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National Competition Policy and Local Government

A revised statement of
Victorian Government policy

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Foreword

The *2008 National Competition Policy and Local Government Statement* sets out the Victorian Government's approach to competition policy, in particular, the implementation of competitive neutrality, in local government. Previously issued in 1996 and 2002, the *2008 Statement* restates local governments' continued obligation to comply with National Competition Policy (NCP) principles even after the discontinuation of NCP payments in 2005-06.

A simple but robust public interest test is embedded in the Victorian approach to competitive neutrality. The *2008 Statement* provides practical advice to councils on how to apply the principles of competitive neutrality while observing assessed local priorities through public consultative processes. The implementation of *Best Value* and *Community Planning* principles in recent years has enabled councils to develop useful approaches to involving communities in the assessment of public interest.

We are committed to working with councils to implement best practice and continuous improvement in the services they provide to our communities. This commitment is currently being further advanced through the on-going review of the regulatory environment for local government, particularly the Councils Reforming Business project, where the Government is working in partnership with the Municipal Association of Victoria. This project is helping councils identify opportunities to share services, improve procurement practices, and reduce their regulatory burden on business in order to enhance services, reduce red tape and drive down costs.

Richard Wynne MP
Minister for Local Government



Contents

Introduction	1
National reform objectives	1
History	1
Competitive neutrality measures	2
National Competition Policy	3
What is NCP?	3
NCP Agencies	4
Victorian local government obligations	5
Application of NCP to local government	5
Competition code/trade practices	5
Local Laws	6
Competitive neutrality	6
1. Significant businesses	7
2. Benefits greater than costs	9
3. Public interest	9
Best Value NCP Integration	12
Best Value Principles	12
Policy integration	13
Process integration	13
Complaints and administration	15
Competitive neutrality complaints	15
Local Government Compliance Statement	16
Appendix	
Appendix A - Abbreviations	17
Appendix B - Best Value Victoria – <i>A New Context</i>	18
Appendix C - Best Value, Competitive Neutrality Service Review	19
Appendix D - Competitive neutrality and tendering	20
Appendix E - Competitive neutrality policy application to aquatic and leisure centres	21
Appendix F - Useful references for councils	22



Introduction

The application of *National Competition Policy* (NCP) to local government in Victoria flows from the *Competition Principles Agreement* which was signed by the Commonwealth, State and Territory Governments in 1995. NCP is an obligation, which has been implemented in conjunction with *Best Value Principles* and community planning, to assist councils in improving procurement processes and service delivery.

National reform objectives

NCP principles require the reform of government monopolies, the separation of a government's regulatory and business functions, the removal of legislative restrictions on competition (unless there is a net public benefit), and the adoption of competitive neutrality policies and processes to recognise and offset advantages enjoyed by government businesses. These reforms are embodied in the *Competition Principles Agreement*. Australian State and Territory Governments recommitted to these principles in 2006.

Government business activities

At the outset, it is worthwhile restating the objectives of NCP and noting that it does not automatically demand greater exposure to competition, although it does require an assessment of how government conducts business activities that compete, or potentially compete, in the market.

'Competition policy is not about the pursuit of competition for its own sake. Rather, it seeks to facilitate effective competition in the interests of economic efficiency while accommodating situations where competition does not achieve economic efficiency or conflicts with other social objectives'
(National Competition Policy Report, Independent Committee of inquiry 1993, p.6).

'The Victorian Government is committed to the ongoing implementation of NCP in a considered and responsible manner. This means that public interest considerations should be taken into account explicitly in any government decisions on the implementation of NCP.'
(Competitive Neutrality Policy Victoria 2000 - Hon. John Brumby MP Treasurer).

These two statements, the latter made seven years after the former, affirm the balance required if NCP is to be applied in the public sector, and achieve its potential to reduce the costs of regulation, infrastructure and government services. These costs ultimately affect the whole community.

History

Competitive Neutrality Victoria was released in October 2002. It superseded the 1996 *Competitive Neutrality: A Statement of Victorian Government Policy*.

In accordance with legislation, councils applied '*Best Value Competitive Neutrality*' principles to all significant businesses during the five year introductory period (2000 to 2005). Beyond the introductory period, it became the responsibility of councils to comply with *Best Value* legislative requirements.

In recognition of compliance with the implementation of NCP, the Commonwealth Government made payments to each of the states and territories. The Victorian Government shared its NCP payments with local government under agreements between the state and Victorian councils.

In 2005-06, the Commonwealth Government abolished NCP payments after having made payments for 10 years. Victoria was one of the few states to receive its payments in full.

In 2006, COAG made a recommitment to the principles contained in the *Competition Principles Agreement*.

Following this COAG decision, this 2008 Statement has been prepared to ensure that Victorian councils are appropriately guided on the continuous implementation of NCP principles even after the discontinuation of NCP payments in 2006.

Victorian councils are required to submit an annual certification of compliance with NCP principles to the Executive Director of Local Government Victoria. See discussion on *Local Government Compliance Statement* on page 16.

The Victorian Competition and Efficiency Commission (VCEC) has overseen compliance with competitive neutrality policy since 2004. Publications that are relevant to competitive neutrality in Victoria are available on the VCEC's web site. www.vcec.vic.gov.au, including the *Competitive Neutrality Guide*.

Competitive neutrality measures

The competitive neutrality principle has been particularly relevant in local government. Competitive neutrality is explained in the Victorian Government's *2000 Competitive Neutrality Policy*, and the *2002 Local Government Policy Statement*. The former provides three measures for implementing competitive neutrality – corporatisation, commercialisation and full cost-reflective pricing – each of which involves a set of structural and accounting reform measures.

