

Competitive neutrality in NSW

Draft Report

December 2022

Tribunal Members

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Invitation for submissions

IPART invites comment on this document and encourages all interested parties to provide submissions addressing the matters discussed.

Submissions are due by Friday, 24 February 2023

We prefer to receive them electronically via our [online submission form](#).

You can also send comments by mail to:

Review of competitive neutrality policy and processes
Independent Pricing and Regulatory Tribunal
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If you require assistance to make a submission (for example, if you would like to make a verbal submission) please contact one of the staff members listed above.

Late submissions may not be accepted at the discretion of the Tribunal. Our normal practice is to make submissions publicly available on our [website](#) as soon as possible after the closing date for submissions. If you wish to view copies of submissions but do not have access to the website, you can make alternative arrangements by telephoning one of the staff members listed above.

We may decide not to publish a submission, for example, if we consider it contains offensive or potentially defamatory information. We generally do not publish sensitive information. If your submission contains information that you do not wish to be publicly disclosed, please let us know when you make the submission. However, it could be disclosed under the *Government Information (Public Access) Act 2009* (NSW) or the *Independent Pricing and Regulatory Tribunal Act 1992* (NSW), or where otherwise required by law.

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Acknowledgment of Country

IPART acknowledges the Traditional Custodians of the lands where we work and live. We pay respect to Elders, both past and present.

We recognise the unique cultural and spiritual relationship and celebrate the contributions of First Nations peoples.

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Chapter 1 >>

Executive summary

Overview of the report and the draft recommendations

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Across the economy, businesses compete to deliver products that meet the needs of their customers. The most efficient, dynamic and innovative businesses succeed because people want to do business with them. They out-compete other businesses with higher costs, slower response times and poorer-quality products. This process gives customers more choice and better value for money.

In NSW, state and local governments run a wide variety of businesses for a wide range of reasons. They operate across a diverse range of industries, including manufacturing, laundry services, construction (including roads), waste disposal, gyms and fitness, tourism services, printing, childcare and aged care. In many cases, government businesses compete, or could compete, directly with private and not-for-profit providers.

Competitive neutrality policy sets the rules that government businesses must follow, to ensure they compete with other businesses on their merits. It prevents them from using the advantages of government ownership (such as, cheaper finance, not paying taxes or not needing to make a profit) to push competing businesses out of the market.

A good competitive neutrality policy ensures that the most efficient, innovative and customer-focused businesses are the ones that thrive. It gives businesses who compete with, or want to compete with, government businesses the confidence to invest and provides them with a mechanism to have their concerns heard. It also requires government subsidies to business activities to be deliberate and considered, providing good value for money for taxpayers.

NSW's competitive neutrality policy was put in place in 1996. It was last reviewed 20 years ago, when the economy and the nature of government business activities were different. Ensuring that NSW has a well-designed and effective policy that is fit for the future will benefit consumers and businesses. It will ensure that resources are used in the best way and that taxpayer funding is directed to the areas where it delivers the greatest benefit. Over time, this will lift productivity and raise our standard of living.

1.1 Overview of the review

Earlier this year, IPART was asked to independently review NSW's competitive neutrality policies and processes, to identify issues and concerns with them and to analyse opportunities to expand their scope. We were also asked to consider how the policies compare to best practice and to recommend improvements.

NSW receives very few competitive neutrality complaints. However, through our consultation process, we have heard from businesses, both large and small, who suspect that the government businesses they compete with are not following the rules. They pointed out the difficulties they face in making a complaint and the lack of transparency around whether and how a government business has considered competitive neutrality.

We have also heard from government businesses about the difficulties they have in identifying which activities they need to apply competitive neutrality to, and what they are required to do. Some government businesses are also concerned that competitive neutrality may require them to act in a way that is not in the public interest.

This Draft Report sets out the findings of our review so far and our assessment of the current policies and processes. It puts forward a range of draft recommendations to assist the NSW Government to develop a revised competitive neutrality policy that works better for both government businesses and their non-government competitors. These draft recommendations are designed to help deliver and maintain a best practice approach. We are seeking feedback on the draft recommendations before finalising our review in 2023.

1.2 Our proposed improvements

We have reviewed NSW's current competitive neutrality policies in detail. We have also looked at competitive neutrality policies and experiences elsewhere, and considered comments made through our consultation process and submissions made to other reviews. In this Draft Report, we propose a number of changes to the NSW policies to bring them up to date and ensure that they reflect best practice both now and into the future. The key proposed changes are:

- Bringing competitive neutrality under a single policy that applies to both state and local government activities, with a clear statement of objective and a simpler, more logical structure.
- Clearer, more consistent tests for determining which activities are covered by the policy. Better tests for defining government ownership, what constitutes a business activity and the threshold for determining significance will make the policy easier to understand and apply.
- A consistent approach that requires all 'significant government business activities' to account for their own costs, as well as any advantages and disadvantages resulting from government ownership, and to estimate a price that would be 'competitively neutral' in the market.
- A proportionate approach to assessing whether charging below the competitively neutral price is in the public interest, recognising that the current competitive neutrality policies do not consistently require this assessment when a government entity decides to charge below the competitively neutral price.
- Establishing a clear and consistent obligation to report on competitive neutrality in the annual reports of government entities undertaking business activities. This includes publishing summary information on when competitive neutrality has or hasn't been applied and the reasons for this, to raise awareness of competitive neutrality and give competing businesses confidence that the government businesses they compete with are playing by the rules.
- A simpler complaints process that is clear and easy to access, removing the requirement for the Minister to refer the complaint for investigation and streamlining the process by having a single complaints body.

We recognise that these changes will require a transition period and may involve training and additional costs, particularly for local government businesses. We are proposing a transition strategy for the new policy that will allow government businesses to adapt to the changes over time rather than all at once. We are also seeking views on the tools and resources that can support government businesses. We consider that the transition should only occur when tools and resources have been developed, ideally through a co-design process, to assist government businesses to adapt to the changes.

A summary of the changes we are recommending and our reasons for them is provided in the sections below.

