



NATIONAL COMPETITION POLICY

APPLYING THE PRINCIPLES TO
LOCAL GOVERNMENT IN TASMANIA

April 2004

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1 INTRODUCTION

The National Competition Policy (NCP) Agreements have now been operational for eight years and have had implications for all levels of government. Local Government in Tasmania has made significant progress in applying the competition principles in relation to competitive neutrality, legislation review, and, in the case of the bulk water authorities, prices oversight. In particular, substantial progress has been made in implementing water industry reforms.

This 2004 Application Statement has been prepared to ensure that Tasmania continues to meet its obligations as a party to the NCP Agreements. It is intended to assist Local Government in the continued application of competition principles to its activities. It reaffirms Local Government responsibilities in relation to each of the competition principles as set out in the NCP Agreements.

Broad guidance on applying the competition principles to Local Government was initially provided in the former Government's policy statement of June 1996, titled *Application of National Competition Policy to Local Government* (1996 Statement). It included a requirement for review, which has been undertaken in consultation with Local Government. The 2004 Statement was developed following that review and replaces the 1996 Statement.

Tasmania has made excellent progress in meeting its obligations under the Agreements. This is due, in part, to the co-operation of Local Government in implementing NCP.

As background to NCP, an outline of the NCP Agreements and accounts of Tasmania's progress in implementing NCP are provided in the Tasmanian Government's annual National Competition Policy Progress Reports. Copies of the latest Progress Report are available at the Department of Treasury and Finance's Internet site: <http://www.treasury.tas.gov.au>. Earlier reports are available from the Department of Treasury and Finance.

Further information on NCP and the NCP Agreements can be found at the website of the National Competition Council at: www.ncc.gov.au.

2 PRICES OVERSIGHT IN RELATION TO LOCAL GOVERNMENT

Clause 2 of the *Competition Principles Agreement* (CPA) requires state and territory governments to consider establishing independent sources of prices oversight advice where these do not exist.

Tasmania's *Government Prices Oversight Act 1995* (the Act) establishes the Government Prices Oversight Commission (GPOC) as the independent body responsible for conducting investigations into, and reporting on, the pricing policies of government bodies that are monopoly, or near monopoly, providers of goods and services. The *Government Prices Oversight Amendment Act 1997* extended the coverage of the Act to include Local Government monopoly, or near monopoly, services.

Schedule 1 of the Act lists the monopoly providers that are subject to the requirements of the Act. For Local Government, the Act has only been applied to the three bulk water authorities. However, the Act provides a mechanism under which other monopoly services can be declared and therefore become subject to a GPOC investigation.

For water and wastewater businesses, councils will continue to apply the *Urban Water and Wastewater Pricing Guidelines for Local Government in Tasmania* (Water Pricing Guidelines). The current Water Pricing Guidelines were issued in January 2003. While minimal changes to the Water Pricing Guidelines are expected, it may be necessary to issue updated Guidelines from time to time.

If a council does not comply with the Water Pricing Guidelines and the State Government is concerned that the council has no plans to address the issue, it may have its service declared as a monopoly service under the Government Prices Oversight Act and be subject to a formal investigation under that Act.

2.1 WATER INDUSTRY REFORM

In accordance with the *Strategic Framework for the Efficient and Sustainable Reform of the Australian Water Industry*, councils are required to progress reforms in relation to urban water pricing, in particular:

- for all schemes, the adoption of water and wastewater pricing regimes which achieve full-cost recovery, including the requirement to meet long-term asset maintenance and renewal costs; and

- implementation of two-part tariffs for water pricing, where it is cost-effective to do so.

For assistance in implementing these reforms, councils will continue to observe the Water Pricing Guidelines.

In relation to full-cost recovery, councils are required to ensure that full cost attribution is applied to all significant business activities (SBAs). All costs must be correctly identified and assessed so that there are no hidden cross-subsidies between water and wastewater rates and general rates, and no hidden inefficiencies in the operations of water and wastewater businesses.

Prices should be sufficient to meet financial costs, but not so high as to provide monopoly rents to the charging authority. Prices may be established within the lower and upper limits of a “band”. The lower limit for pricing is the minimum level required for a business to remain viable, including recovering the cost of asset refurbishment/replacement, but not providing a return on the cost of capital. The upper limit is the maximum allowable revenue that avoids monopoly rent.

