

DRAFT LGNSW SUBMISSION

IPART Review of NSW Competitive Neutrality Policies and Processes

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1. Introduction

Local Government NSW (LGNSW) is the peak body for local government in NSW, representing NSW general purpose councils and related entities. LGNSW facilitates the development of an effective community-based system of local government in the State.

LGNSW welcomes the opportunity to respond to the Issues Paper for the IPART Review of NSW Competitive Neutrality Policies and Processes. This submission focusses on the application of Competitive Neutrality to local government.

This is a draft submission and is subject to review and approval of the LGNSW Board. Any changes will be advised at the earliest opportunity.

2. General Comments

Background

LGNSW appreciates that the application of Australian National Competition Policy (NCP) and Competitive Neutrality (CN) principles in NSW have not been reviewed for over 20 years and that that a review is overdue. There has been considerable change in the way all spheres of government deliver infrastructure and services over the intervening period and the applicability of the policy needs to be tested. Furthermore, LGNSW maintains that all policy, regulation and legislation should be subject to periodic review.

LGNSW is generally supportive of the NCP and was consulted by NSW Treasury on the introduction of NCP to NSW and particularly in the development of *NSW Policy Statement on the Application of National Competition Policy to Local Government* that were released in June 1996. LGNSW engagement helped ensure that that NCP as it applied to local government was realistic, proportionate and not overly onerous.

The NSW Government, in agreement with LGNSW, rejected a prescriptive approach to competition policy in councils. It is recognised that, to be effective, competition policy must provide cost effective benefits in the wide range of councils from small rural to large urban. The Guidelines were built on that approach. This included:

- That the Guidelines should be subject to benefit cost analysis – CN actions should only be applied where the net public benefit exceeds cost.
- Recognition that competition policy does not require that all individual businesses compete on an equal footing. Councils and other government agencies will have advantages through size, buying power, specialised expertise assets etc in the same way the private sector will have its own characteristics.
- Stressing that the principle of CN applies only to the business activities of councils and not to their non-business, non-profit activities.
- Recognition that councils have a number of competitive disadvantages compared to the private sector. This includes limitations on borrowings, reduced flexibility to respond to markets, requirements for additional public accountability, legislative duties and Community Service Obligations (CSOs).
- Recognition that a business activity will involve the supply of goods and services for a fee or charge but not all activities involving the supply of goods and services would necessarily be classified as business activities.
- Discretion for local councils to make their own determination as to which of their activities are classed as businesses (other than those classified by the Australian Bureau of Statistics (ABS) e.g. water and sewerage).

These were sound considerations in developing the Local Government Guidelines and LGNSW consider it to be essential that IPART apply the same considerations in this Review.

The Guidelines identified a number of Local Government activities that were classified as businesses by the Australian Bureau of Statistics (ABS) as businesses, namely:

- Water supply and sewerage
- Gas production and reticulation
- Abattoirs

Other activities/businesses would be treated on a case by case basis. Of the listed businesses, only water and sewerage remain as activities currently conducted by NSW councils. There are reports that one council may build and operate an abattoir. More comments on water and sewerage are provided later in the paper.

Justification for the Review

While LGNSW supports the periodic review of policies, our research and consultation cannot establish that there are compelling reasons for a major overhaul of CN as it applies to local government. Councils have not advised of any difficulties and there have been negligible complaints against council business activities since its introduction. There are none in recent years and it seems the handful of complaints that were made in earlier years, did not proceed or were not upheld. There is no apparent justification for seeking to expand the application of CN to local government based on business or community demands.

There are, however, some changes that should be made to improve the system from a local government perspective. These are presented in Section 5 of this paper.

NCP Policy

NCP is based on blind acceptance of economic theory - a belief that competitive neutrality policies are important because they create opportunities for lower prices, better quality and greater choice for customers, by supporting competition, innovation and efficiency. There may be elements of truth in this but the assumption has not been supported by any empirical evidence.