1.2.1 Policy structure, objective and scope

Under our draft recommendations, the overall process for applying competitive neutrality would be clearer and more consistent. We are recommending that competitive neutrality in NSW is brought under a single policy, which would be applied to determine which activities competitive neutrality applies to and what the obligations are, irrespective of which sector the activity is in, the level of government (local or state) it is owned by and what type of entity is undertaking it.

We are also proposing that the policy includes a clear upfront statement of the objective and scope that would guide the application of the policy. The objective statement should note that the removal of net advantages from significant government business activities seeks to achieve an efficient allocation of resources between non-government and government businesses.

At this stage, we consider that there is insufficient evidence to support expanding competitive neutrality principles beyond significant government business activities. Historical competitive neutrality obligations, including pricing and other costing principles cannot easily be applied to non-business government activities.

1.2.2 Which activities competitive neutrality applies to

Competitive neutrality currently applies to 'significant government business activities'. We are not proposing to change that. However, we are recommending that the policy be clearer on which activities would fall into this definition. We are recommending that the policy include the following 3 tests:

- **The government ownership test** – An activity carried out by an entity that is owned or controlled by the NSW state or local government. Examples of entities that are owned or controlled by government include departments and agencies, State Owned Corporations (SOCs), local councils; and any entities they own or control. See the full test proposed in Box 4.1.
- **The business activity test** – An activity is a business activity if it involves regular, systematic supply of goods or services with a commercial or business-like character (subject to some exclusions for policy or regulatory functions). It is not necessary that payment is charged for the goods and services produced. An activity will be a business activity if the activity is undertaken by a public non-financial corporation, including a SOC, or public financial corporation, even if it would not otherwise pass the business activity test. See the full test proposed in Box 4.2.

- **The significance test** - An activity will be significant unless it has an annual turnover of less than \$3.7 million (indexed annually),^a a market review shows it's not significant, or if there is no possibility of a competing business (for example, the activity is legislated as a monopoly service). We are also recommending that in certain circumstances the Minister may declare an activity significant that would not otherwise pass the test. See the full test proposed in Box 4.3.

If any of these tests are not satisfied, then competitive neutrality policy does not need to be applied to the activity.

1.2.3 What competitive neutrality requires government entities to do

The current policies need amending to include a clear, consistent set of obligations that apply to all significant government business activities. Those obligations include estimating costs of providing the business activity, and the consideration of cost and non-cost advantages and disadvantages that arise from government ownership.

We are recommending the following main changes:

- **Estimating costs:** clearer guidance on when to use an avoidable cost method and when to adopt a fully distributed costing approach, having regard to the proposed objective of competitive neutrality policy (efficient allocation of resources).
- **Cost advantages and disadvantages:** methods for calculating the rate of return that are easier to implement, in addition to adjustments to prices to account for other advantages and disadvantages. Taken together with estimates of the costs of providing the business activity, this yields the competitively neutral price.
- **Non-cost advantages and disadvantages:** high-level guidance for government business activities that may need to adjust their practices or prices to reflect non-cost advantages or disadvantages, such as preferential access to information. Adjustments should only be made to the extent that the non-cost advantages or disadvantages derive from government ownership and not the businesses' scale or market power.
- **Structuring a business:** what government entities would need to do to satisfy their competitive neutrality obligations is likely to vary depending on their business structure. Commercialised businesses will more easily be able to demonstrate compliance with competitive neutrality. The policy should include some high-level guidance on the types of business structures and when each would be appropriate.

^a To be found non-significant based on low turnover, the turnover threshold must not be exceeded if the price of the business' goods and services was set in line with the market price of non-government providers in the same or similar area.

1.2.4 Charging below the competitively neutral price

Under our proposed recommendations, a public interest test would need to be undertaken by government entities where they seek to charge below the competitively neutral price or retain a non-cost advantage. This would be undertaken after applying competitive neutrality principles to expose the cost of the subsidy and to demonstrate that the benefits of not applying competitive neutrality outweigh the costs.

A clear, easy-to-apply framework for undertaking the public interest test is needed. A simple, qualitative approach for local government will reduce the regulatory burden on councils seeking to subsidise business activities. Currently, local governments can subsidise for any reason once they have estimated the competitively neutral price. For state government, we recommend that the public interest assessment should be quantitative where possible, consistent with the current competitive neutrality policies.

We are also recommending government entities publish their public interest assessments, subject to the removal of confidential information, to promote greater transparency.

1.2.5 Making it easier to lodge a complaint

We have identified opportunities to improve the complaints handling process. The current process imposes excessive barriers to making a complaint. Key changes include removing the requirement for a Minister to refer a complaint to IPART, allowing anyone to make a complaint and reducing the number of complaints handling processes and bodies to a single complaints body and process.

1.2.6 Ensuring the policy is kept up to date and government entities comply

Regular review of the policies by NSW Treasury (as the owner of the proposed combined policy) or the NSW Productivity Commission is recommended, to ensure that the policies remain up-to-date and accessible for government and non-government stakeholders alike.

We are also proposing annual reporting by government entities undertaking business activities to provide greater transparency and awareness about the application of competitive neutrality in NSW. This would involve reporting of basic competitive neutrality information by government entities in annual reports and a report on complaints, inquiries, and other matters to parliament by IPART.

To support agencies to apply the policies, we suggest that IPART, in its role as complaints body, develop tools and resources, such as templates and checklists. These resources should be designed for both government entities and potential complainants, to complement the provision of advice by NSW Treasury to government entities. We are seeking views on what resources would be most useful to government entities. We are also recommending that Treasury's role in providing assistance to government businesses is expanded to incorporate local government businesses, which provides further opportunities for local government businesses to lower their compliance costs.

1.2.7 Out of scope issues

Stakeholders have raised competition and other concerns that fall outside of the scope of competitive neutrality. This includes decisions on procurement, subsidising services, providing grants, and providing access to data. There is scope for the NSW Government to consider competition impacts more systematically when making these policy decisions. Like a best-practice competitive neutrality policy, systematic consideration of competition issues ensures that the most productive businesses thrive and helps raise standards of living for NSW citizens.

