



Government of **Western Australia**
Department of **Treasury**

Operating Subsidy Guidelines

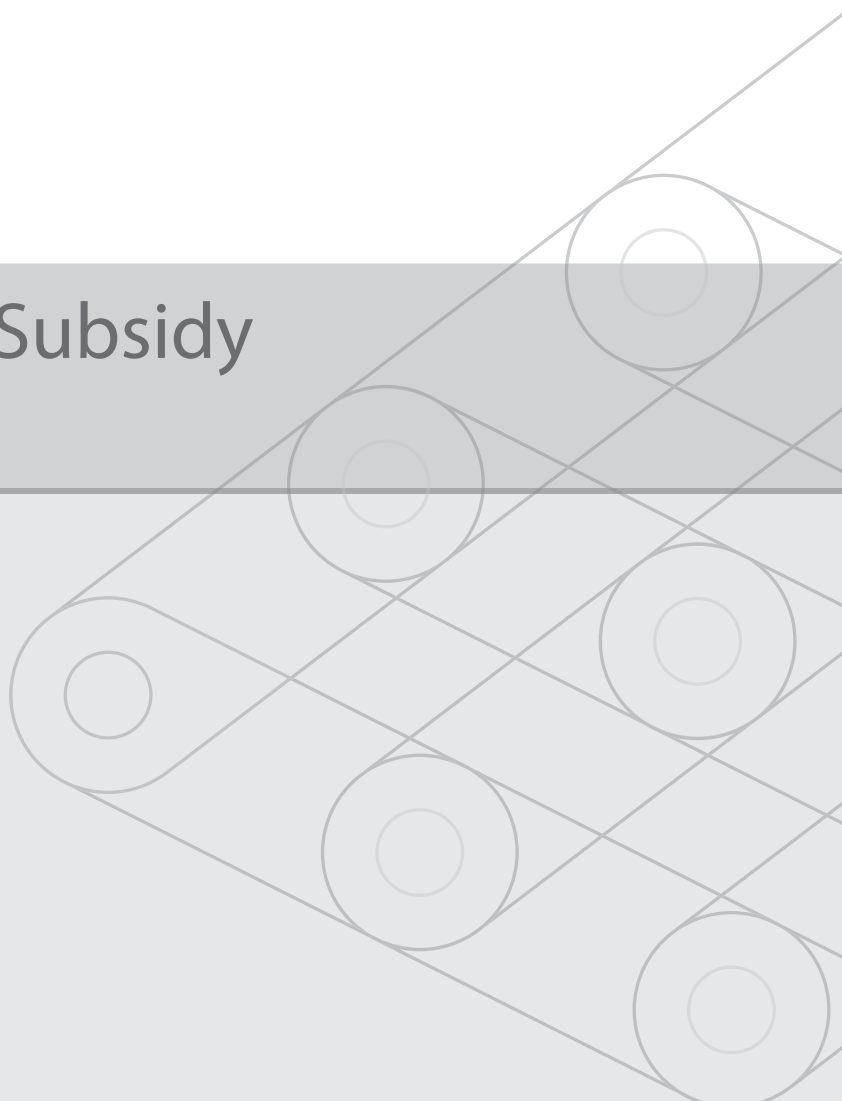
June 2015



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Department of **Treasury**

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ISBN 978-0-7307-4542-6

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Intent of these Guidelines

The purpose of these Guidelines is to establish and promote an agreed set of principles for the identification, costing, funding, monitoring and review of operating subsidies in Western Australia.

These Guidelines are to be considered and applied over time as new operating subsidies, or variations to existing operating subsidies, are being considered, or as operating subsidies are reviewed.

Scope of these Guidelines

What is an operating subsidy?

For the purposes of these Guidelines an operating subsidy is defined as follows:

An operating subsidy is a payment by Government, on behalf of the community, to a commercial entity for the provision of a good or service that would otherwise not be supplied, or would only be supplied at higher prices, had the supply of the good or service been assessed by the entity on purely commercial grounds.

Using this definition, operating subsidies can include arrangements such as price subsidies to general consumers, price subsidies to particular groups of consumers, rebates, special billing and payment arrangements or non-commercial community projects.