Community service obligations (CSO) are permitted, provided they are transparent. The definition, identification and funding of CSOs is explained in the *Community Service Obligation Policy and Guidelines for Local Government in Tasmania*, November 2000 (CSO Policy).

Under the GPOC audit process, all councils are required to provide advice to GPOC each year on the performance of their water and wastewater businesses, to allow GPOC to assess their compliance with the Water Pricing Guidelines and the CSO Policy. The GPOC audit process commences in November each year.

Regulation 32 of the *Local Government Regulations 1994* requires that councils’ annual reports include:

- a statement reporting on a council’s plans in relation to water supplied by it for domestic consumption; and
- sufficient financial information to demonstrate that it is applying the pricing guidelines in relation to water supplied by it for domestic consumption as specified in the Water Pricing Guidelines.

In relation to two-part tariffs for water pricing, where, as a result of the 1999 cost-effectiveness assessment process, a council continues to use a single tariff, it may choose to change to two-part tariffs at any time in the future.

3 COMPETITIVE NEUTRALITY

Clause 3(1) of the CPA requires that government businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership. This is the principle of ‘competitive neutrality’. The objective of competitive neutrality is the elimination of resource allocation distortions arising out of the public ownership of entities engaged in SBAs, so that ultimately all government businesses compete on fair and equal terms with private sector businesses.

The CPA provides two separate models of competitive neutrality. These are the corporatisation model (clause 3(4)) and the full cost attribution model (clause 3(5)). The CPA requires these models to be applied to the extent that it is in the public benefit. While the CPA sets out these models as alternatives, there is considerable merit in a staged approach to the introduction of competitive neutrality. This involves:

- councils identifying all business activities within their operations;
- councils identifying which of these are SBAs;
- application of full cost attribution to those SBAs, to the extent that it is in the public benefit;
- identification of those SBAs which are potentially suitable for corporatisation;
- undertaking public benefit assessments of the corporatisation of those business activities; and
- corporatisation of those business activities where a public benefit assessment indicates that the benefits outweigh the costs of doing so.

Councils should refer to the document, titled *Significant Business Activities and Local Government in Tasmania*, April 2004, which provides guidelines on identifying and reporting on Local Government SBAs. Amongst other things, this document provides that while, in the first instance, councils identify which business activities are significant, the ultimate decision as to what is a business activity and a SBA may need to be resolved by GPOC, in the event of a complaint under the *Government Prices Oversight Regulations 1998*.

The document *Corporatisation Principles for Local Government Business Activities*, December 1998, provides a detailed account of the principles underlying corporatisation and its application to Local Government and will be useful in determining if corporatisation of a SBA is appropriate.

This process has already been undertaken by councils and, in particular, the examination of corporatisation for water and sewerage businesses has been completed. However, all

councils will regularly review their activities to determine if there are any activities that should be classified as business activities and/or SBAs and therefore to which the competitive neutrality principles (either corporatisation or full cost attribution, as appropriate) should be applied.

Under NCP, single and joint local government authorities are required to comply with competitive neutrality principles in the CPA. The *Local Government Act 1993* also imposes obligations on single and joint local government authorities to adhere to competitive neutrality principles.

3.1 FULL COST ATTRIBUTION AND COST REFLECTIVE PRICING

Under the full cost attribution model, councils are required to identify the full costs of providing a SBA. Under clause 3(5)(b) of the CPA, it must be ensured that the prices charged for goods and services of SBAs reflect full cost attribution for these activities as well as taking account of taxes and tax equivalents, debt guarantee fees and application of regulations to which the private sector are normally subject, where appropriate. To assist in determining the appropriate prices, the Department of Treasury and Finance will be issuing the *Cost Reflective Pricing Guidelines* in 2004. These guidelines provide for prices to be set based on the avoidable cost, which is explained in the above document. In determining these costs for an activity, the value of all resources consumed in the provision of that activity must be considered. To determine these costs, the following must be considered:

- operating costs (direct and indirect) per unit or period, including wages, materials and corporate services costs; plus
- capital costs (direct and indirect) per similar unit or period, such as the opportunity cost of capital; plus
- competitive neutrality costs per similar unit or period, including taxation and guarantee fees.