1.2.8 Expected impact of the changes

The proposed changes that would come into the revised policy will necessarily impose some additional costs on government businesses and may require additional training for staff. All government businesses will need to educate themselves on the new policy and go through a process of re-evaluating their activities to determine whether they are significant, checking their costing and adjustment processes to ensure they are consistent with the updated policy and putting systems in place to record and report on their application of competitive neutrality. We recognise that it will take time for government businesses to change their processes and review their activities. We are proposing that the government considers a transition strategy for the new policy that will allow government businesses to adapt to the changes over time rather than all at once. We propose that this transition only occur when tools and resources have been developed to assist government businesses, particularly local government, to adapt to the changes.

1.3 List of draft recommendations

We are seeking your feedback on our draft recommendations for this review. Submissions are due by 24 February 2023. More information on how to make a submission is set out on page ii of this report. Other ways you can provide feedback to us are discussed in section 2.4.

Draft Recommendations

1.	Bring the competitive neutrality policies into a single document that covers both local and state government business activities.	29
2.	Apply a consistent set of obligations to all entities regardless of their sector or business structure.	30
3.	Include a clear statement of objective and scope up-front in the policy. We recommend the objective is framed around achieving an efficient allocation of resources through the economy and clearly articulate the benefits of applying the policy. The suggested technical wording is provided in Box 3.1.	34
4.	Retain the current scope of competitive neutrality policy, which focuses on applying competitive neutrality principles to significant government business activities where it is in the public interest.	36
5.	The 'government ownership test' be revised to improve clarity and make it easier to apply. The proposed test focuses on whether the activity is undertaken by an entity that is government owned or is controlled by government. The proposed government ownership test is set out in Box 4.1.	41
6.	The 'business activity test' be revised to improve clarity and make it easier to apply. The proposed test focuses on whether the activity is: undertaken by a public corporation; it involves the supply of goods and/or services with system and regularity and has a commercial character; or is bidding for goods and services. The proposed business activity test is set out in Box 4.2.	50
7.	The 'significance test' be revised to better target activities where competitive neutrality is likely to be cost effective. The proposed significance test is set out in Box 4.3. An activity would not pass the significance test where:	56
	a. the activity has an annual turnover below \$3.7 million (indexed over time)	56
	b. the entity undertaking the activity has assessed it as having a low market impact,	56
	or	56
	c. there is no prospect of competition.	56
8.	The competitive neutrality policy continue to provide information on how to estimate both avoidable costs and fully distributed costs, as valid approaches for estimating a government entity's own cost of business. However, we recommend that the revised policy provide clearer guidance on how to select the most efficient approach. The guidance we are recommending is set out in Figure 5.1.	77
9.	The approach to adjusting for net cost advantages in the current competitive neutrality policies be retained as it is appropriate. However, we recommend that the revised policy provide clearer guidance to assist government entities to estimate an appropriate rate of return.	84
10.	Include guidance in the revised policy on dealing with non-cost advantages and disadvantages. We recommend that the guidance states that where possible, the advantage or disadvantage be removed altogether or converted into an adjustment that can be accounted for in the government entity's costs.	89
11.	Non-cost advantages and disadvantages experienced by government business activities that are not experienced by competitors be treated as a competitive neutrality issue, unless the advantage/disadvantage is already addressed through another policy or obligation. Such advantages or disadvantages could arise from government ownership or market power.	89

12.	Include a chapter in the revised policy on business structure that sets out high level guidance but does not require a government entity to adopt any particular structure for its business activities. We recommend including the guidance in Box 5.8	91
13.	The public interest test be undertaken in accordance with the following proposed framework:	101
	a. define what is being proposed and how it differs from the competitively neutral action	101
	b. identify the benefits and costs considering the factors set out in Box 6.1.	101
	c. assess whether the benefits outweigh the costs	101
	d. consider whether there is a less costly way to achieve the benefits.	101
14.	Establish different guidance for undertaking the public interest between state and local government:	101
	a. For local government business activities, a qualitative assessment for the public interest test is acceptable, although the financial cost of the subsidy must be quantified at minimum.	102
	b. For state government, the public interest assessment must be quantitative where possible and reasonable (i.e. effort and cost involved in quantification of costs and benefits is proportionate to the size of the business activity).	102
15.	Government business activities re-apply the public interest test when there are major changes in the market and at minimum, once every 5 years.	102
16.	The revised competitive neutrality policy outline circumstances where government businesses may decide that applying competitive neutrality would not be in the public interest. This includes:	104
	a. CSOs that meet the criteria and principles set out in the CSO Guidelines	104
	b. below cost pricing where the government business activity has significant up-front costs, the market is growing, and costs are to be recovered within a reasonable period (1-2 years)	104
	c. not setting prices to cover dividends, taxes or other costs avoided by not-for-profits or charities (as relevant) where most competitors are not-for-profits or charities, and there is a role for government in the market.	104
17.	Public interest assessments be published, subject to the removal of any commercial-in-confidence material. As part of this, a template identifying information for inclusion and information that might be considered commercial in confidence would be developed by IPART.	105
18.	The revised competitive neutrality policies encourage but not mandate consultation on the public interest test.	105
19.	The complaints process be made more open and accessible with a single process and a single investigative body (IPART). Complainants would be able to make complaints directly to the investigative body removing the need for Ministerial referral. Restrictions on who can make a complaint and requirements to contact the government business first would be relaxed.	112
20.	IPART have a similar complaint handling process to that in Victoria's competitive neutrality regime, to be implemented through amendments to Part 4C of the IPART Act. Under this process IPART would not be able to initiate an investigation and would not have enforcement powers. IPART would have discretion as to whether it will investigate a complaint.	115
21.	The IPART Act be updated to reflect a broader range of options for outcomes from a complaint, including no investigative action or non-investigative action, similar to the outcomes available in Victoria.	116

