 1) stated:

... social policy will not be ignored or marginalised as commercialisation increasingly focuses on GTE management with respect to efficiency and financial performance. Rather the policy [aims] to ensure that the "right" services are provided in the most efficient and effective manner possible.

For similar reasons, the continuing effectiveness of CSO delivery should be encouraged by better performance monitoring. Responsible ministers will have

incentives to establish performance indicators to ensure that their delivery specifications are met.

In previous reports, the Commission has recommended contracts as an effective method for monitoring CSO performance. For example, in its inquiry (1991b, p. 205) into rail transport the Commission stated that contracts:

... provide information about the costs of particular services and put pressure on the rail authority, through the process of re-negotiating the contracts, to keep costs down. They also assist the government to make decisions on which services are no longer warranted.

Contracts can be used to improve the efficiency of CSOs even where they will be supplied by GBEs which have significant degrees of natural protection. For example, the IC (1995, p. 192) reports that the NSW Transport Department has a contract with the State Rail Authority under which it only funds the SRA at estimated best-practice costs for its CSOs. In conjunction with some other reforms, this has led the SRA to introduce a number of cost-reducing measures, such as contracting-out some rural rail services to private bus operators. Private firms can also supply CSOs through contracts. Whereas in the past the Commission (IC 1991a, p.58) reported that private utilities had been forced to offer pensioner concessions, in the wake of competitive reforms they are now being offered contracts to do so.

Summary

Competition policy reform can contribute to social policy goals by enhancing the supply of goods and services to the Australian community. By creating the potential for increased productivity and employment, it can reduce pressures on government social welfare programs. By creating the potential to expand government revenue without adding to taxation, it may also add to the capacity of governments to meet their social welfare commitments.

Australian governments have been revising their CSO policies for several years to ensure more effective delivery of these obligations and to reduce their impact on GBE efficiency. The Competition Policy Agreement does not require governments to abandon or reduce their CSOs. It provides for systematic consideration of these obligations where governments are considering structural reform of their GBEs. This will help ensure that CSOs are being delivered to those who deserve them and in the most cost effective manner.

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