To be in scope of these Guidelines, an operating subsidy would have the following elements:

- It is a direct recurrent payment from Government to a 'commercial entity' (which includes public financial corporations, public non-financial corporations, and private sector commercial entities) – it does not cover cross subsidies between groups of consumers, or other implicit subsidies.
- A specific decision by Government is required to pay for a good or service 'on behalf of the community' (for example, so that concessional services can be offered to particular groups) – it is not intended to include circumstances where the entity pursues non-commercial activities for its own benefit, or where the Government purchases goods or services for its own use.
- The definition requires that the entity would not have supplied the good or service on a commercial basis in the absence of the decision by the Government to provide an operating subsidy, or it would have done so only at higher prices to consumers.

Operating subsidies provided to the Public Transport Authority for public transport services are within the scope of these Guidelines.

What is not an operating subsidy?

Government subsidies paid to the general government sector agencies, such as community service subsidies provided to health agencies, or subsidies paid to training authorities, are not within the scope of these Guidelines.

Regulatory arrangements applying to both public and private sector entities (for example, environmental regulations and health and safety standards) are not considered to trigger the need for Government-funded operating subsidies.¹

Cross subsidies are not within the scope of these Guidelines. Operating subsidies are preferable over cross subsidies in that they are more transparent, create greater accountability for the commercial entity receiving the subsidy, and have fewer deleterious effects on economic efficiency.

¹ For goods and services subject to an operating subsidy, the cost of the operating subsidy should reflect the extent that regulatory requirements increase the cost of provision.

When should an operating subsidy be used?

Operating subsidies are often only one of a number of policy options to address particular policy objectives and outcomes. Advice to the relevant Minister and Government on policy options would address the costs and benefits of an operating subsidy versus other options.

In principle, an operating subsidy should be used when it is shown to be the most cost-effective mechanism for delivering the stated policy objective after taking the following considerations into account:

- What is the policy objective or problem that needs to be addressed? What is the status quo? Is the problem significant enough to warrant government intervention?
- Who is the target group?
- Is it possible for the good or service to be provided on a commercial basis, taking into consideration the necessary levels of quantity, quality and/or price requirements?
- Is there a clearly defined market failure that results in a good or service being provided at sub-optimal levels to consumers or classes of consumers?
- Can this issue be addressed through reforming or removing regulations in the relevant market?
- Are there existing mechanisms or programs that can be used to address the problem?
- What subsidies, concessions or other policy mechanisms are already being provided by the agency, other agencies, or other levels of government?
 - If existing mechanisms are judged to be inadequate, is this supported by evidence?
- What is the suite of available policy mechanisms to address the problem?
 - This could include operating subsidies, direct payments to consumers, vouchers, and industry assistance grant programs.

- What are the costs and benefits of the status quo and each alternative approach?
 - If possible, the costs and benefits of the alternative approaches should be quantified. Where the quantification of costs and benefits is not possible or too costly, a qualitative assessment should be provided.
 - Are there indirect costs or benefits that require consideration? Are there any externalities or equity considerations that need to be considered?

Principles for designing and implementing operating subsidies

The following high-level principles should guide the design and implementation of operating subsidies. Operating subsidies:

1. are transparent and consistently reported;
2. are highly targeted at their intended objectives and outcomes;
3. impacts on competition and economic efficiency are minimised as far as practicable;
4. be considered to be made contestable where appropriate;
5. are costed using a consistently applied methodology based on either efficient or benchmarked costs; and
6. are governed by robust:
 - a. approval processes;
 - b. agreements between the responsible Ministers and the relevant commercial entities;
 - c. monitoring processes; and
 - d. evaluation and review processes.

Further explanation of these principles is outlined below.

1. Operating subsidies are transparent and consistently reported

Public reporting on specific operating subsidies – such as in Budget papers, annual reports and Statements of Corporate Intent – should be consistent to the extent possible. Information on the nature, scope and costs of operating subsidies for goods and services delivered on behalf of the Government should be available to the public.

Any specific reporting requirements relating to particular operating subsidies should be included in the agreement between the Government and the commercial entity delivering the subsidised good or service (see principle 6.b).

2. Operating subsidies are highly targeted at their intended objectives and outcomes

Given the range of competing Government priorities and the associated demands on State finances, the design of operating subsidies should be guided by specific objectives that are highly targeted at intended outcomes (e.g. economic development, social amenity, and social equity).

Objectives should be specific, measurable, attainable, relevant, and time bound.² Effectively targeting operating subsidies will help to ensure that operating subsidies are delivered in a cost-effective manner.