The issues paper does not question the theoretical foundation and does not attempt to identify and quantify economic benefits or provide a benefit cost analysis of the implementation of NCP and CN to NSW. This would provide a stronger and better informed basis for a review. Instead, we seem to be working on the untested assumption that NCP and CN produce net economic benefits.

The issues paper reveals that that no other comparable country other than Spain has introduced the equivalent of NCP. While they mostly have policies that deal with business competition or the lack of, including monopoly behaviour and consumer protection, they have not introduced a policy that applies to government. This indicates that the vast majority of comparable countries don't share Australia's belief in the benefits of NCP and begs the question of why Australia remains committed to the policy.

While it is beyond the scope of this review, LGNSW considers that there is a case for fundamental review of NCP at the national level to assess the merits of the policy and quantify the benefits.

3. Council Business Activities

Councils undertake few activities that would be considered business activities. Few if any are undertaken with the primary purpose of generating income although many operate on a cost recovery process.

Where councils do undertake activities that some may consider to be business activities councils are largely responding to CSOs, market failure and gaps in service availability, community needs and demands or to support regulatory responsibilities.

The relevance of NCP and CN to councils is probably less now than it was in the late 1990s and early 2000s. At that time there was a trend towards the creation of business units for different council activities, particularly outdoor operations (e.g. road construction and maintenance services), establishing funder provider splits, adopting Activity Based Costing and outsourcing core functions. This trend was often supported by misinterpretation of NCP requirements. For a short while this led to the proliferation of council determined business units with revenues over the \$2 million threshold. These practices were largely unsuccessful and the new structures were subsequently dismantled as the management fad ended.

Current council activities that are designated as businesses or are most likely to be exposed to CN complaints are discussed below.

Water & Sewerage

Local government is responsible for the provision of water and sewerage services outside the metropolitan areas serviced by the Sydney and Hunter Water State Owned Corporations (SOCs). Water and sewerage are essential public services

The services are provided by councils through entities referred to as Local Water Utilities (LWUs). Most are operated by individual councils with some services provided regionally through local government owned County Councils. There are currently 92 LWUs in NSW servicing around 2 million people and covering the vast majority of the land area of the State.

LWUs have been designated as businesses by the Australian Bureau of Statistics (ABS) regardless of size or turnover. However, water and sewerage services are in practical terms, natural monopolies. They are not in competition with other businesses in the provision of these services. While provision is made for competition under the *Water Industry Competition Act* (2006), this has largely been applied for niche services, not mainstream operations. The size and dispersal of LWU markets in regional areas tends to make them uneconomic as private investment propositions (73% of NSW LWUs have less than 10,000 connections).

LWUs are highly transparent and accountable. They are closely regulated and supported by the Department of Planning and Environment (DPE)- Water, NSW Health and the Office of Local Government (OLG). This includes adherence to CN policy. For example, LWU finances are ring fenced from council general funds under s409 of the *Local Government Act* (1993) and best practice pricing principles apply. Many of the LWUs depend on State Government grant funding for significant assets.

Given the above, it is not surprising that LGNSW is not aware of any CN complaints in relation to LWUs. There is no apparent reason to further extend CN in this functional area.

Aged Care

Many councils are involved in the delivery of a range of direct aged care services to the community as well as non-direct services to build the capacity of the aged care sector. Councils are also often the first point of contact for older members of the community, who have a strong sense of trust for council services. This is especially true in thin markets for aged care like rural areas, where country councils have a particularly strong connection with their local community. This often results in councils supporting the more vulnerable members of society and providing advice, advocacy and referral to other local services to meet community needs.

The recent Royal Commission report into Aged Care Quality and Safety called for fundamental reform of the aged care system. This included an integrated system for the long-term support and care of older people and their ongoing community engagement. This needs to include an ongoing role for local government in service provision in aged care. As with the delivery of many essential services, LGNSW believes that councils do not receive a competitive advantage over other aged care services but are part of an integrated network of the aged care service system.