Corporatisation is relevant to councils that own and operate major trading businesses. These councils effect a structural separation between the business and the parent council by creating corporations that are distinct entities under Corporations Law. Some councils adopt a form of commercialisation that involves undertaking structural reform by administratively separating regulatory and business functions and creating internal business units that can include external members to provide commercial expertise.

Most councils, however, have found that the appropriate competitive neutrality measure for most of their significant business activities is the application of full cost reflective pricing. The key requirement of full cost reflective pricing is that councils should aim to recover the full costs of their business activity over the medium to long term. Full cost reflective pricing takes into account all of the costs that can be attributed to the provision of the good or service, and the cost advantages and disadvantages of ownership.



National Competition Policy

What is NCP?

The NCP is underpinned by three interrelated agreements signed by the Commonwealth and State and Territory governments in April 1995. These are:

- 1) The *Competition Principles Agreement*, which:
 - sets out the obligations for overseeing the pricing of State and Territory government business enterprises (clause 2), competitive neutrality (clause 3), structural reform of public monopolies (clause 4) and legislation review and reform (clause 5);
 - applies the reforms to local government (clause 7);
 - sets out a (non-exhaustive) list of 'public interest' factors that governments should consider when assessing the costs and benefits of a particular policy or course of action (sub-clause 1(3)); and
 - establishes arrangements for access by third parties to services provided by significant infrastructure facilities (clause 6 and Part IIIA of the *Trade Practices Act 1974* (TPA)).

The *Competition Principles Agreement* was amended by COAG on 13 April 2007.

- 2) The *Conduct Code Agreement*, which:

- commits State and Territory governments to extend the prohibitions against anti-competitive behaviour in the TPA to virtually all businesses in Australia; and
- requires each government to notify the Australian Competition and Consumer Commission when it enacts legislation that relies on section 51 of the TPA. Section 51 enables State and Territory Governments to exempt conduct from the prohibitions against anti-competitive behaviour in Part IV of the TPA.

- 3) The *Agreement to Implement the National Competition Policy and Related Reforms* (Implementation Agreement), which:

- sets out the reform obligations covering national markets in electricity and gas, water and national road transport regulations; and
- provides for payments by the Commonwealth to States and Territories where they achieve satisfactory progress with the implementation of the NCP and related reforms.

These agreements formed the foundations for the subsequent development of States' and Territories' NCP policies.

Among other things, the *Competition Principles Agreement* requires the States and Territories to publish policies on competitive neutrality (clause 3 (8)) and the application of NCP to local government (clause 7(2)). The 1996 *National Competition Policy and Local Government – A Statement of Victorian Government Policy* was Victoria's first clause 7 statement. The statement was revised in 2002, and this document is the third version.

Many of the NCP reforms – such as reviewing the stock of legislation to remove unjustifiable restrictions on competition – have been completed. The single most important principle with ongoing application to local government is competitive neutrality.

Under the *Conduct Code Agreement*, States and Territories agreed to extend the application of Part IV of the TPA dealing with restrictive trade practices to all persons – including municipal councils – within their jurisdictions. This ensures that competitive conduct rules apply equally to all market participants regardless of their ownership or legal form.

Source: National Competition Council, <http://www.ncc.gov.au/>

NCP agencies

Two new national competition bodies were established for NCP:

- The Australian Competition and Consumer Commission (ACCC)
- The National Competition Council (NCC).

The ACCC enforces the *Competition Code* (the restrictive trade practices provisions of Part IV of the TPA enacted by the States and Territories) and the TPA.

The NCC is a national advisory body whose roles included monitoring compliance with the COAG agreements and advising whether the States and Territories have satisfied the conditions for receipt of competition payments. Following the cessation of competition payments in 2005, the NCC's role has been to administer third party access provisions.



Victorian local government obligations

Application of NCP to local government

Councils are required to apply NCP reforms in three areas:

- Competition Code/ trade practices;
- Local laws; and
- Competitive neutrality.

Competition code/ trade practices

Councils undertook initial audits of trade practices in 1995-96, and subsequently developed compliance strategies. It is expected that councils are, by now, fully aware of their obligations under trade practices legislation and the severe corporate and individual penalties that can be imposed where breach is proven. However, they may still find it useful to manage their risk by conducting audits of the whole or parts of their organisation periodically. This is particularly important in view of the amendments to the TPA from time to time; for example, the repeal in 2007 of s.2D and the insertion of s.2BA as well as other, more generally applicable, changes to the Act, in particular to Part IV.¹

Areas where councils could be at risk of engaging in conduct that breaches the *Competition Code* or consumer protection provisions of the TPA include:

- Arrangements with other councils to charge agreed fees for a particular service or use of a facility that operates in competition with the market.
- Use of profits from monopoly activities to subsidise activities with the purpose or intent of damaging a competitor (predatory pricing).
- Misuse of regulatory power to damage a competitor in a market where the council is both a regulator and a supplier.
- Procedures for procurement, tendering and contracting in relation to the potential for collusion and misleading or deceptive conduct.

An awareness program is an accepted compliance strategy. The local government sector has developed trade practices compliance programs to raise awareness within council organisations of the conduct that is prohibited as anti-competitive under the *Competition Code* and to promote behaviour that complies with the Code. Councils could consider having compliance programs that encompass both councillors and staff.

Some councils may encounter specific trade practices issues from time to time as their service businesses develop. For example, where a council has concerns that a partnership proposal to develop a service business could be construed as an anti-competitive agreement, it may want to approach the ACCC for authorisation. The ACCC has power to authorise conduct, save for misuse of market power, which would otherwise offend Part IV provisions. Authorisation is subject to the public interest test provisions of the TPA. The ACCC may grant authorisation if the public benefits outweigh the anticompetitive detriment of the contract, arrangement, understanding or conduct.