3. Operating subsidies' impact on competition and economic efficiency are minimised as far as practicable

Proposals for new or amended operating subsidies should consider existing or potential competitive distortions in the market; especially those which could act as barriers to long-term reform efforts in industry sectors. These competitive distortions should be minimised to the extent possible.

An assessment of the merits of implementing an operating subsidy will necessitate consideration of the trade-off between the policy objectives and economic efficiency. This would take into account competitive effects, economies of scale, externalities (such as environmental or health impacts) and other direct and indirect effects.

Any proposal for new operating subsidies (or evaluation of existing ones), should detail this assessment.

4. Operating subsidies be considered to be made contestable where appropriate

Contestable operating subsidies can be considered as an option where there are alternative private providers for the good or service supported by the proposed operating subsidy, and where there are net economic and/or State financial benefits from doing so. Markets are contestable where multiple providers are participating and competing in the market, or have the potential to do so in the future.

² While operating subsidies may be intended to be an ongoing arrangement, they are time-bound in the sense that periodic reviews should be conducted to assess their ongoing policy merit and cost-effectiveness.

The decision to implement a contestable operating subsidy is at the discretion of the Economic and Expenditure Reform Committee (EERC) and Cabinet. Advice provided to EERC and Cabinet would outline why making the operating subsidy contestable is desirable, how it would operate, and the process by which it would be established.

The Government should decide on whether to implement a contestable operating subsidy before engaging with potential providers.

Key matters to be considered in this initial advice to EERC and Cabinet, and in the design and implementation of a contestable operating subsidy, are outlined at Attachment A.

5. Operating subsidies are costed using a consistently applied methodology based on efficient or benchmarked costs

Costing methodologies used for operating subsidies should be consistently applied between commercial entities operating in the same industry. For commercial entities subject to economic regulation governing their fees, investments and cost structures, only efficient costs should be funded to ensure that the most efficient production processes are adopted. For other firms, industry benchmarks, or competitive tender processes, should be used to determine appropriate costs.

Where a contestable process is adopted, guidance on costing methodologies to apply in bids should be provided up front.

There are a number of approaches that could be taken in costing operating subsidies. Whatever methodology is used, it should be clearly documented, capable of being verified independently, appropriate for the entity and type of operating subsidy, and be satisfactory to Department of Treasury (Treasury).

If the operating subsidy is new, or a substantial change to the costing methodology of an established operating subsidy is proposed, Treasury may request detailed information on the methodology to inform its advice to EERC on any proposal for a new or significantly varied operating subsidy arrangement.

For significant operating subsidies, it may be appropriate to seek advice from an independent body (either the Economic Regulation Authority (ERA) or an alternative body agreed by Government) on the appropriate cost methodology, assumptions and cost allocation for the subsidy. The entity, Treasury and any relevant oversighting portfolio agency would provide input to this process. Information explaining potential costing approaches can be found at Attachment B.

6. a Operating subsidies are governed by robust approval processes

All proposals to implement new, or significantly vary existing, operating subsidies should be considered by the EERC. To the extent possible, this is to occur in the context of the State Budget or Mid-year Review processes.

Before a proposal for a new or significantly varied operating subsidy is provided to the EERC and Cabinet for approval, Treasury should be consulted on the proposal. Where the operating subsidy is to be provided (or is provided) to a private sector commercial entity, arrangements for scrutiny by Treasury or other agencies should be agreed up front with the entity.

In general, the process to be followed in considering new or varied operating subsidies is as follows. Once the parameters of the operating subsidy are agreed by Government:

- the entity would calculate the operating subsidy and prepare an explanation of the methodology;
- this information would then be submitted to the relevant portfolio agency (if appropriate) for review and Treasury; and
- Treasury would work with the entity (and the relevant portfolio agency) to agree on the methodology before being included in the submission to the EERC.

Consulting Treasury throughout the process will help ensure that estimates provided by the commercial entity are appropriately costed and independently verified. As discussed under Principle 5, for significant operating subsidies, it may be appropriate to seek independent advice to establish appropriate costing methodologies, assumptions and cost allocations to underpin the operating subsidy.

6. b Operating subsidies are governed by robust agreements between the responsible Ministers and the relevant commercial entities

To ensure clarity of intent and outcomes, operating subsidy arrangements should be supported by clear agreements between the Government and commercial entities receiving the operating subsidy.