22.	IPART's role in assessing complaints about the public interest test be confined to assessing whether framework requirements have been applied and a reasonable conclusion reached.	117
23.	Treasury or the NSW Productivity Commission review the competitive neutrality policy every 5 years, consistent with other Treasury review processes.	120
24.	Treasury continue to provide advice to support state government entities to understand and apply competitive neutrality policies and principles. This advice would also be extended to local government entities, if the local and state government policies are combined (Draft Recommendation 1).	122
25.	A suite of resources and tools, such as templates and checklists, be developed by the complaints handling body through a co-design process to support stakeholders to understand and apply competitive neutrality policies and principles.	122
26.	Further evidence is required before investing in higher cost resources for stakeholder education, such as workshops, online modules and in-person training	122
27.	Government agencies undertaking business activities be required to report basic information about competitive neutrality in their annual reports, subject to any commercial confidentiality restrictions (see Box 8.1). Templates should be developed that clearly set out the minimum reporting requirements for agencies.	125
28.	The revised competitive neutrality policy not extend to council as a purchaser of services. We recommend that the Office of Local Government considers whether the current regulations and guidance regarding procurement for local councils needs to be revised to include content that is currently sitting within the competitive neutrality policy but that would be removed under our recommended approach.	130
29.	The NSW Government review its processes to ensure that it systematically considers impacts on competition when making policy decisions that are likely to impact competition and which may not be picked up by regulatory impact assessments. This includes:	133
	– subsidising services in a market	133
	– acquiring minority government ownership of a business when competitive neutrality policy does not apply because the government does not control the business	133
	– providing grants to businesses	133
	– providing or removing access to data.	133
30.	Consider providing a transition period to assist government businesses time to adjust to the changes. We recommend that the transition period provide an appropriate timeframe for government businesses to review their business activities against the revised tests and to update their internal policies and processes to reflect the requirements of the new policy. We recommend that this transition period commence once Treasury and IPART have provided the advice, resources and training necessary to support and guide government businesses to implement the proposed changes.	140



Let's discuss your ideas

In this Draft Report we describe our preliminary findings and recommendations to improve competitive neutrality policies in NSW.

We will ask questions to try and understand whether stakeholders agree with our findings, can implement our recommendations, or have other ideas about how to improve the policies. Stakeholders may respond to any part of our report or recommendations. In responding to our report, stakeholders may wish to consider:

1. How could we further improve or simplify the competitive neutrality policy?
 - a. What is the impact of a consolidated policy, particularly for local government?
 2. Do you agree with the proposed objective statement and its inclusion in the policy?
 3. When applying the tests to current government activities:
 - a. Is it clear what activities are and aren't captured by the tests?
 - b. How do the tests differ in scope from the existing tests?
 - c. What further guidance might be needed to help apply these tests?
 - d. What are the pros and cons of allowing for the Minister to declare an activity significant?
 4. Can government businesses easily identify and apply the relevant costing approach:
 - a. Does it reflect current practice?
 - b. How easily can be integrated into existing systems and processes?
 - c. What improvements, information or tools could help?
 5. How easy will it be to account for the advantages and disadvantages of government ownership? What additional guidance would help?
 6. Do you agree with our proposed approach to the public interest test?
 - a. How does this approach differ from current practice?
 - b. What tools, templates and guidance would assist?
 - c. What information should be published about a public interest test?
 7. Do you agree with the proposed changes to the complaints process? What else do we need to consider?
 8. What types of training and advice could IPART and/or Treasury offer to best support government entities implement and comply with competitive neutrality principles?
 9. Do you agree with our proposal for annual reporting on competitive neutrality? How can we best balance the need for transparency with the administrative costs and need to treat commercial information with confidence?
 10. Are there any additional issues that should be addressed by competitive neutrality policies?
 11. Do you agree with our findings on out-of-scope issues?
 12. Are there other case studies we should consider? What other elements would be helpful to demonstrate how to apply the revised policy?
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Chapter 2 >>

Introduction

What the review is about, why we are doing it, where it is up to and what we have heard so far

02

Across its 9 operational clusters, the NSW Government delivers a diverse range of products and services to the citizens of NSW, using its workforce of over 400,000 employees.¹ Similarly, the 128 local councils in NSW employ over 48,000 staff and deliver a combined \$12 billion of infrastructure facilities and services to their local communities.²

These products and services are delivered using a variety of models including partnering with, procuring or in direct competition with the non-government (private and not-for-profit) sector. When governments provide services through their own business activities, competitive neutrality policies set the rules for how they engage in the market, to ensure that they compete on their merits. This protects the competitive process so that the most efficient, dynamic, and innovative businesses can succeed.

Government entities engaged in business activities (referred to in this report as government businesses) can have a range of advantages that are not available to other businesses. These include not having to earn a profit or pay taxes, access to cheaper funds and hidden subsidies. Competitive neutrality policies and processes are aimed at preventing government businesses from using these advantages to out-compete other businesses. They require governments to account for the full cost of providing goods and services and make the value of any taxpayer subsidies explicit. Without them, government businesses may price their goods and services too low, which locks other businesses out even where they are more efficient and ultimately leads to higher costs and poorer services. This does not however prevent government from explicitly deciding to subsidise its business activities when it is in the public interest to do so (see Chapter 6).

We are reviewing NSW's competitive neutrality policies and processes. We have been asked to identify issues and concerns with current competitive neutrality policies and analyse opportunities to expand their scope to other government activities. We have also been asked to consider how the policies compare to best practice and recommend potential improvements.

This review delivers on the commitment made by the NSW Government to review its competitive neutrality policies in response to the recommendations of a review of Australia's competition policy undertaken in 2015.³

This Draft Report sets out our draft recommendations for the review. We are seeking feedback on these draft recommendations, which we will consider before making final recommendations.

2.1 What we are reviewing and why

The competitive neutrality policies currently require government businesses to account for the full cost of providing goods and services and make the value of any taxpayer subsidies explicit. Without them, government businesses may price their goods and services too low, which locks other businesses out and ultimately leads to higher costs and poorer services.

By helping to develop effective competition, competitive neutrality gives all businesses incentives to innovate, improve their products and become more efficient. It also gives non-government businesses, particularly small businesses, confidence that they will not be unfairly disadvantaged due to a government owned competitor operating in the same market.

In NSW, the current competitive neutrality policies:

- apply to significant state and local government businesses where there is a public interest in applying them
- set out costing and pricing principles for government businesses to follow when setting prices for their products
- provide a framework for handling complaints from competitors^a who feel that they have been disadvantaged by a government business that is not following the competitive neutrality principles.