In most cases, to demonstrate compliance for trade practices, a council is required:

- to have an ongoing trade practices awareness program in place;
- to have a process for dealing with any trade practices complaints; and
- to report on the outcome of any independent investigation of a complaint by the ACCC.

¹ This amendment clarifies that Part IV applies to the business activities of local government.

Local laws

Similarly, for local laws, councils have satisfied the primary NCP obligation to review existing legislation and remove or justify any restrictions on competition. The ongoing obligation for councils is to ensure that their local laws, and the policies and guidelines that inform their application (for example, in determining whether to issue a permit under a local law), do not restrict competition unless:

- a council can demonstrate that the benefits of the restriction to the community clearly outweigh the costs; and
- the objectives of the local law can only be achieved by restricting competition.

Under Schedule 8 of the *Local Government Act 1989*, councils are required to apply this 'competition test' to any new local law. However, because a non-restrictive local law can become restrictive through the manner in which it is applied, councils should continue to review their local laws, policies and guidelines from time to time.

There may be occasions when a local law will impact on competition and lead a private business operation to query the law or question the issue within a competitive neutrality context.

For example, councils can impose controls on signage. These controls can achieve visual amenity objectives or reduce barriers to pedestrian flows on footpaths. But such controls can also affect competition by making it more difficult for new firms to promote their services, or existing firms to promote new services. If only private firms are affected, this would be an issue that should be examined against the NCP tests outlined in schedule 8 of the *Local Government Act 1989*. Any complaints about such laws should be raised with the local government. If the issues are not adequately resolved, the issue can then be raised with Local Government Victoria, within the Department of Planning and Community Development. However, if a council business has fewer constraints on its signage than its competitors, and thus is at a competitive advantage, this also would become a competitive neutrality concern, and could be subject to a complaint. Again, in the first instance, the issue should be raised with the local government. If these competitive neutrality issues are not adequately resolved, the issue can then be raised with the VCEC.

Competitive neutrality

The aim of competitive neutrality policy is to account for inequalities between private businesses and government businesses that are due to public ownership when it is appropriate to do so.

"The objective of competitive neutrality policy is the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities: Government businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership. The principles only apply to the business activities of publicly owned entities, not to the non-business, non-profit activities of these entities."

Competition Principles Agreement clause 3(1)

Implementation of the Victorian competitive neutrality policy has been streamlined into three simple steps.

- 1) Councils are responsible for determining whether an activity is a significant business in the relevant market and therefore subject to the policy.
- 2) The council should then weigh up the expected benefits and costs of introducing an appropriate measure to achieve competitive neutrality.
- 3) Once a council has concluded the expected benefits of introducing the measure outweigh the costs, it should then consider whether implementation is in the public interest. Councils should conduct a public interest test to ensure that competitive neutrality policy is implemented responsibly by incorporating recognition of other public policy objectives which may be jeopardised by the competitive neutrality measure.

The competitive neutrality policy comprises rigorous financial principles with a strong public interest test and requires transparency in decision making.

1. Significant businesses

Competitive neutrality applies only to significant government businesses. However, there is no comprehensive and objective definition of a 'significant business'.²

A council must make its own two-part assessment to determine whether, in each case, an activity is:

- a business, and, if so
- a significant business.

The first part of the assessment clarifies whether an activity is a business, rather than a regulatory or governance activity. In making this distinction, councils may be assisted by an understanding of trading (business) activities gained in conducting trade practices audits. Competitive neutrality does not apply to non-business, non-profit activities.

For the purposes of competitive neutrality policy, a range of factors need to be taken into account in determining whether an activity is a business. These include whether:

- the activities of the entity result in the sale of a good or service;
- the costs of providing the goods or services by the entity are predominantly met by users;
- there is an actual or potential competitor; and
- the managers of the activity have a degree of independence in relation to the production or supply of the good or service and the price at which it is provided.

The second part of the assessment clarifies whether a business is significant. Significance is not determined by a council's expenditure or revenue on an activity relative to the council's total expenditure or revenue. Significance is relative to the market in which the service operates. Useful questions for 'significance' are:

- **Size of market share**
How many consumers are there for the services offered by the council business activity compared with those for similar privately provided services? What is the size of the council service compared with the size of the whole market? Sales figures may indicate the relative size of a council's market share. Consider the size of the relevant business activity in relation to the size of the relevant market.

- **Influence in the market**
What is the competitive impact of the council business activity in the relevant market? Is the council service a market leader or a minor player? Is the council service growing? If the council's service performance were to decline, how readily could other providers take over its market share? If it improved, would it draw new customers? Consider also, particularly where the council business is the only local or regional provider of the service, would competitors emerge if the council were to call for tenders?

Sometimes a government business will be a local monopoly. It is still the expectation that while there is no private competitor, competitive neutrality pricing should be considered to ensure that resource allocation decisions reflect a true estimate of the implicit subsidy to the activity by rate payers or the community.

² Discussion on significant business is provided in greater detail in the competitive neutrality policy and guidelines.

It is the council's responsibility to determine if their business activities fall within the scope of the competitive neutrality policy. Determination of whether or not an activity is a significant business must be made on a case-by-case basis. The assessment of 'significance' inevitably requires a degree of subjectivity and this makes it critical for a council to document the basis for its assessment. This is necessary to ensure that the determination of significance is defensible and can withstand scrutiny in the event of an investigation.