NCP allows councils to charge less than full cost in order to meet CSOs. The *Community Service Obligation Policy and Guidelines for Local Government in Tasmania*, November 2000, sets out when a CSO can be used and how it must be reported and accounted for.

Councils should also refer to the document, titled *Full Cost Attribution Principles for Local Government*, June 1997, for a detailed guide to applying full cost attribution to

their business activities. For guidance on setting prices for SBAs, councils should refer to the above-mentioned *Cost Reflective Pricing Guidelines*.

3.2 FUNCTIONAL SEPARATION

Councils should separate policy, regulatory and contract management functions from operational or service delivery functions where feasible. This is necessary to ensure there is no conflict of interest and that business activities do not enjoy any regulatory advantage over their private sector competitors. However, it is recognised that, for smaller councils, it may not be possible to fully separate these functions.

3.3 CORPORATISATION

Corporatisation involves establishing a separate legal entity to run a commercial business with the relevant government as its sole shareholder or owner. It does not necessarily involve incorporation under Corporations Law.

Under NCP, corporatisation must be considered for local government businesses that are Public Trading Enterprises (PTEs) or Public Financial Enterprises (PFEs), as defined under the Australian Bureau of Statistics' Government Financial Statistics Classification. A corporatisation model should also be considered for SBAs which are not PTEs or PFEs but need only be adopted to the extent that it is in the public benefit.

Corporatisation of an activity should proceed where there will be a demonstrated public benefit. Where this is determined, the corporatisation model requires that:

- full Commonwealth, state and territory taxes or tax equivalent systems be imposed;
- debt guarantee fees directed towards offsetting the competitive advantages provided by government guarantees on borrowings be imposed; and
- those regulations to which private sector business are normally subject be imposed on an equivalent basis.

There will also need to be separation of policy, regulatory and contract management functions from operational or service delivery functions if this has not already occurred in the application of full cost attribution.

Where there is a public benefit to corporatisation, the corporatised activity will then need to be established as a separate legal entity. Where it is determined that there is no public benefit in adopting the corporatisation model for a significant business activity, councils are required to continue to apply the full cost attribution model.

Provided that an entity:

- is unambiguously corporatised;
- pays taxes or tax equivalents,
- pays guarantee fees;
- faces the same regulation as the private sector; and
- seeks to earn a commercial rate of return, particularly for new investment projects,

its pricing can usually be assumed to be commercially based, and there will be no requirement for the separate definition and application of a full cost attribution model. Where GPOC is not satisfied that all of these criteria have been met, GPOC will look for application of full cost attribution principles and cost reflective pricing policies for goods and services.

To ensure that the corporatisation model adopted is unambiguous, councils should ensure that the principles outlined in *Corporatisation Principles for Local Government Business Activities*, December 1998, are adhered to fully. This requires, among other things:

- providing the entity with clear and non-conflicting commercial objectives;
- separation of supplier and purchaser roles, ensuring ‘arms length’ trading arrangements;
- appointment of an impartial Board of Directors, based on commercial skills and experience for the business activity concerned (with no councillors appointed as Directors);
- specification of a dividend expectation by the owner council via a Charter or equivalent;
- a clear requirement to return a profit and a commercial rate of return on the owner council’s investment or interest on internal borrowings; and
- that any CSO funding is in accordance with the CSO Policy.

Assessments as to whether or not corporatisation is appropriate may need to be revisited from time to time and should be undertaken for new activities.

3.4 PUBLIC BENEFIT ASSESSMENTS

Where councils are required to consider corporatisation of a SBA, they will be required to undertake a thorough and transparent public benefit assessment. For guidance on undertaking a public benefit assessment, councils should refer to clause 1(3) of the *Competition Principles Agreement* and the document titled *The Public Benefit Test for the Corporatisation of Local Government Public Trading Enterprises*, November 1998.

3.5 COMPLAINTS MECHANISM

Clause 3(8) of the CPA requires each state and territory to establish a complaints mechanism to oversee the application of competitive neutrality principles. GPOC has been given this role in Tasmania under the Government Prices Oversight Act and the Government Prices Oversight Regulations. GPOC receives and investigates complaints against State and Local Government SBAs. That is, when a person believes that a government body undertaking a SBA has contravened any of the competitive neutrality principles and considers that he or she is adversely affected by the contravention, that person may complain to GPOC. GPOC will only become involved in a matter in the event of a complaint.

