



**COMMONWEALTH GRANTS COMMISSION**

**DISCUSSION PAPER CGC 2000/6**

**IMPACT OF CHANGES IN PUBLIC  
ADMINISTRATION**

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## **SYNOPSIS**

This paper provides a summary of the results of research undertaken by the Commission on prospective major changes in public administration and whether they can, or will, be adequately taken into account by current assessment methods.

The major changes continue to stem from micro-economic reform (MER), National Competition Policy (NCP) and technological advances.

We remain of the view that the assessment framework used in the Concessions and Other Payments (COP) and the Contributions by Trading Enterprises categories is an appropriate way to deal with the effects of NCP on public trading enterprises services and contributions to the budget. Individual category assessments for the COP categories and for some common factors will need to be re-considered as part of the 2004 Review.

Other changes associated with MER, such as outsourcing and regulation, and with technological advancement are likely to affect many categories and factors. However, they will have different impacts which we believe are best handled on an individual category or factor basis. We also note that many categories or factors will require only limited change as the calculations of standards and disabilities automatically pick up the required changes through the use of regularly updated data in updates and the re-estimation of cost parameters in reviews. The current assessment methods appear robust enough to handle many changes. Again, any required changes can be dealt with as part of the normal processes associated with the 2004 Review.

## **AIM**

1. This project identifies the changes taking place in public administration and attempts to assess their impact on the assessments of States' needs. It describes how such changes were dealt with in the 1999 Review and considers what systematic changes to assessment methods might be desirable for the 2004 Review.

## **BACKGROUND**

2. Some impacts of changes in public administration were considered in the 1999 Review. Specifically, these included MER (particularly NCP), and the more widespread use of computer technology. Some States argued that the latter changes enabled all States to provide services more efficiently and should therefore result in a reduction in expenditure and in assessed disabilities, particularly scale and dispersion.

3. As a result of the impacts of MER, the Commission took two threshold decisions.

- (i) It created a new group of expenditure categories called Concessions and Other Payments (COP)<sup>1</sup>. This included expenditure on subsidies or payments of community service obligations (CSOs) towards the costs of services previously provided by public trading enterprises (PTEs). The assessments were undertaken on this basis because States were no longer directly providing the PTE services and were making subsidies to public and private providers, including CSOs, clearly identifiable.
- (ii) It abandoned the assessment of differential needs for contributions to State budgets by trading enterprises, arguing that:
  - if costs and needs were appropriately recognised on the expenditure side of the budget, all PTEs would have the same capacity (as a proportion of investment) to contribute to revenue; and
  - differences in investment in PTEs were the result of policy differences between the States.

4. No direct changes in assessment methods were made for the impacts of privatisation, outsourcing and technology as these impacts were assumed to be largely taken into account by using updated data, especially financial data. The Commission rejected the argument that some States were disadvantaged because of a lower capacity to privatise as it did not see the sale of capital assets as relevant to the assessments. It also rejected the views of some States that increased technology necessarily reduced disabilities because it allowed all States to provide services more efficiently and at lower cost. The Commission's view was that the greater use of technology was as much about enhancing service provision (particularly to rural and remote areas) as about reducing costs.

5. At a conceptual level, the assessment methods handle changes in public administration, such as the above, in two ways.

- (i) Through the revenue or expenditure standard to which disability factors are applied. For example, a reduction in States' expenditure due to changes in technology will reduce the national per capita average expenditure (the standard), which will in turn reduce the needs associated with that expenditure function.
- (ii) Through the disability factors applied to the standard. Disability factors measure influences beyond the States' control that affect their relative costs of providing services or capacity to raise revenue. The recalculation of the cost, demand and capacity relationships used in disability factors, based on access to the most recent data, captures changes in these.

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<sup>1</sup> The six categories in the group are Electricity and Gas, Water Supply and Sewerage, Freight, Non-urban Passenger Transport, Other Trading Enterprises and Other Concessions.

6. Nevertheless, some States still question whether the Commission's methods adequately respond to the rapid and widespread changes taking place in the provision of government services, and the Commission recognised the need to address those concerns. As a result, Discussion Paper CGC 99/2, *The 2004 Review Proposed Work Program*, listed 'Impact of Changes in Public Administration' as a priority issue.