Competitive neutrality costing, pricing and subsidy

Competitive neutrality requires councils to remove or offset any net competitive advantages arising from government ownership of significant business activities. Some potential competitive advantages include:

- exemption from various taxes (e.g. land tax, pay-roll tax) council rates and charges;
- exemption from various regulatory regimes;
- explicit or implicit government guarantees on debts;
- concessional interest rates on loans or insurance;
- not being required to achieve a commercial rate of return on assets;
- effective immunity from bankruptcy;
- access to various corporate overheads free-of-charge (e.g. office accommodation, IT services); and
- being both a regulator and competing business operator for a particular activity.

The competitive advantages of public ownership arise from the savings on additional costs (or other factors affecting supply of goods or services) which would be faced by a government business if it were a private firm.

The competitive disadvantages of public ownership also need to be considered by councils. These include:

- any extra costs in meeting employment conditions required by the government;
- greater accountability costs due to public sector reporting and regulatory requirements;
- limited flexibility in reducing or restructuring corporate overheads; and
- compliance with various Commonwealth and State legislation.

The competitive neutrality measures available to offset competitive advantages include corporatisation, commercialisation and full cost reflective pricing. Further information on corporatisation and commercialisation is available in the *Competitive Neutrality Guide*.

In practice, councils rarely employ corporatisation or commercialisation. Councils should be aware that section 193 of the *Local Government Act 1989* may be invoked by a corporatisation proposal and that they may require prior approval(s) before proceeding.

Full cost-reflective pricing ('competitive neutrality pricing') is the most commonly used competitive neutrality measure. It is a process of determining the competitive neutrality adjusted cost of undertaking an activity and applying a pricing structure that reflects the full cost apportioned to the business activity of the council activity only. Over the medium to long term, councils are expected to recover competitive neutrality costs for the business. Usually, appropriate market-based, pricing policies are required to recover competitive neutrality costs. Abnormally high competitive neutrality pricing (relative to market price) could be indicative of inefficient resource use.

Should a council not price the output of a significant business to recover costs including net competitive neutrality adjustments, it is subsidising an activity. A subsidy must be made transparent and the community resources it consumes need to be justified in public policy terms.

Should the use of the competitive neutrality measure conflict with some other policy objective, then the council may subsidise the difference between the full cost-reflective price and actual price paid by the consumer. The subsidy should be justified by the council priorities, reflected through its public policy commitment, to provide a section of the community with a service or access to a facility that would otherwise not be serviced. However, some public policy objectives may be achieved through subsidies in terms of specific cost elements of the business.

The competitive neutrality guidelines anticipate that councils will use the fully distributed cost method for competitive neutrality pricing in nearly all instances. Fully distributed cost takes into account all direct and indirect costs and competitively neutral adjustments. Direct costs include wages and other direct cost of inputs. Indirect costs, or overheads, are costs that might be split between the commercial and non-commercial outputs which may include human relations services, information technology services and administration. The avoidable cost method is appropriate only where a council can demonstrate that the majority of its indirect costs (overheads) remain unaffected by the activity in question. Under avoidable cost a council need only consider the extra (direct) costs that it could avoid, plus competitive neutrality adjustments.

The operation of an aquatic centre provides an example of when a council may use the avoidable cost allocation methodology. A council swimming pool may be partly used to provide “learn-to-swim” programs but is mainly used for recreational community use. Only the “learn-to-swim” programs are subject to competitive neutrality. The avoidable cost allocation methodology can be applied if the council can demonstrate that a significant proportion of the pool’s use is non-commercial. Further information is in Appendix E.

A Cost Allocation Methodology guidance note can be found on the VCEC website, www.vcec.vic.gov.au

2. Benefits greater than costs

NCP reforms apply when the costs of implementing the competitive neutrality measure do not outweigh the benefits of its introduction. Competitive neutrality principles need only be implemented to the extent that expected benefits outweigh the costs of implementation. Further information on the assessment of benefits and costs of introducing a competitive neutrality measure is given in *Competitive Neutrality Guide*, p. 4.

3. Public interest

The *Competition Principles Agreement* recognises the existence of competing public policy objectives and allows for the consideration of a range of matters to determine how best to achieve particular policy objectives, these include:

- government legislation and policies relating to ecologically sustainable development;
- social welfare and equity considerations, including community service obligations;
- government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity;
- economic and regional development and investment growth;
- the interests of consumers generally, or of a class of consumers;
- the competitiveness of Australian businesses; and
- the efficient allocation of resources.

Competition Principles Agreement, Clause 1(3).

This list is not exhaustive; nor does it imply any priority or weighting. Other matters that may be relevant for local government include:

- local or regional policies relating to economic or business development;
- employment, quality of goods and services, timeliness of supply;
- impact on the local or regional community; and
- impact on the State and national economies, if any.

Competitive neutrality is not intended to override the public policy objectives of a council. Public policy objectives reflect the public interest of a council’s community and may be social, environmental, economic or regional in nature. Each council decides its own public policy goals, bearing in mind State and Commonwealth policies. The Best Value context (explained in chapter 4) in which councils operate provides an opportunity to reassess and restate public policy objectives through an open and transparent public consultation process.

A council needs to ensure that it has identified and documented its public policy objectives, which may be specific for each significant business. Where there is a potential conflict between the application of competitive neutrality and other public policy objectives, competitive neutrality policy mandates a public interest test process. The public interest test involves appropriate public consultation in relation to a range of costed options that council may propose to the relevant stakeholders. The process needs to be open and transparent to ensure that council is able to justify any anti-competitive arrangements, and demonstrate that it delivers net benefits to the community.