This would entail an agreement between the portfolio Minister and the Treasurer representing the Government, and the entity covering the definition of the goods or services to be provided, administrative arrangements, costing methodologies, invoicing, payment and reconciliation arrangements, performance monitoring, and review.

Due consideration should also be taken to the management of risk and dispute resolution mechanisms in any agreement. Further guidance is found on Attachment C.

Although the form of these agreements may differ depending on the entity, their content should be clear and enforced:

- In the case of public corporations, these may take the form of an administrative arrangement between the Minister and the commercial entity.
- For private providers, clear commercial contracts would be needed outlining the relevant requirements.
- For regulated entities it may be more appropriate for these arrangements to form part of licensing conditions or other regulatory arrangements, with the regulator to play a role.

The relevant terms and conditions of this agreement need to be consistent with the terms of the original EERC/Cabinet agreement on the operating subsidy.

Draft agreements must be prepared by the relevant portfolio agency and the commercial entity in the first instance, with Treasury input sought before final versions are submitted to the Minister and Treasurer for agreement.

6. c Operating subsidies are governed by robust monitoring processes

Monitoring arrangements must be clearly set out and agreed by the Minister and the Treasurer (representing Government) and the entity delivering the subsidised good or service, with input from Treasury and the portfolio agency advising the Minister.

These arrangements would include key performance indicators, progress reporting obligations and any arrangements for monitoring budgeted and actual operating subsidy expenditure. These would be covered in the agreement (or contract) governing the operating subsidy (Principle 6.b).

If the operating subsidy is subject to the State Government's Sunset Clause Policy, monitoring arrangements would need to take into account provisions in this policy.

Treasury monitors operating subsidy expenditure. Any significant variations to agreed expenditure are subject to formal approval by Government as part of the Mid-year Review or Budget processes, with the reconciliation of any under or over payments occurring at that time. It is important that acquittals and reconciliations of operating subsidy costs and payments occur to ensure any over or under payment of amounts are identified and remedied.

6. d Operating subsidies are governed by robust evaluation and review processes

Operating subsidies are subject to annual reviews conducted by Treasury as part of the State Budget process, and in-depth reviews undertaken periodically as directed by Government.

Annual reviews of operating subsidies

Treasury currently reviews operating subsidies annually in the Budget process, consistent with the level of scrutiny applied to other Budget policy initiatives. In undertaking these reviews Treasury considers:

- the nature of the operating subsidy;
- its funding and impacts on State financial aggregates, including net operating balance, over the budget year and forward estimates;
- its cost reflectivity over this period; and
- its ongoing appropriateness.

Commercial entities responsible for delivering goods and services funded by significant recurrent operating subsidies may be requested to provide Treasury with the details of modelling used to assess the impact of changes to tariffs, fees and charges set by the Government on operating subsidies.

Expectations regarding sharing of information in the Budget processes (or other times in the year) would be spelt out in the operating subsidy agreement. Any portfolio agencies involved with oversight of the Government Trading Enterprise (GTE) maybe requested to assist in this process.

Periodic in-depth reviews

Annual reviews should be supplemented by more in-depth reviews undertaken periodically. These reviews would be completed at least every five years.

Government determines the responsibility for, timing, and content of these in-depth reviews, either at the time of initial agreement on the operating subsidy, or at other times as determined by Government. This decision should be incorporated into the relevant agreement between the Government and the commercial entity delivering the good or service.

The time, rigour and resources devoted to the in-depth review would depend upon the significance of the operating subsidy in question. For financially significant operating subsidies, a detailed analysis including quantitative modelling of options would be required. For significant operating subsidies in regulated markets it would be appropriate to incorporate advice from the ERA or another source of independent advice on the efficient (or industry benchmark) costs and appropriate charges for goods and services funded by operating subsidies.

Regardless of who is conducting the review, Treasury should be consulted at key stages in the process.

Further guidance on matters to consider in an in-depth review are outlined at Attachment D.