### **MAIN CHANGES IN PUBLIC ADMINISTRATION**

7. The changes that have been considered in preparing this paper include:

- (i) the further implementation of NCP;
- (ii) increased privatisation or corporatisation of public trading enterprises;
- (iii) the creation of larger or separate government regulation authorities;
- (iv) further use of outsourcing and contracting out;
- (v) greater use of purchaser/provider arrangements;
- (vi) further changes in technology;
- (vii) the widespread use of accrual accounting;
- (viii) the introduction of the GST and the associated tax reform and other issues; and
- (ix) increased emphasis on the provision of services to rural areas.

8. We concluded that those most likely to have a continuing impact on our assessments were:

- (i) MER – mainly NCP, privatisation, corporatisation, outsourcing and regulation costs;
- (ii) technological advances – including their impact on regional and rural areas; and
- (iii) tax reform and associated matters.

As the changes resulting from the GST arrangements are being introduced into the assessments in updates, this paper concentrates on the first two broad groups.

## MICRO-ECONOMIC REFORM

9. For State governments, MER and NCP means opening up government service provision to competition through:

- (i) corporatising, privatising or outsourcing of government activities;
- (ii) separating service provision and regulatory functions so that each is provided by a different entity;
- (iii) making CSOs and the associated payments for them transparent; and
- (iv) ensuring that government business activities have the same elements in their cost structures as does the private sector, including the imposition of tax regimes and private sector like fees to pay for reduced risk.

### *National Competition Policy*

10. Since NCP was introduced in 1995, all States have made significant progress in implementing the associated reforms. All States have now received full payments for the first part of their second tranche NCP payments from the National Competition Council.

11. While NCP/MER have changed States' revenue capacities and expenditure levels, these changes are reflected in the revenue and expenditure standards. The decisions the Commission makes on whether differential assessments are required pick up where revenue raising capacity or cost savings are accruing differentially between the States.

12. For example, the approach the Commission introduced in the 1999 Review for the assessment of needs relating to services provided by and revenues received from PTEs seems well suited to capturing the further changes States are making to the financial interactions between their budgets and their trading enterprises. More PTEs have been privatised or corporatised and State budgets are more clearly identifying CSO payments to them, including CSO payments to allow the enterprises to provide a rate of return to the budget through dividends. Standard tax equivalent regimes and private sector-like charges for debt, use of capital and so on have been introduced.

13. There does not seem to be any evidence that a change should be made to the equal per capita (EPC) assessments introduced for the revenue categories Contributions by Trading Enterprises, provided disabilities are adequately assessed for the COP categories.

14. For the COP categories, there is some evidence already that the assessments will need review in 2004. The 1999 Review assessments largely recognised cost disadvantages arising from differential numbers of people for whom a CSO was paid. The payments could be either socio-economic based (subsidies for pensioners) or location based (subsidies to people in rural areas). A cost disability was also assessed in the Water Supply and Sewerage category for differences in costs faced by States in supplying water because of their different physical environments.

15. There is growing evidence that States are providing CSOs for reasons other than socio-demographic or locational based disadvantages. States are also providing CSOs to compensate for cost differences in overcoming environmental problems, to enable enterprises to provide a standard rate of return to the government or simply to fund the enterprise's deficit. If these become standard policies and there are differences in the cost structures faced by States in operating at these standard policies, further consideration of the assessments may be required.

16. Similarly, a review of common disability factors recognised across the assessments will ensure that appropriate changes are made in the cost and demand differentials they capture. For example, the electricity input cost factor may need to be reviewed as further changes take place in the electricity market as a result of NCP implementation.

### ***Outsourcing***

17. In the process of implementing MER/NCP reforms, it is evident that all State governments are outsourcing service provision. Outsourcing is expected to reduce costs by introducing competition. Governments can use these efficiency gains to reduce costs or increase levels of service. There is also some evidence that not all outsourcing is leading to cost reductions. However, whatever the Australia-wide impact of these changes (more or less expenditure), they will be captured by changes in expenditure standards. No disabilities will be calculated for differential needs in the level of outsourcing available to States unless evidence can be produced to show that the States have different capacities and that these different capacities impact differentially on costs.

18. This issue will arise as a matter of course during the 2004 Review when the basis and means of calculating disability factors is reconsidered. At this stage, the Commission does not see this as a big issue and we do not propose to change any expenditure category or factor assessments to account for differences in levels of outsourcing.