If a council believes that applying competitive neutrality measures could jeopardise the achievement of its policy objectives, it will need to conduct, and document, a 'public interest test.' To satisfy the formal requirements of the competitive neutrality policy, the test should at a minimum:

- clearly identify the policy objective(s) that is to be achieved and ensure that the policy objective(s) has official council endorsement;
- demonstrate that the achievement of identified policy objective(s) would be jeopardised if the particular competitive neutrality measure under consideration was implemented; and
- determine the best available means of achieving the overall policy objectives, including an assessment of alternative approaches.

The 'public interest test' should be undertaken in consultation with the community through an open and transparent process. At the conclusion of the process, the conduct and outcomes of the public interest test should be documented and made publicly available subject to commercial confidentiality. Information that is commercial-in-confidence may be excluded, provided this is noted in the public documentation.

As a result of the public interest process, the council will determine the best option for addressing all objectives, including competitive neutrality policy. If the outcome of the test finds that the public policy objectives are compromised by the application of competitive neutrality measures, the council need not apply competitive neutrality measures.

This constitutes application of competitive neutrality policy regardless of the extent to which competitive neutrality pricing is applied.

A council's Best Value Program can assist in the public interest test process by integrating the Best Value Principles with those of competitive neutrality. The Best Value Principles are discussed in the Section 4 below. Councils should refer to the *Best Value Principles* and the *Competition Principles Agreement* in reassessing the public interest and policy objectives for their activities.

The table on page 11 highlights the key points local governments need to consider when implementing competitive neutrality.

A council will demonstrate that it is compliant with competitive neutrality by:

- documenting its decisions identifying 'significant business activities'; and
- documenting whether the benefits of applying competitive neutrality to a significant business outweigh the costs.

Where there is a net benefit, but the council believes other public policy objectives would be jeopardised by applying competitive neutrality, council must conduct a public interest test which will:

- identify public policy objectives for the business;
- demonstrate that the achievement of the stated objective would be jeopardised if the particular competitive neutrality measure under consideration was implemented;
- assess the best available means of achieving the overall policy objectives, including an assessment of alternative approaches to achieve the policy objectives;
- conduct public consultation exploring options to determine whether the application of competitive neutrality is in the public interest. Consultation should include key stakeholders, competitors and/or the public. There are different opportunity costs associated with the various options;
- document the conduct and outcomes of the public interest test; and
- make the documentation publicly available, subject to commercial confidentiality, but noting that a statement specifying the claim to confidentiality is noted in the public documentation.



Best Value NCP Integration

Best Value Principles

Increasingly, the *Best Value Principles* will be reflected in councils' vision and mission statements, corporate planning processes, governance, services to the community, facilities, capital works and grants made to other bodies. Key public policy objectives in the *Best Value Principles* are:

- performance in accordance with quality and cost standards;
- responsiveness to community needs;
- accessibility to members of the community for whom services are intended;
- continuous improvement in the provision of services;
- regular consultation on services provided to the community; and
- regular reporting on achievements in relation to the Best Value Principles.

Factors informing the application of the *Best Value Principles*, listed in section 208C of the *Local Government Act 1989* (see Appendix B), further expand the potential range of councils' public policy objectives.

The principles were introduced in the December 1999 amendment to the *Local Government Act 1989*:

- all services must meet the quality and cost standards developed by the council (sections 208B(a) and 208(D)(1));
- all services must be responsive to the needs of its community (section 208B(b)),
- each service must be accessible to those members of the community for whom it is intended (section 208B(c));
- a council must achieve continuous improvement in the provision of services for its community (section 208B(d));
- a council must develop a program of regular consultation with its community in relation to the services it provides (section 208B(e)); and
- a council must report regularly to its community on its achievements in relation to the principles (section 208B(f)).

In developing quality and cost standards for services to the community, councils must take account of five factors set out in section 208C:

- the need to review services against the best on offer in both the public and private sectors;
- an assessment of value for money;
- community expectations and values;
- the balance of affordability and accessibility of services to the community; and
- opportunities for the growth or retention of local employment.

In their application of the *Best Value Principles*, councils may take into account other factors. Two of these are listed in section 208C:

- the value of potential partnerships with other councils and State and Commonwealth Governments, and
- potential environmental advantages.

Policy integration

Best Value Victoria and Competitive Neutrality Policy Victoria 2000 both redirect local government's focus to the community and serving the public interest. Economic efficiency remains vital to the proper accountability for community assets.

Both the competitive neutrality policy and Best Value Principles help shape the public policy objectives of local government and consequently provide the framework for the conduct of the public interest test. They direct a council to its relationship with the community – in setting quality and cost standards for all services; responding to community needs; providing accessible and appropriate targeted services; consulting regularly with the community; and reporting frequently to the community. (A description of the Best Value Principles and a statement on the Government's objectives in introducing Best Value Victoria can be found in Appendix B.)

Best Value standards for services that are not provided by significant businesses may be improved by the application of competitive neutrality costing, at the discretion of a council. Councils should note that the application of competitive neutrality costing to services could enhance the accuracy of their Best Value reviews. This applies both to the comparison of council services 'against the best on offer in both the public and private sectors' and in relation to the assessment of 'value for money in service delivery' (section 208C(a) and (b) *Local Government Act 1989*).

A council has a variety of mechanisms available to it in making these assessments: for example, benchmarking, process mapping, innovative management methods and market testing. If its market testing involves public tendering, a council must apply competitive neutrality pricing to an in-house tender and must make any council subsidy available equally to in-house and external tenderers.

As a council continues its Best Value Program, it should consider its review of services within the context of competitive neutrality, the impact of competitive neutrality on its public policy objectives and priorities, and the need to integrate Best Value Principles with competitive neutrality in conducting its public interest test.