Early Childhood Education and Care (ECEC)

In NSW, over 300 ECEC services are operated by local government, including pre-school, long day care, family day care, mobile care, occasional care, vacation care and outside of school hours care.

Council services cater to a high number of vulnerable families and children with disability – the types of clients often turned away from private ECEC providers. Already councils are widely valued as affordable childcare providers, offering a critical service to disadvantaged families. In rural NSW, councils are sometimes the only providers of childcare services. In an increasingly difficult economic environment, there is very real concern that some councils may be forced to withdraw from this space, leaving families without the excellent and affordable childcare services they need.

Although council run ECEC services receive Child Care Subsidy from the Commonwealth Government at the same rate as ECEC services run by other providers, unfortunately council-run ECEC services were not eligible for the full range of financial support offered to businesses and employees by the state and federal governments during the stay-at-home orders in the previous few years. If financial losses continue, councils will need to make difficult decisions as to whether early childhood education and care provision continues to be the role of local government when demands on other council services escalate during times of crisis.

LGNSW advocates that councils do not receive a competitive financial advantage in their running of ECEC services.

Rural Health

Healthcare professional shortages in rural and regional areas has been a long-standing issue for councils. The abrogation of responsibility for service delivery by State and Commonwealth Governments means councils often have no choice other than to take on additional responsibilities, such as support for medical services (premises, accommodation, subsidies) and aged care facilities. Small, widely dispersed and sometimes remote communities, can struggle to reconcile high delivery costs with a small own source revenue base.

LGNSW is of the view that councils do not receive a competitive advantage over other health businesses, but rather are providing a service where there is a gap in the provision by other spheres of government or the private sector.

Cemeteries

Local government has an essential role in interment services in NSW, providing almost half of the interments across NSW, more than any other operator category. Council operated cemeteries conduct almost 85% of the interments in regional areas outside of Sydney.

Councils operate within a pre-existing regulatory environment. Additional, duplicative regulation will increase operating costs which cannot be absorbed by councils and would eventually need to be passed to consumers via increased fees and charges.

IPART's interment costs and pricing review in 2020 found that council run cemeteries were often very reasonably priced and provide an essential community service that would otherwise not be available to residents of many communities. It also noted that a lack of competition has not led to higher prices, although other factors may have (e.g. wages).

Caravan Parks

Councils operate numerous caravan parks across NSW. These are largely Crown lands properties under the care, control and management of councils. The caravan parks are ring fenced from a council's general operations and receive no council subsidies. Any surpluses/profits made by the caravan parks must be reinvested in upgrading the caravan park or and surrounding Crown reserves. There are no transfers to council's general fund. Coastal and other caravan parks with profit potential are subject to a turnover levy, effectively a tax, paid into the Crown Reserves Improvement Fund which supports Crown lands across the state. Details are provided below:

- 5% of the annual gross income generated from the Crown caravan park and its ancillary facilities and services
- 10% of the annual rent received by the Crown land manager in association with the leasing or licensing of the Crown caravan park and/or its ancillary facilities and services

Clearly, councils do not receive direct financial benefits from the operation of Crown lands caravan parks. If anything, the financial benefits accrue to the State Government as funding to subsidise the operation and maintenance of the broader Crown reserves estate. The main benefits for councils are indirect and come from having facilities to support the growth of the local visitor economy. In many areas, the council operated caravan parks also benefit the local economy by providing accommodation for seasonal agricultural workers and more recently we have seen these parks drafted into providing emergency housing for flood and fire evacuees.

It is also important to be aware that DPE-Lands has created a new business-like entity to manage and market Crown lands caravan parks. The entity known as Reflections has assumed management of a large portfolio of Crown lands caravan parks under one brand, most of which were transferred from council management. Reflections is more commercially oriented than individual council operators and is supported by stronger marketing. It is more likely that CN issues would relate to Reflections and DPE-Lands than councils.