19. There have also been arguments that differences in the levels of outsourcing undertaken by States have had an influence on their revenue raising capacities because there is more activity in the private sector and therefore more capacity to raise payroll tax, land tax, etc. While the Commission sees some merit in this argument, it believes that the size of any adjustment would be too uncertain or small to justify. To the extent that the privatisation has or has not occurred in the PTE sector, there should be no impact on assessments because MER/NCP should ensure that these enterprises will be treated the same whether they are privatised or remain corporatised within the government sector.

20. The only differential impact due to outsourcing that might need to be taken into account because of its impact on revenue bases would be if there are large differences in the level of outsourcing in the general government sector. At this stage, the Commission does not think any differences in this area are worth further examination.

## ***Regulation***

21. One effect of the NCP reforms is the increase in State expenditure on regulation. This is because many of the newly corporatised enterprises have had their regulatory functions removed because it is inappropriate to give regulatory functions to private enterprises involved in providing the service. Again, the change is captured by changes in the standard of the relevant category — Regulatory and Other Services. The application of appropriately measured disability factors, such as scale, to changes in the standard automatically recognises any increase or decrease in States' relative needs for this expenditure. The overall impact of such changes on grant shares is expected to be small.

## ***Conclusions***

22. We have concluded that the changes resulting from MER and NCP will not require further major systematic changes in Commission assessments. There is scope for a review of the particular assessment methods used in the COP categories and for some common factors. However, it seems that the issues raised will be best considered during the 2004 Review on a case-by-case basis within individual assessments.

## **TECHNOLOGY**

23. For the 2004 Review, we want to ensure that methods of assessing States' expenditure needs are able to adequately respond to the impact of changes in technology on cost structures and disabilities.

24. Our research suggests that these changes are unlikely to affect States' expenditure patterns or revenue capacities in a way that will require major changes in assessments across a number of categories. We think that any changes to improve existing methods are best handled on a category or factor basis and that, in most cases, only refinements to existing methods will be required.

25. It is likely that individual category assessments will require change as service providers and tax collectors make use of new technologies in ways most appropriate for them. For example, education service providers are making changes in the way distance and remote education services are provided. Thus, the increasing cost of communications (internet use), particularly in rural and remote areas, could be an issue in the Schools assessments. In health services, tele-health is developing apace and may have wide ranging implications for service delivery costs in the health assessments.

26. We will also need to consider whether technological changes should change the way some factors are assessed. For example, the rapid expansion of the internet might require a separate assessment of its costs within the dispersion factor. The telephone cost weight now covers all telecommunications costs and assumes identical cost differentials for both telephone and data services. It may be necessary to have separate internet and telephone cost components.

27. It is unlikely that major changes will be required to the administrative scale factor. It reflects the need for some States to spend more per capita than others to provide the basic structure of government (head office services and State-wide service such as the Treasury function). It was assessed using estimates of the proportion of expenditure for each function affected by administrative scale related disabilities. If technology changes mean that these costs are reduced, then using revised data reflecting this reduction will automatically capture the impact of technology on the disability.

28. Some change may be needed to the service delivery scale factor which is designed to reflect the diseconomies of small scale associated with smaller service delivery units (such as small police stations and schools). However, this will depend on data availability. The factor is currently calculated using information on staffing levels by service delivery unit. It does not capture the differential costs that might exist because it is more expensive to operate satellite dishes, the internet and computer hardware in small service delivery outlets. Thus, unless States can provide data on non-salary costs by location, changes in this disability factor will only reflect the effect of technological advances on staff.

29. Again, the analysis to date suggests that the effects of technological change on different services and on different disabilities are probably best handled on a category by category or factor by factor basis. It seems to us that this is best done as part of the normal 2004 Review processes.

## CONCLUSIONS

30. Our research suggests that the threshold decisions taken and methods adopted by the Commission during the 1999 Review will take account of the more important future changes in public administration. We think that any changes to improve existing methods will be refinements that can be addressed through the normal review process.

31. Although this topic was listed in the 2004 Review Work Program as a subject to be discussed at a conference in June 2001, the Commission no longer thinks that necessary. Unless States indicate otherwise, the matters raised in this paper will not be covered as priority issues.