Competitive neutrality provides an avenue for councils to effect shifts in community priorities over time. Focusing on removal of subsidies may facilitate achievement of new services and programs.

Should a council believe that the continuation of a competitive neutrality measure may conflict with a public policy objective, it will conduct a public interest test and consult with the community. At the same time, the council may wish to consult on Best Value quality and cost standards for the service provided by the significant business. That is, the council will apply competitive neutrality in a Best Value context.

Process integration

There is no need for Best Value and competitive neutrality processes to be conducted separately; in fact, there are considerable benefits to be gained by integrating these processes. For example, a council may engage in consultation with the community for Best Value review and competitive neutrality public interest purposes at the same time, avoiding duplication of these processes.

Each council will determine how best to integrate its processes for implementing the two policies. The following table demonstrates how processes might be streamlined using an integrated series of seven questions based on the key steps in each policy framework.

Implementing competitive neutrality in a Best Value Victoria context

1. What is the council service , as defined for Best Value Review purposes?	
Key Questions	Other Considerations
2. Is the service, or any part of it, operated as a business , or, is it an internal service supporting only regulatory or governance functions of the council?	Even if a service is not operating as a business, consider applying competitive neutrality costing to ensure 'like with like' comparison when applying the Best Value review factors (s.208C).
3. What market does the business operate in?	The market may have changed since the council first started providing the service. A market previously lacking providers may now be well supplied and a council's priorities for resource allocation may need to be reconsidered.
4. Is it a significant business in that market?	Even if a service is not operating as a significant business, consider applying competitive neutrality costing to ensure 'like with like' comparison when applying the Best Value review factors (s.208C).
5. What competitive neutrality measure is appropriate to the significant business?	Full cost-reflective pricing is likely to be the appropriate measure to ensure that the business is fully recovering costs. This will be useful when considering service delivery options under Best Value (s.208C).
6. Will the benefits of the competitive neutrality measure outweigh the costs ?	The assessment of benefits and costs should include the opportunity costs of addressing other priorities.
7. Could the competitive neutrality measure compromise the achievement of other policy objectives? Is it in the public interest ?	Best Value service reviews require consultation with the community, as does the competitive neutrality public interest test. The two consultation processes could be held together.



Complaints and administration

Competitive neutrality complaints

It is the responsibility of a council to:

- identify the activities to which competitive neutrality applies;
- take the necessary action to comply; and
- document the decisions it has made and, make the material available to the public and the Competitive Neutrality Unit on request.

Under the *Competition Principles Agreement*, the Government is obliged to investigate complaints regarding councils' adherence to competitive neutrality. To assist in undertaking this function, the Government created the Competitive Neutrality Unit (CNU) (located in the Victorian Competition and Efficiency Commission).

The CNU operates on the assumption of compliance rather than non-compliance in determining the extent to which a council's actions comply or do not comply with competitive neutrality policy. There are a number of important procedural and administrative features of the complaints mechanism. The CNU:

- accepts complaints from a directly affected person or business, as well as from industry or community groups. Complaints are assessed in accordance with *Competitive Neutrality Policy Victoria 2000*. When a complaint is received, the first response of the CNU is to encourage direct resolution between the council and the complainant, failing this, the CNU will seek verification from the council as to its compliance with the competitive neutrality policy;
- cannot initiate an investigation. A complainant must lodge a formal complaint pro forma prior to the CNU instigating an investigation;
- will abide by principles of procedural fairness and will investigate all complaints fairly, independently and rigorously and will come to a finding on the basis of the best available information. Where the CNU recommends a course of action which a council should take to comply with the competitive neutrality policy, it will request further information to follow-up on how compliance with the competitive neutrality policy has been achieved;
- will consult with, and seek comments from, all parties involved before finalising its investigation. Final investigation reports – excluding any commercial in-confidence information – are provided directly to the parties and published on the VCEC web site;
- has no enforcement power; and
- does not recommend any compensation or termination of contractual arrangements.

The CNU does not assess anti-competitive behaviour that is already covered by the TPA or the *Competition Policy Reform (Victoria) Act 1995*, nor does it deal with probity issues arising from tendering processes of councils.

The protocols for the conduct of a competitive neutrality investigation are fully documented on the VCEC web site at www.vcec.vic.gov.au

The contact details for the VCEC are as follows:

Executive Director
Victorian Competition
& Efficiency Commission
GPO Box 4379
Melbourne VIC 3001
Australia

Tel: (03) 9092 5828
Fax: (03) 9092 5845
Email: cn@vcec.vic.gov.au

In line with the Treasurer's role as the Minister responsible for NCP, Department of Treasury and Finance has the broader responsibility for ensuring overall compliance with the NCP.

Local Government Compliance Statement

Councils are required to complete an annual statement of compliance with the requirements of NCP prepared in accordance with reporting guidelines issued by Local Government Victoria.

In the statement, a council is asked to certify:

- whether it is compliant or non-compliant with respect to the requirements of trade practices legislation;
- whether it has applied the competition test to all new local laws made during the reporting period; and
- whether it has applied competitive neutrality measures to all significant businesses and, if not, provide justification for this or cite actions to redress the situation.

Councils are asked to either include a copy of this statement in their Annual Report or, if that is not possible, to provide a copy to the Executive Director of Local Government Victoria.