2.1.1 The competitive neutrality policies in NSW are overdue for review

Competitive neutrality policies have applied to NSW's state and local government business activities since the late 1990s. While Australia's competitive neutrality policies are highly regarded worldwide,⁴ most of NSW's policies have not been reviewed in over 2 decades. NSW's competitive neutrality policies were developed at a time when government business ownership was more common than it is now. Government ownership of businesses and involvement in the economy has since evolved.

Across Australia, many large government businesses have been sold or corporatised, making them subject to the same set of costs and taxes as private businesses. Local governments have also outsourced or divested a range of business activities. Many of the services that are still provided by the Commonwealth, State and local governments are also now provided by private and not-for-profit sectors alongside them.

Given the significant changes in government economic activities since the NSW competitive neutrality policies were introduced, this review is an important step in ensuring the policies remain relevant and fit-for-purpose. The review also provides the opportunity to review stakeholders' experience with applying competitive neutrality policies and to consider whether they reflect best practice.

2.1.2 Aspects of the current policies are not working well

Competitive neutrality policies cover a broad range of industries and businesses, and they are not always well understood by the businesses they apply to or impact. The 2015 Harper Review of Australian Competition Policy found that competitive neutrality remains a matter of concern for stakeholders. Submissions to the Harper Review cited many examples of private businesses with concerns around their government owned competitors using the advantages of government ownership to penetrate markets more deeply and set artificially low prices.⁵ As a result, the Harper Review recommended all Australian governments review their competitive neutrality policies.

^a Including potential competitors

In 2020, the NSW Productivity Commission found that potential competitive neutrality complainants may be prevented from making a complaint because they don't know how to, or even because the process eats up too much time and resources. The NSW Productivity Commission recommended that IPART update NSW's competitive neutrality policies and processes, including by improving the complaints process and addressing stakeholder concerns about how competitive neutrality policies apply.⁶

In response to these recommendations, the NSW Government has asked us to evaluate the scope and effectiveness of NSW competitive neutrality policies and processes in ensuring a level playing field between government business activities and their non-government competitors.^b This review will allow us to seek views of stakeholders about which aspects of competitive neutrality policies in NSW are working and what can be improved.

2.2 Overview of the review process to date

On 24 February 2022, we received the final Terms of Reference for a Review of NSW Competitive Neutrality Policies and Processes by IPART. The first step in our approach to this review was to develop an understanding of how competitive neutrality policies and processes are currently implemented in NSW. To achieve this, we met with stakeholders responsible for overseeing the competitive neutrality policies, such as representatives from the NSW Productivity Commission (Treasury) and the Department of Premier and Cabinet (DPC). We engaged with representatives from SOCs and local government who were responsible for ensuring their businesses complied with competitive neutrality principles. We also spoke with representatives of businesses who compete with government businesses about the issues they face.

In our analysis of competitive neutrality policy, we compared NSW's competitive neutrality policies and processes to those in other jurisdictions. We considered how other jurisdictions implemented competitive neutrality policy and conducted investigations into complaints. In addition to desk studies, this involved meeting with those responsible for overseeing competitive neutrality policy in other jurisdictions, including the Commonwealth, Victoria, South Australia, Queensland, and Western Australia.

This research informed our Issues Paper, which was published on 28 June 2022. We also published 3 Information Papers to improve understanding of competitive neutrality policy and engagement with the key questions in the Issues Paper.

We received a total of 17 submissions in response to our Issues Paper. These submissions included:

- 3 from local governments or representative bodies
- one from a SOC
- 3 from government agencies in NSW

^b Under a terms of reference available on our [website](#).

- 10 from private businesses or representative bodies, representing industries such as water, medical imaging, waste collection, tertiary education, and camping and caravan parks.

These submissions can be viewed on IPART's [website](#).

On 8 and 9 August 2022, we hosted 3 online workshops aimed at local government businesses, state government businesses, and non-government businesses, although any person could attend any session. These workshops were facilitated by Deloitte on behalf of IPART. Attendee numbers for each workshop are as follows:

- Workshop 1: Local government businesses – attended by 37 individuals (excl. IPART & Deloitte staff).
- Workshop 2: State government businesses – attended by 20 individuals (excl. IPART & Deloitte staff).
- Workshop 3: Non-government businesses – attended by 20 individuals (excl. IPART & Deloitte staff).

The purpose of these workshops was to hear about what is and isn't working under the current NSW competitive neutrality policies and what improvements could be made.

A workshop summary report which provides more information about the workshops can be found on IPART's [website](#).

This Draft Report is informed by the research and consultation we have conducted to date. It presents our draft recommendations, discusses the supporting analysis, and seeks further input from interested stakeholders. We will consider further submissions and comments from stakeholders in relation to the draft recommendations before finalising the review.

2.3 What we have heard

Stakeholders' views differ on the effectiveness of the current policies and the need for reforms to the competitive neutrality policies in NSW. However, most submissions to the Issues Paper acknowledge the need to review the NSW competitive neutrality policies. Some submissions only sought minor updates to the documents to reflect changes since the original drafting (e.g. updating out of date references, escalating the local government significance thresholds). Others advocated for more substantial changes to the policies and guidance documentation.

Several submissions⁷ stated that competitive neutrality principles are difficult to apply because the relevant policies are vague or unclear, difficult to read, and hard to source. These stakeholders called for the provision of further guidance and support to understand concepts and testing methods embedded within the NSW competitive neutrality policies. Additionally, some stakeholders⁸ asserted that the competitive neutrality complaints handling process is inaccessible, difficult to navigate, and that it is not worth the effort of lodging a complaint.