Attachment A: Contestable Operating Subsidies

Matters to consider in whether to make an operating subsidy contestable

The following matters should be considered to determine if an operating subsidy is suitable to make contestable, and presented to EERC for decision:

- Does legislation allow for operating subsidies in this area to be made contestable (or is legislative amendment required)?
- Are there both public and private suppliers within this market, or is there potential for private providers to enter the market?
- If the operating subsidy were not made contestable, would this lead to significant competitive advantages for public providers over private providers?
- Do relevant public providers have competitive advantages over potential private providers (e.g. lower borrowing costs, rates of return etc.) and how will these be addressed/considered?
- What are the likely impacts on State finances of making operating subsidies contestable, taking into consideration matters such as:
 - Whether there was evidence of a direct cost saving from providing an operating subsidy to a private provider; and
 - The impacts on dividends and tax equivalent payments received from public corporations, or of costs arising from previous asset investments, from providing the operating subsidy to a private provider instead of a public provider.
- What are the likely impacts on the economy – would making the operating subsidy contestable facilitate greater industry competition, scale and/or improved productivity?
- If it were desirable to make the operating subsidy contestable, what is the appropriate mechanism by which this should be established:
 - How would a competitive tender process be established to allow fair and equitable opportunities for both private and public entities to participate?

- What contractual and governance requirements are required – for example, if the operating subsidy under consideration is to be applied to a regulated market (for example, the water or electricity sector), should the delivery of services supported by operating subsidies be built into licensing conditions?

Design of a contestable operating subsidy process

The following is general advice on the implementation of a contestable operating subsidy process. The specifics of how this could apply to an individual sector would depend upon the relevant legislative and policy frameworks, and the detail of commercial contracting or procurement guidelines.

Processes should adhere to Government Procurement policies where applicable. Depending on the scale and individual requirements, it may be appropriate to consider a two-stage process (e.g. expression of interest and request for proposal phases).

The procurement process would clearly outline the Government's requirements with respect to:

- quality, quantity, delivery timeframes, performance indicators, risk assignment and price;
- monitoring, reporting and review (including provisions for periodic in-depth review and contract renewal); and
- guidance on costing methodology to allow fair comparison of proposals.

In regulated markets there may be instances where it may be more appropriate to make operating subsidies accessible to all providers that are licensed to operate in the market.

Regardless of whether a private sector commercial entity or a government trading enterprise is chosen to deliver the contestable operating subsidy, it must be provided under a formalised arrangement between the Minister(s) and the commercial entity (see Principle 6.b, and Attachment C).

Attachment B: Approaches to calculating operating subsidies

There are a number of approaches that could be taken in costing operating subsidies.

Where the operating subsidy is provided to fund subsidised or free goods or services, these would be based on either long-run marginal cost or long-run avoidable cost to ensure that only the relevant costs of providing the good or service are appropriately recovered. Other methodologies are discussed below, though the key weaknesses of these are that they may include other costs not directly relevant to the good or service in question.

Where the operating subsidy is used to fund a discrete project or program, rather than an ongoing good or service, a more traditional accounting approach may be more relevant.

Another useful resource in considering costing methodology issues is Treasury's guidelines on costing and pricing government services.³

Marginal cost

Theoretically, economic efficiency is optimised when price is set so as to recover long-run marginal cost. It would, therefore, seem most appropriate to cost an operating subsidy on the basis of the difference between the revenue generated by the good/service supported by the operating subsidy and the long-run marginal cost of the good/service (where this would comprise operating costs, the loss in value of associated assets and the cost of capital).

However, there are a number of practical difficulties associated with the measurement of long-run marginal cost, including the following:

- Judgement is required to determine the appropriate unit of output in order to estimate marginal cost. This involves a balance between what is feasible and what is theoretically ideal (i.e. the smaller the unit, the better). The problem of specifying the size of the unit of additional output is a reflection of a more general problem in estimating marginal costs, namely that of common costs.

³ Department of Treasury and Finance (2007), 'Costing and Pricing Government Services: Guidelines of use by agencies in the Western Australian Public Sector', Fifth Edition, http://www.treasury.wa.gov.au/cms/uploadedFiles/costing_pricing_government_services_april2007.pdf.

- Common costs arise where a commercial entity utilises the same plant to produce multiple goods or services. As a result, a large proportion of the costs of these enterprises are common to several services. However, there is no single theoretically 'correct' method of allocating joint costs.
- Marginal costs can vary considerably over quite short periods of time as demand changes and it is often not practicable to make exhaustive calculations of the constantly changing marginal cost of each additional unit of output. For industries such as the electricity supply industry, which face demands that vary substantially over the day and year, and which have marginal production costs which vary with the size of demand to be met, there are in effect as many products as there are time periods in the year for which it is meaningful to distinguish. For each of these products there will be a marginal cost.