At the outset, all Local Government bodies should make their own assessment of the significance of business activities. However, in the event that a complaint is lodged with GPOC in relation to an activity that has not been defined as a SBA by a Local Government body, GPOC is responsible for applying the guidelines contained in the document titled *Significant Business Activities and Local Government in Tasmania*, April 2004 to determine if the activity is firstly a business activity and then if it is a SBA. If GPOC finds that the activity is a SBA, and the other requirements of the Regulations are satisfied, the investigation can then commence. This is a similar process that is used in relation to complaints against Government agencies.

The process for making and assessing competitive neutrality complaints is detailed in the *National Competition Policy Competitive Neutrality Principles Complaints Mechanism Guidelines*, 1998 published by GPOC. Briefly, the process is as follows:

- a formal complaint is lodged in writing with GPOC (after the complainant has first discussed the complaint with the relevant Local Government body);
- GPOC assesses if the complaint relates to a SBA and if the complainant has been adversely affected;

- if the complaint relates to a SBA and the SBA's action has had an adverse effect on the complainant, GPOC accepts the complaint and refers the complaint to the relevant Local Government body for review;
- the Local Government body must undertake an internal review and advise GPOC, within 30 days, whether the complaint is justified and, if so, what action is proposed to be taken. If the Local Government body does not believe that the complaint is justified, it should provide the reason for such belief and the relevant supporting information to GPOC;
- GPOC reviews the findings of the Local Government body and the outcome of the internal review and, if necessary, conducts a further investigation;
- following a review of the Local Government body's findings and any further investigation undertaken, GPOC provides a report with recommendations for appropriate action (GPOC may recommend no further action where none is found to be necessary) to the complainant, the Treasurer, the Minister responsible for Local Government and the Local Government body;
- the Minister and the Local Government body must advise GPOC, within 30 days, of what action will be, or has been, taken to address the recommendations; and
- GPOC provides an account of complaints and any actions taken arising from its recommendations in its annual report.

Therefore, councils and other Local Government bodies (including single and joint authorities) are required to establish their own internal procedures for dealing with competitive neutrality complaints as the complainant must first discuss the issues in question with the Local Government body before a formal complaint may be lodged with GPOC. If a complaint arises, the most appropriate place for its resolution is with the council or authority itself, rather than the complaint continuing to a full GPOC investigation. Councils and authorities should therefore endeavour to resolve the issue at this stage in cases where it assesses that there is a genuine cause for complaint.

In this regard, it is recommended that councils and single and joint local government authorities nominate a particular officer to be responsible for NCP and any competitive neutrality complaints that may arise. Complaints that are unable to be resolved at the Local Government level, for whatever reason, will continue through the complaints process to GPOC for assessment and possible investigation.

4 STRUCTURAL REFORM OF PUBLIC MONOPOLIES

Clause 4 of the CPA requires governments considering the introduction of competition to a market traditionally supplied by a public monopoly, or the privatisation of a traditional public monopoly, to undertake a review into the:

- appropriate commercial objectives for the public monopoly;
- merits of separating any natural monopoly elements from potentially competitive elements of the public monopoly;
- merits of separating potentially competitive elements of the public monopoly;
- most effective means of separating regulatory functions from commercial functions of the public monopoly;
- most effective means of implementing the competitive neutrality principles set out in the CPA;
- merits of any CSOs undertaken by the public monopoly and the best means of funding and delivering any mandated CSOs;
- price and service regulations to be applied to the industry; and
- appropriate financial relationships between the owner of the public monopoly and the public monopoly, including the rate of return targets, dividends and capital structure.

In addition, before a government introduces competition to a sector traditionally supplied by a public monopoly, it must remove from the public monopoly any regulatory functions in accordance with clause 4.

5 LEGISLATION REVIEW

Clause 5 of the CPA provides that legislation should not restrict competition unless it can be demonstrated that:

- the benefits of the restriction to the community as a whole outweigh the costs; and
- the objectives of the legislation can only be achieved by restricting competition.