Appendix A

Abbreviations

ACCC	Australian Competition and Consumer Commission
CNU	Competitive Neutrality Unit
COAG	Council of Australian Governments
CPA	Competition Principles Agreement
NCP	National Competition Policy
TPA	<i>Trade Practices Act 1974</i>
VCEC	Victorian Competition and Efficiency Commission



Appendix B

Best Value Victoria – A New Context

History

In December 2000, the Minister for Local Government published a framework to further assist councils in implementing Best Value Victoria. The framework addresses how the legislated Best Value Principles should be interpreted and applied to achieve the government's objectives. The framework makes it clear that Best Value Victoria is an operating environment which is part of the culture of local government, building upon and contributing to good governance. The framework confirms the breadth of application for the Best Value Principles – to all services a council delivers, irrespective of how they are delivered and who funds the service. It also establishes the areas of discretion available to a council in making detailed decisions about the appropriate application of Best Value Victoria for its own community.

Best Value Victoria objectives

Unlike the system of Compulsory Competitive Tendering that it replaced, Best Value Victoria is focused on meeting the needs of the community. It applies to all council services, whether provided by council staff, volunteers or contractors.

Councils implemented Best Value Victoria by reviewing their services and applying the Best Value Principles to them.

In detail, the Government's objectives in introducing the Best Value Principles are:

a. Local accountability

To make councils accountable to their own communities for the provision of services and the performance of the organisation.

b. Whole-of-organisation response

That a council's implementation of the Best Value Principles be a whole-of-organisation response applied through its corporate planning responsibilities, including all its services and functions.

c. Benefits not costs

The benefits of councils applying the Best Value framework should outweigh the costs.

Councils benefit through improved efficiencies. Councils are discovering connections between Best Value and Council plans, Community Plans and other State or Commonwealth required strategies.

In addition, the Best Value Commission has reported councils incorporating Best Value Principles into the Australian Business Excellence Framework or their Business planning processes in order to assist in the identification of opportunities to improve service delivery and whole-

of-organisational performance.

d. Consultation on performance

Facilitate the setting of objectives and targets by councils, following community consultation, and demonstrating accountability by measuring and reporting on its performance to its community.

For councils to consider community consultation as being part of their culture.

e. Best Value outcomes

Best Value is a framework aimed at enhancing services and organisational performance across local government and enabling the sector to demonstrate to the State Government that it has achieved these objectives.

The efforts of the Best Value Commission have seen the identification of links between sound business practices and continuous improvement.

Best Value is now considered by councils to be an important element of their management approach and governance framework.

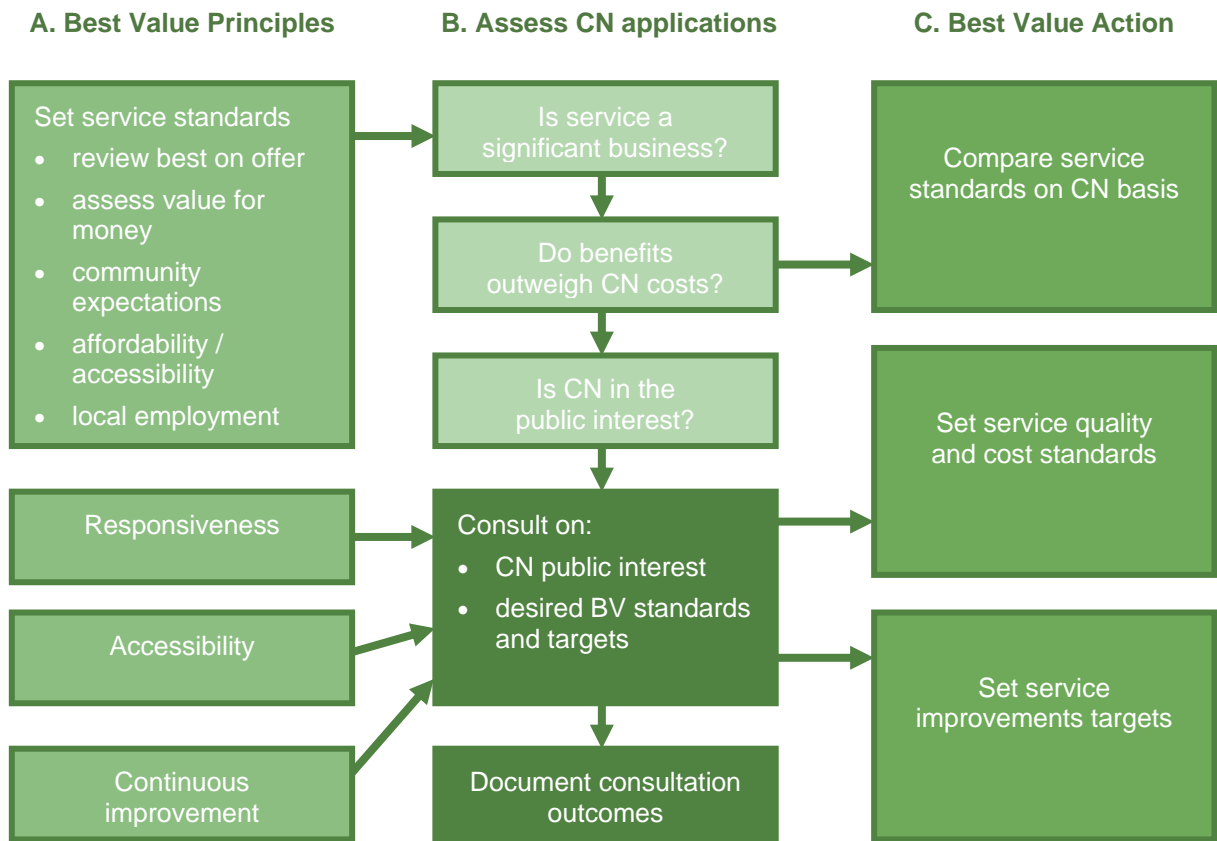
f. Encouraging innovation

To encourage councils to adopt innovative and creative responses to service delivery, including a range of partnering relationships.