A further complexity is introduced when the pricing practices of enterprises with investments that are typically large and lumpy in nature, or which are subject to peak and off-peak demand, are considered. Many Western Australian GTEs fall into one or both of these categories. For these GTEs, long-run marginal cost pricing can lead to the inefficient use of the existing capacity of a GTE. If a GTE's capacity exceeds demand, pricing on the basis of long-run marginal costs can unnecessarily depress demand and accentuate under-utilisation of capacity. The opposite can occur if capacity cannot meet demand.

In these circumstances capacity is utilised most efficiently if prices are based on short-run marginal costs including congestion costs in an environment of excess demand.

Costing operating subsidies on the basis of short-run marginal costs gives rise to the problem of classifying costs between short-run and long-run. For example, depreciation needs to be disaggregated to distinguish asset wear and tear costs that vary with production from provisions for obsolescence that are related to the age of assets rather than its intensity of use.

Long-run avoidable costs

The long-run avoidable cost approach is similar to that for marginal cost in that it identifies the economic cost of a particular service as the change in cost associated with an increase/decrease in the production of that service. In contrast to marginal cost (defined as the cost of an additional unit of output), long-run avoidable cost is defined as the cost of an additional range or block of output and includes the incremental variable costs of the extra output and additional capital costs where increased capacity is required. It can therefore be viewed as a mixture of short- and long-run marginal costs.

Long-run avoidable cost is, therefore, essentially a measure of marginal cost, which requires specification of the incremental block of output to be avoided. This is necessary since avoidable costs will vary depending on the dimension and the scope of the output quantum under consideration. The longer the time frame considered, the more inputs, and therefore input costs, would be variable and hence avoidable. Similarly, long-run avoidable costs will be greater the larger the unit of output specified.

Like marginal costs, long-run avoidable costs are attributable on the basis of causality; i.e. they would not be incurred if the output were not provided.

If the provision of the operating subsidy leads to additional capacity requirements, then it is necessary to include the capital cost of this extra capacity. This raises the question of the appropriate rate of return for measuring the opportunity cost of funds devoted to services supported by the operating subsidy. Other issues requiring resolution include the appropriate valuation of the capital of an enterprise (i.e. whether it should be based on historic or current costs) and the appropriate method of allowing for depreciation.

The long-run avoidable cost approach encounters some of the practical difficulties that were also outlined under marginal cost pricing, including the problem of allocating common costs.

Clearly, the task of calculating long-run avoidable costs also requires accounting and management systems that are able to generate sufficiently disaggregated cost data for estimation purposes.

Fully Distributed Costs

Fully Distributed Costs (FDC) allocates the total cost of the commercial entity (including costs not directly attributable to particular activities) to all the different activities it undertakes. For a particular activity some costs can be directly attributed, whereas other (joint/common) costs are allocated on the basis of some pre-determined (arbitrary) allocation scheme. Thus, with FDC, some proportion of joint costs, such as overheads, is allocated to the operating subsidy even though these costs would still have been incurred had the operating subsidy not been provided.

A problem with this measure is that it does not associate costs with activity in a causal sense.

Where economies of scale exist (a common feature of GTEs) over-estimation of the cost of the operating subsidy is likely when compared with the marginal costing approach.

Stand-alone costs

Stand-alone cost is the cost of providing a good or service in isolation from other products, i.e. the existing costs of an enterprise less those costs which would be avoided by deleting the supply of all other products or services. The use of stand-alone cost as a benchmark for estimating the cost of operating subsidies can result in mismeasurement where economies (or diseconomies) of scale and scope are present.

Attachment C: Matters to be included in an operating subsidy agreement

The detail and burden of requirements placed on the commercial entity in operating subsidy agreements should be proportionate to the materiality and sensitivity of the operating subsidy in question.