Clause 5 requires that governments review and, where appropriate, reform all legislation that restricts competition by the year 2000. However, the Council of Australian

Governments agreed to extend this deadline to 30 June 2002 following the review of the NCP Agreements undertaken in 2000.

The State Government's Legislation Review Program established a timetable for the systematic review of all legislation that restricts competition, to ensure that only those restrictions that are fully justified in the public benefit are retained. The timetable included State Government legislation that impacts on Local Government and legislation from which Local Government is exempt, but with which its private sector competitors are required to comply.

5.1 LOCAL GOVERNMENT BY-LAWS

Under section 145 of the Local Government Act, a council may make by-laws in respect of any act, matter or thing for which a council has a function or power under that act or any other act.

All proposed by-laws must be made in accordance with the *By-law Making Procedures Manual* administered by the Local Government Division of the Department of Premier and Cabinet. The Manual represents the by-laws section of the Government's Legislation Review Program. It outlines the statutory and administrative requirements for making by-laws and provides guidance to councils on how to comply.

An important requirement under the Local Government Act is that a council must prepare a regulatory impact statement for by-laws it intends to make (section 156A). The only exceptions are where the purpose of a by-law is to repeal an existing by-law or, under certain circumstances, to amend an existing by-law. The purpose of this requirement is to ensure that any restrictions on competition or significant impacts on the community as a result of the by-law are fully justified as being in the public benefit.

Under the Local Government Act, councils are required to obtain certification from the Director of Local Government of the regulatory impact statement and proposed public consultation program. If the Local Government Division is in any doubt as to whether a proposed by-law properly observes the NCP principles, it will consult with the Regulation Review Unit within the Department of Treasury and Finance.

Other important requirements that apply for all proposed by-laws are:

- public consultation is mandatory;

- a qualified legal practitioner must confirm that a by-law was processed in accordance with the Local Government Act and the General Manager of the council must certify that it is in accordance with the Local Government Act;
- once made by a council, a by-law must be confirmed by the Minister for Local Government and then published by the council in the *Gazette*;
- a by-law is effective from the gazettal date or on a later date specified in the by-law;
- a by-law must be laid before each House of Parliament within the first 10 sitting days after gazettal. Either House of Parliament may disallow a by-law; and
- following gazettal, a by-law should also be forwarded to the Subordinate Legislation Committee of Parliament for assessment. If the Committee is not satisfied that the by-law is adequately justified in the public benefit, it may recommend to Parliament that it be disallowed.

6 THIRD PARTY ACCESS

Clause 6 of the CPA requires the State Government to give consideration to establishing a legislated right for third parties to negotiate access to services provided by significant infrastructure facilities.

Since 1995, no councils have operated any infrastructure facilities to which clause 6 applies. It is therefore unlikely that councils will be required to take any action under this clause.

7 REPORTING

Councils will continue to demonstrate their compliance with NCP by reporting on the following matters in their annual reports:

- progress in implementing competitive neutrality principles;
- the outcome of any public benefit assessments undertaken;
- a list of the councils' SBAs as determined by councils and any determined as such by GPOC following a competitive neutrality complaint;
- any complaints received and the outcome of investigation of those complaints;
- the outcome of any assessments undertaken of proposed by-laws; and

- the outcome of any review of the structure of a council monopoly.

As discussed above, the Local Government Regulations require that each council's annual report includes:

- a statement reporting on the council's plans in relation to water supplied by it for domestic consumption; and
- sufficient financial information to demonstrate that it is applying the pricing guidelines in relation to water supplied by it for domestic consumption as specified in the Water Pricing Guidelines.

As also discussed above, under the GPOC audit process, all councils are required to provide advice to GPOC in November of each year on the performance of their water and wastewater businesses, to allow GPOC to assess their compliance with the Water Pricing Guidelines and the CSO Policy.

This information is included in Tasmania's Progress Reports to the National Competition Council.

8 CONTACT

Copies of this document can be obtained from the Regulation Review section of the Treasury website: <http://www.treasury.tas.gov.au> or by contacting Treasury as set out below:

Assistant Director
Economic Policy Branch
Department of Treasury and Finance
GPO Box 147
HOBART TAS 7001

Ph: (03) 6233 3407

Fax: (03) 6233 5690

Email: regulation.review@treasury.tas.gov.au