In their submissions, central government agencies such as the Department of Premier and Cabinet (DPC) and the NSW Treasury have expressed views that indicate an appetite to reform the current policies:

- the NSW Productivity Commission (part of NSW Treasury) expressed the view that the current competitive neutrality policies are not fit for purpose and are not best practice.⁹
- DPC considers this review of competitive neutrality policy is beneficial to assist the NSW Government ensure its competition policy is fit for purpose for the changing needs of a competitive marketplace. However, DPC also submitted that any expansion of the scope of competitive neutrality policies should be based on a cost benefit analysis to ensure it delivers a net benefit.¹⁰

Submissions from representatives of local government and state government entities indicate that they generally seek minimal changes to the scope or obligations of the current competitive neutrality policies. However, these submissions do express support for minor amendments to the existing competitive neutrality policies, including the clarification of key concepts, additional guidance to implement competitive neutrality policy, and a review of the \$2 million significance threshold for local government business activities.¹¹

Throughout our review, we have experienced difficulty identifying information that would quantify the significance of the current competitive neutrality issues in NSW. We consider that the lack of awareness of competitive neutrality and the hurdles to making a complaint are 2 reasons for this. In their submissions, stakeholders have drawn different conclusions about this lack of information^c and have sought analysis in this Draft Report to quantify the impact of competitive neutrality policy to the NSW economy.¹²

Other competition or cross jurisdictional issues that were raised in submissions (some of which are out of scope for this review) relate to access arrangements to water infrastructure, Commonwealth funding (including Medicare and HECS-HELP assistance) and subsidies or other sources of funding.

Throughout the workshops, we heard a mix of views across the 3 different stakeholder representative groups. State and local government representatives reported a medium to high level of awareness of competitive neutrality within their agencies. However, some workshop attendees in these groups expressed that they had a limited understanding of applying competitive neutrality principles to relevant business activities, such as applying competitive neutrality tests for significance or public interest. Additionally, discussions within these workshops seemed to indicate that there is a low level of understanding of the purpose of competitive neutrality policy across state and local government agencies.

^c Local Government NSW questions the benefit of competitive neutrality policy in its submission to the Issues Paper (p 3) while the NSW Treasury submission to the Issues Paper indicated the low and decreasing level of complaints across NSW and other jurisdictions may be caused by both the difficult complaints process in NSW and the rectification of non-compliance at the introduction of competitive neutrality policies (p 11).

Awareness of competitive neutrality was low amongst non-government business workshop attendees. Despite this, representatives from non-government workshops seemed to have a strong understanding of the purpose and importance of competitive neutrality policy. Some non-government business representatives questioned why the government sector was providing services in competition with the non-government sector. These stakeholders felt that when government competitors can provide low-cost services due to their status as government entities, it undercuts the business of private entities. Moreover, participants in this workshop reflected that governments should consider contracting more business activities to private entities rather than conducting them internally.

When discussing transparency and reporting requirements, representatives from non-government businesses considered that there is currently not enough information publicly available to ascertain if a government business is complying with competitive neutrality principles. These stakeholders suggested that relevant government business should provide information which demonstrates compliance with competitive neutrality policy in their annual reporting, such as costing approaches. In addition to promoting transparency and accountability, this information would assist non-government business owners to understand if there were grounds for a competitive neutrality complaint.

However, representatives from state and local government entities raised concerns about potentially being required to release further information in their annual reports. They maintained that there is already a considerable regulatory burden to publish financial information in their annual reports. An increase in reporting requirements would incur additional costs relating to gathering data and responding to public questions. Furthermore, these stakeholders asserted that a requirement to publish further financial information could place them in a position of competitive disadvantage.

Throughout the workshops, we asked attendees how the NSW competitive neutrality policies could be improved. There was a clear demand for training and guidance resources from state and local government representatives. These stakeholders suggested that training and guidance documents should be provided to support them to comply with competitive neutrality policy. We explore possible options for the provision of training and guidance resources in Chapter 9 of this report.

Non-government business representatives requested that our review consider the approaches taken towards implementing competitive neutrality policies in other jurisdictions. There was a particular emphasis that we observe the South Australian and Tasmanian approaches. Additionally, these stakeholders called for a more simplified and direct complaints handling mechanism.

Throughout our analysis in this review, we have considered this diversity of views to offer a fair and balanced approach in developing our draft recommendations.

2.4 How to give us feedback

Have your say

Your input is critical to our review process.

[Submit feedback »](#)

You can get involved by making a submission or attending a public hearing.

[Attend the public hearing »](#)

We are seeking written submissions on this Draft Report. Submissions are due by Friday 24 February 2023. Information on how to make a submission and our submissions policy is included on page ii of this document.

We will hold a public hearing in February. This will provide the opportunity to comment on our draft recommendations. We will provide more information and will take expressions of interest on our website. Please subscribe to updates via our website if you would like to be kept updated. Alternatively, you can phone one of the staff members listed at the front of this report or email Ineke Ogilvy at ineke_ogilvy@ipart.nsw.gov.au.

We also invite stakeholders to meet with us to discuss their questions and feedback about our draft recommendations. If you would like to speak directly with the review team or request a meeting with us, please get in touch with one of the staff members listed on page ii.

2.5 How this Draft Report is structured

The remainder of this report discusses our analysis and draft recommendations in detail. It is structured as follows:

- **Chapter 3** discusses the structure, objectives, and scope of NSW competitive neutrality policy.
- **Chapter 4** discusses which activities should be subject to competitive neutrality.
- **Chapter 5** discusses competitive neutrality obligations.
- **Chapter 6** discusses the public interest test.
- **Chapter 7** discusses the complaints handling process.
- **Chapter 8** discusses governance, training, and transparency.
- **Chapter 9** discusses related issues that are outside the scope of NSW competitive neutrality policy.
- **Chapter 10** discusses our analysis of the impact of the changes we are proposing on government businesses.
- **Appendices A-C** set out:
 - Terms of Reference for this review.
 - Glossary of terms used throughout this report.
 - Case studies of the full application of competitive neutrality principles.

Chapter 3 >>

Structure, proposed objectives and scope

Ensuring that the policy is easy to understand and is clear on what it is trying to achieve and its scope

03

This chapter sets our draft recommendations in relation to the overall operation of competitive neutrality policy in NSW. This includes the structure and objectives of competitive neutrality policies. It also includes consideration of whether there is a need for different treatment of different sectors or types of business activities or levels of government, and the scope of the policy. It discusses the case for expanding the scope of competitive neutrality to activities that would not be considered 'significant government business activities'.

The structure of competitive neutrality policy affects how accessible it is to government and non-government stakeholders, who either need to implement or are affected by the policy. It also impacts how consistently the policy is applied across NSW Government business activities. A clear statement of objectives sets the tone for the policy, shapes the content and provides guidance on how to deal with 'grey areas'.