An operating subsidy agreement should include (but is not limited to) the following matters:

- Definition of the goods or services to be provided – what is being provided and to whom (including criteria for access to relevant goods or services).
- Administrative arrangements – who has responsibility for the relevant policy, who administers funding and oversight for the operating subsidy, who delivers the good or service, and how these arrangements would operate in practice.
- Costing methodologies – what methodology is used for the operating subsidy, how cost allocations are determined, what assumptions underpin the operating subsidy, and arrangements for revisions to cost parameters (whether/how/when these would be reviewed and/or varied).
- Invoicing, payment and acquittal arrangements – when invoices should be presented, what detail and explanatory information is required, who should receive them, who arranges payments to the entity, and what reconciliation or acquittal arrangements are required.
- Performance monitoring arrangements – what objectives and performance indicators are required and how this information will be collected and used.
- Reporting requirements and guidelines – what reporting requirements are required, when and to whom.
- Evaluation and review arrangements – data collection arrangements, when a review is required, what the review should cover and who commissions the review, who conducts it, and who bears the costs.

There should also be clear guidance in the agreement on the assignment of risk and dispute mechanisms, recognising:

- the legitimate commercial interests of the commercial entity;
- allocating risks to the party/parties that is best able to manage the risks;
- clearly defining the extent of liabilities for the government and the provider;

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- basing the price on efficient or industry benchmark costs and be made clearly transparent;
- establishing fair and equitable processes; and
- ensuring that information on the operating subsidy be made available to the Minister, Parliament and the public except to the extent that there is a compelling commercial in confidence rationale to withhold it (advice from the State Solicitor's Office or another expert authority can be sought on this matter).

Attachment D: Matters to be considered in an in-depth review

An in-depth review of an operating subsidy makes detailed findings and recommendations to Government on the following matters:

- whether ongoing government involvement is appropriate;
- whether the objective of the operating subsidy remains relevant and current;
- whether similar operating subsidies or other Government funded programs have since been implemented that address similar policy objectives;
- how the administration, reporting, monitoring and other governance arrangements around the operating subsidy compares to the principles outlined in this document;
- whether the operating subsidy is meeting the policy objective as intended, including whether it is resulting in any unintended or perverse impacts;
- whether the operating subsidy is impeding competition in the market for the good or service and/or whether the operating subsidy could be made contestable;
- whether the good or service can be provided commercially;
- whether the current value of the operating subsidy is appropriate;
- cost growth/indexation of the operating subsidy and its longer term sustainability;
- the appropriateness of the costing methodology and the level of efficient or industry benchmarked costs;
- findings and recommendations to improve the efficiency and effectiveness of the operating subsidy, including:
 - the status quo (continuing the operating subsidy in its present form);
 - changing the costing methodology, eligibility, and/or governance arrangements for the operating subsidy;
 - consolidation with other operating subsidies;

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- increasing cost reflectivity with a view to reducing the value of operating subsidy; and
- phasing out/eliminating the operating subsidy; and
- findings and recommendations to improve the administration and governance of the operating subsidy, and future review arrangements.

The time, resources and methodology devoted to the review would depend upon the significance of the operating subsidy.

Glossary

Operating subsidy	An operating subsidy is a payment by Government, on behalf of the community, to a commercial entity for the provision of a good or service that would otherwise not be supplied, or would only be supplied at higher prices, had the supply of the good or service been assessed by the entity on purely commercial grounds.
Commercial entity	Any entity that delivers goods and services on a commercial basis and are public financial corporations, public non-financial corporations, or private sector providers.
Efficient costs	Costs faced by a firm operating in an effectively competitive environment. In regulated markets, efficient costs are often calculated based on comparisons with benchmark firms in other markets.
Externalities	Costs or benefits arising from an economic activity to people not engaged in that activity and not reflected in market prices. For example, the effects of different economic activities on pollution or health outcomes.
Economic efficiency	When the goods and services that are produced are the ones that are most valued by society, produced at least cost, and allocated to those who value them most highly. Economic efficiency comprises: <ul style="list-style-type: none"> • allocative efficiency – allocating resources to their most productive use; • technical efficiency – providing goods and services at least cost; and • dynamic efficiency – ensuring that investments are optimal over the long-term in both their timing and location.
Economies of Scale	The cost advantages that arise due to increases in size, output or scale of operation of a firm, or an industry as a whole.

Competitive neutrality	The principle that government businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership. The Western Australian Government's policy on competitive neutrality is set out in the <i>Policy Statement on Competitive Neutrality</i> (1996).
Contestable market	Markets are contestable (or potentially contestable) where multiple providers are participating and competing in the market, or have the potential to do so in the future.
Regulated commercial entity	A commercial entity subject to market regulation governing its prices, rates of return and other commercial parameters by the Economic Regulation Authority or similar regulatory body.