Appendix C

Best Value, Competitive Neutrality Service Review





Appendix D

Competitive neutrality and tendering

Competitive neutrality and competitive tendering are distinct mechanisms. Competitive neutrality does not require tendering. However, when councils use internal or external tenders to provide services, they should apply competitive neutrality to those tenders as a matter of good tendering practice.

Staff bids should be fully costed, including overheads and a rate of return, and be adjusted for taxes comparable with those incurred by private sector tenderers. Cost adjustments, both positive and negative, should be made to ensure full cost reflective pricing is applied to offset any net competitive advantages that a government business may enjoy as a result of its public sector status. The adjustments are necessary to ensure that all tenderers are assessed on an equitable basis.

A council often has a choice between providing a service in-house or contracting it out. Where the service has been previously out-sourced, a council may choose to bring the service back in-house at the end of the contract period. To determine whether or not to in-source the service, the council may choose to seek public tenders and prepare an in-house bid. Alternatively, it may decide to bring the service back in-house without market testing.

Where a council chooses to seek public tenders and submits an in-house bid, it must apply competitive neutrality pricing to its own bid. It must also make any council subsidy of the service equally available to both in-house and external tenderers.

It is good practice to apply competitive neutrality pricing principles to estimate a council's costs when considering whether the service should be provided in-house or not. However, this is not mandatory.

If a council decides to in-source a service that is not operated as a business activity, such as a regulatory function or other activities that do not directly compete with private businesses (such as garbage collection), it is not necessary to undertake competitive neutrality costing exercises on an on-going basis.



Appendix E

Competitive neutrality policy application to aquatic and leisure centres

In July 2003 the Treasurer approved an amendment to the *Competitive Neutrality Policy, Application of Competitive Neutrality policy to council owned aquatic and leisure centres*. A summary of the policy amendment is provided here. The full text is available on the VCEC website: www.vcec.vic.gov.au

Pre-2003 interpretation of competitive neutrality policy application to council owned aquatic leisure centres

The range of facilities and programs offered by different council centres vary but centres generally include aerobic and gym facilities and programs, aquatic facilities for learn to swim programs and recreational swim use, and spa and sauna facilities. Centres might also include a café, a crèche and a sporting merchandise shop. Councils were required to apply a full cost reflective pricing structure inclusive of all costs and net competitive neutrality cost adjustments for all activities and programs available at such centres.

Prior to the introduction of the 2003 competitive neutrality policy amendment, the whole of a council owned aquatic leisure centre was considered a significant business activity subject to the competitive neutrality policy.

The large capital investment in aquatic leisure centres meant that councils had to include a large competitive neutrality cost adjustment for the cost of capital. Councils were required to recover this adjustment from users via a full cost reflective pricing structure to comply with competitive neutrality policy. A large part of the cost of capital was attributable to the aquatic component of a centre.

Competitive Neutrality policy amendment

The amendment to competitive neutrality policy distinguished between two broad aquatic based activities: learn-to-swim programs and recreational activities (recreational swimming, wave pool). Aquatic recreation activities are now regarded as non-commercial activities, while learn-to-swim programs are regarded as commercial, business activities. The aquatic recreation activities are not subject to competitive neutrality. This position was consistent with the position regarding council owned outdoor swimming pools, which councils have traditionally subsidised. Other facilities, such as aerobic, gym and sauna facilities continue to be regarded as commercial, business activities for competitive neutrality purposes.

To apply the competitive neutrality policy amendment, councils are still required to calculate a net competitive neutrality cost adjustment attributable to the aquatic component of the centre and then apportion the cost adjustment between the learn-to-swim program (business) and community recreation (non-business) components. Councils then can determine a full cost reflective pricing structure that excludes competitive neutrality cost adjustments attributable to the aquatic recreational activity.

The outcome of the policy amendment is that councils are now able to determine and apply a full cost reflective pricing structure to the business activities of aquatic leisure centres. Should a council still not be able to apply a full cost reflective pricing structure, it will then be required to calculate the competitive neutrality adjusted subsidy and conduct a public interest test to comply with the competitive neutrality policy.



Appendix F

Useful references for councils

Best Value Victoria – a Guide

Department of Infrastructure, December 2000.

Competitive Neutrality Policy Victoria 2000

Department of Treasury and Finance, October 2000.

Competitive Neutrality Guide to Implementation Victoria 2000

Department of Treasury and Finance, October 2000.

Competition Policy – a Guide

Department of Premier and Cabinet, 1996

This document sets out the full text of all three 1995 COAG agreements on which NCP was founded.

National Competition Council web site

<http://www.ncc.gov.au>

This site is a useful general reference on competition policy documentation, including the NCP agreements. It also contains the NCC's reports on its assessment of state and local government NCP compliance.

Victorian National Competition Policy web site

<http://www.dtf.vic.gov.au/CA25713E0002EF43/pages/economic-and-financial-policy-national-competition-policy>

Victorian Competition and Efficiency Commission web site

<http://www.vcec.vic.gov.au>

Amendment To Competitive Neutrality Policy

- Application of competitive neutrality Policy to Council Owned Aquatic and Leisure Centres, July 2003 – accessed at:

[http://www.vcec.vic.gov.au/CA256EAF001C7B21/WebObj/competitiveneutralityAquatic/\\$File/competitiveneutrality%20Aquatic.pdf](http://www.vcec.vic.gov.au/CA256EAF001C7B21/WebObj/competitiveneutralityAquatic/$File/competitiveneutrality%20Aquatic.pdf)

Department of Planning and Community Development

National Competition Policy and Local Government policy statement – January 2002

Local Government Best Value Commission Annual Report