The Competition Principles Agreement specifies that competitive neutrality be applied to "significant government business activities".¹³ We have been asked in our terms of reference to consider the costs and benefits of broadening the scope of competitive neutrality to a wider range of activities where government and other service providers operate in the same market, such as human services.

If the scope of competitive neutrality policies is too narrow, opportunities that would deliver real benefits for consumers for lower prices, better service quality and greater choice may be missed. On the other hand, if the scope of competitive neutrality policies is too broad, it creates costly administrative processes for little gain and could slow down government processes.

3.1 Overview of the draft recommendations

We are proposing changes to the way the current competitive neutrality policies are structured and applied to different government entities. The current structure of the documents does not promote accessibility, consistency of application, or clarity. The policies are spread over multiple documents, with different obligations depending on the level of government and structure of the significant business activity. We are recommending that the competitive neutrality policies be brought into a single document that applies to both local and state government and all significant government business activities, regardless of how the business activity is structured.

We also recommend that the competitive neutrality policy should include a clearer statement of objectives upfront. This statement should note that competitive neutrality seeks to achieve an efficient allocation of resources between non-government and government businesses, through the removal of net advantages from government ownership of significant business activities.

We recommend no additional changes to expand the scope of competitive neutrality policies beyond significant government business activities. Competitive neutrality obligations include pricing and other costing principles that cannot be easily applied to non-business government activities. The costs of expanding competitive neutrality to these activities are likely to outweigh the benefits, add unnecessary bureaucracy and slow down government processes. There was no clear stakeholder support for an increase in scope, and where specific issues were raised through our consultation that sit outside the recommended scope, we consider that they are better dealt with via other processes.

Our proposed changes to competitive neutrality policy, including making the complaints process more accessible should help us to gather more information over time about areas where there may be benefit in expanding the scope of competitive neutrality policy. Changes to the complaints process are discussed in Chapter 7. Out of scope issues are discussed in Chapter 9.

3.2 A single policy document with a consistent set of obligations

The current competitive neutrality policies are not well structured. They discuss a range of obligations but are not clear about when each applies. The policies are spread over several separate documents. Some policies cover the same ground but apply different tests or standards. For example, the local and state government policies have different definitions of business activity, with no clear policy reason on why it should differ across the levels of government.^a

The NSW Productivity Commission raised issues about the structure and content of the current policies in its submission. It suggested that a refresh of the policy could involve reducing the number of separate policy documents and ensuring that relevant competitive neutrality principles are clear, consistent, and easy to understand.¹⁴

Restructuring the policies so that the key information is contained in a single policy document would improve the accessibility of the policies. The single policy document should have a clear statement of objectives and scope provided up-front. This would set the tone for the policy and inform the content.

We propose that the policy cover both state and local government business activities and cater for the differences between the 2 in a consistent and principled way.

We also consider that there is value in having all entities that undertake significant government business activities apply competitive neutrality principles, irrespective of business structure.

Below is a proposed outline of what the policy should cover.

1. Background to Competitive Neutrality policy.
2. The objectives of the policy.
3. Application and scope of the policy
 - a. tests for government business activity, significance, and public interest.
 - b. interaction with the Commercial Policy Framework.
4. Competitive neutrality measures:
 - a. guidance on business structure.
 - b. estimating the competitively neutral price
 - c. addressing non-cost advantages and disadvantages

^a The Local Government policy statement states that a local government business activity will generally involve the supply of goods and services for a fee (NSW Government – *Policy Statement on the Application of National Competition Policy to Local Government*, June 1996, p 12), whereas the *NSW Policy Statement on the Application of Competitive Neutrality (TPP 02-1)* requires trading in goods and/or services and a large measure of self-sufficiency (p 3).

- d. guidance on pricing below the competitive neutral price or not addressing non-cost advantages.
5. Compliance and reporting obligations.
6. The complaints mechanism.

3.2.1 State and local government business activities

The Competition Principles Agreement specifies that the principles in the Agreement are to be applied to local governments.¹⁵ It allows for a separate statement of principles for local government.¹⁶ Other jurisdictions have adopted a range of approaches – in Victoria and South Australia, a single policy applies to local and state government businesses.¹⁷ In Queensland, Western Australia and Tasmania, local government is dealt with separately to state government businesses.¹⁸

We consider that it is best practice to combine the state and local government policies, to improve accessibility for stakeholders and to create a more principled approach to key concepts such as the definition of a significant business activity.

There may be differences between state and local government business activities in terms of size, resourcing or the nature of activities that they undertake. We consider that these differences can be addressed in a joint policy by distinguishing business activities based on size or other characteristics, rather than whether the business activity is carried out by local or state government.

3.2.2 Corporatised or commercialised businesses

The NSW *Guidelines for Pricing of User Charges (TPP 01-02)*, do not apply to government businesses that are part of the Commercial Policy Framework (including both commercialised and corporatised businesses).¹⁹ Only the remaining significant government business activities that compete with the private sector are subject to the pricing and costing guidelines.

For most, if not all, commercialised and corporatised entities subject to the Commercial Policy Framework, we expect that there will be no further action that needs to be taken to comply with the guidelines for establishing the competitively neutral price. However, as a matter of good practice, we consider that all entities undertaking significant business activities should be obliged to consider whether there are remaining net competitive advantages that should be accounted for.

Competitive neutrality policy focuses on 'business activities' rather than entities. Given the range of different government entities undertaking business activities and the potential for a mix of business and non-business activities, this is appropriate. Conversely, corporatisation/commercialisation is focused on entities. In many cases, the distinction does not matter. For example, if a SOC needs to pay tax on its profits, none of its business activities have an advantage in not having to pay taxes.

However, it is possible that corporatised/commercialised entities may undertake business activities where there could be legitimate concerns that they have a net competitive advantage as a result of their government ownership. This may particularly be the case where they are able to exploit an existing function for commercial gain in a different or related business activity, in the same way that a government department or local council may be able to.

For example, where a corporatised or commercialised entity fulfils significant CSOs^b, it may have capacity to cross-subsidise business activities if there is excessive funding of the CSOs.