LGNSW is of the view that councils do not receive a competitive advantage in the operation of caravan parks over private sector operators. LGNSW also refutes any conflict of interest

arising from councils being the local planning authority. The caravan parks are ring fenced from other council operations and there is no financial incentive for councils to discriminate against private operators in planning decisions.

4. Council Awareness of CN

Feedback provided in the IPART workshops indicated a low level of awareness of NCP and CN in business, state government and local government. This seemed to raise concerns among some participants. LGNSW does not consider this to be a significant cause for concern. In the case of local government there are several potential explanations for this. These include:

- The low level of complaints means that most staff have never had cause to refer to it personally.
- Competitive Neutrality principles have been embedded into council policies, operations and reporting practices since the late 1990s and are accepted as a matter of course. (for example, the finances of Local Water Utilities are ring fenced from the council and Integrated Planning and Reporting requires councils to report on CN annually). Council staff largely comply with requirements mechanically without a need for a greater understanding of CN.
- Local government works with a higher degree of transparency and public accountability than any other sphere of government.
- The majority of council activities are not defined or assessed as businesses and therefore most council staff are not exposed and have no real reason to be aware of NCP and CN.

5. LGNSW Recommendations for Improvement

LGNSW has identified a number of ways that the application of CN to local government can be improved in NSW. These include:

LGNSW Recommendation/Requests

1. Increase the threshold for council business activities to \$10 million.

The current threshold of \$2 million was determined in the mid-1990s and is unrealistically low 25 years later. This should be brought into line with the thresholds in place in Queensland, Western Australia and the Commonwealth of \$10 million.

This would remove activities that aren't material and reduce the overall regulatory burden.

LGNSW Recommendation/Requests

2. Introduce a 10,000 connections threshold for LWUs

This would bring NSW into line with Queensland, the only other State that where local government provides water and sewerage services.

This would also remove activities that aren't material and reduce the overall regulatory burden. As previously noted, most individual LWUs are relatively small and do not compete with other businesses.

LGNSW Recommendation/Requests

3. Remove rate exemption from Forestry Corporation of NSW

While other SOCs pay council rates on operational lands as a result of NCP, Forestry Corp remains exempt.

This is an anomaly and conflicts with NCP and CN as it provides a competitive advantage to Forestry Corp over privately owned forestry operators. Councils have reported other rating anomalies relating to other SOCs including Sydney Water. These anomalies should be subject to full review.

LGNSW Recommendation/Requests

4. Improve council staff and Councillor awareness of NCP and CN.

Councils participating in the IPART workshops indicated that resources including simple guidelines, checklists and templates would increase awareness and also reduce the administrative burden.

LGNSW Recommendation/Requests

5. Reduce the Regulatory Burden

Councils widely share the view that the regulatory burden should be reduced and that no additional reporting and regulatory obligations be created as a result of the review.

6. Conclusion

LGNSW accepts that significant council business activities that have the primary objective of generating income should operate on a level playing field with private competitors. This is consistent with the current application of CN to local government.

There does not seem to be any evidence to support a case for expanding the reach of CN for local government or introducing a more rigorous compliance regime. If anything, the relevance of CN has declined for local government since the 1990s.

Councils are strongly opposed to any increase in the current regulatory burden and support an increase in the financial threshold for business significance to prevent burden creep. LGNSW has recommended that it be increased to \$10 million in line with Queensland and WA. The \$2 million threshold was set 25 years ago and at a minimum, should be escalated by inflation.

LGNSW considers the current process for processing CN complaints against local government businesses is fit for purpose and appropriate. There is no evident need to escalate or create a new process. However, LGNSW accepts that there may be a need to increase business awareness of the availability of the process. Business peak bodies could play a role in this.

For further information on this submission, please contact Shaun McBride, Chief Economist, on [REDACTED]