A stance of applying competitive neutrality principles to all government business activities provides a more principled approach that will be flexible enough to deal with changing circumstances. Ultimately, a government entity undertaking a business activity may decide that there is no advantage resulting from its government ownership. In this case no further action needs to be taken. However, concluding that no adjustment needs to be made after undertaking the analysis is not the same as being exempt from the need to *consider* whether an advantage exists.

Some of the submission comments we have received relate to activities of corporatised government entities.²⁰ Confirming that all government business activities should apply the principles in the competitive neutrality policy will clarify that these activities can be the subject of a competitive neutrality complaint.

3.2.3 Not-for-profit businesses

Some existing NSW Government businesses are also classed as 'not for profit' as per *TPP21-07 Distinguishing For-profit from Not-for-profit entities*²¹, including Sydney Opera House Trust²² and Venues NSW²³. From a competitive neutrality perspective, establishing government businesses as 'not for profit' could mean that there is no requirement to adjust for (or pay) dividends, or potentially tax equivalents.

There is limited guidance around how these businesses should be treated from a competitive neutrality perspective:

- Under the Competition Principles Agreement, 'non-business, non-profit activities' of publicly owned entities are excluded from the application of competitive neutrality principles and policies. In our view, this is a reference to activities engaged in by an entity rather than the non-profit status of the entity itself. For example, a large government department may operate a small bookshop selling departmental publications. The presence of the bookshop operation would not determine the classification of the department as a whole.²⁴

^b Under NSW Treasury *Guidelines for Community Service Obligations (TPP 19-02)* (January 2019), a community service obligation must meet the following criteria: it would not be pursued by a government business operating on a purely commercial basis; it has a specified policy objective; there is an explicit government agreement, as in either a portfolio Minister directive or government department agreement, with the business that the activity should be pursued; and there is funding from the responsible government department.

- The 2016 *Intergovernmental Agreement on Competition and Productivity-Enhancing Reforms (IGA)*, signed by 6 jurisdictions, including NSW, re-committed to the application of competitive neutrality principles to government business activities that compete with private providers, whether for-profit or not-for-profit.²⁵ There may be several interpretations of 'not-for-profit', including application to government businesses, private providers that compete against government businesses or both.
- The NSW competitive neutrality policy statement makes no reference to government not-for-profit organisations.

The NSW Government policy *Distinguishing For-profit from Not-for-profit entities* states that:

"financial reports should reflect economic substance rather than legal form. The exercise of professional judgement is considered essential in identifying the principal objective of any entity. There is no single factor that can conclusively determine the status of an entity. While it is possible that a not-for-profit entity could have minor operations that could be regarded as for-profit, classification should be based on a consideration of the main activities of the entity."²⁶

The policy also states that:

"The fact that an entity is classified as *not-for-profit* under Australian Accounting Standards does not imply that it is not required to operate efficiently, or in a commercial manner, as set out by its governance framework (including the NSW Commercial Policy Framework). Such a classification does not override legal requirements e.g. a requirement to pay dividends to owners. Similarly, the fact that an entity is classified as *for-profit* does not mean it is released from wider obligations to society imposed by owners or other external parties."²⁷

Not-for-profit organisations play a significant role in the economy and the community more broadly.²⁸ In many industries (childcare for example), it is normal for not-for-profit organisations to compete against for-profit businesses.

We are proposing that when identifying whether a government business activity has a net competitive advantage compared with other businesses, that it compares itself to for-profit competitors (see Chapter 5). Where its competitors are mostly not-for-profits or charities, the government business may decide that it is in the public interest for the government business to also not include dividends or tax equivalents in its prices (see Chapter 6).

This approach means that the form of the government entity itself (whether for-profit or not-for-profit) is not the deciding factor as to whether it is required to include dividends and tax equivalents in its prices. Otherwise, the government would be able to set up their businesses as not-for-profits to avoid the need to pay dividends or tax equivalents, which is not in the spirit of applying competitive neutrality principles.

Draft Recommendations

1. Bring the competitive neutrality policies into a single document that covers both local and state government business activities.

2. Apply a consistent set of obligations to all entities regardless of their sector or business structure.

Seek Comment



1. How could we further improve or simplify the competitive neutrality policy?
 - a. What is the impact of a consolidated policy, particularly for local government?

3.3 A clear objective and scope

We consider that the policy should have a clear objective that is stated up-front within the policy. The Competition Principles Agreement, which was the initial agreement to implement competitive neutrality amongst the various Australian jurisdictions, sets out the following objective and scope of competitive neutrality:

"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. These principles only apply to the business activities of publicly owned entities, not to the non-business, non-profit activities of these entities."²⁹

In drafting their own competitive neutrality policies, each jurisdiction has introduced other objectives and set a scope for their policy. Currently, there are some ambiguities within the NSW competitive neutrality policies about their purpose and the circumstances that they apply to. Policy aims and objectives are referred to multiple times throughout the different documents making up the competitive neutrality policies, with changes in wording and emphasis. For example, the local government pricing policy states that the objective of competitive neutrality is to achieve a level playing field between government and non-government businesses, but this is not always consistently reflected in the application of the policy, particularly where costing is concerned.³⁰

We consider that the revised policy should include an opening statement which clearly outlines its objectives and scope. The objectives will determine what sits within and outside the scope of competitive neutrality policy and the nature of competitive neutrality obligations. The proposed statement of objective and scope is contained in Box 3.1.

3.3.1 What competitive neutrality covers

Where governments operate their own businesses to deliver products and services, they may have a range of advantages that are not available to the non-government businesses they compete with or could compete with. These include not having to earn a profit or pay taxes, access to cheaper funds and hidden subsidies. Competitive neutrality policy is aimed at preventing government businesses from using these advantages to out-compete other businesses unless it is in best interests of the community for them to do so.

Competitive neutrality requires government businesses to assess their advantages and disadvantages from being government owned and offset any net competitive advantages. One common way government businesses do this is by pricing goods and services to reflect all costs that a private equivalent business would have to pay in the same market.

3.3.2 What competitive neutrality does not cover

Competitive neutrality does not address any advantages or disadvantages that come from the size, structure or scope of a government business' operation because these are types of advantages or disadvantages other competing businesses may also have. Competitive neutrality does not ensure that every business will be able to make a profit, or that private business will not face any competition from government.

Box 3.1 Proposed statement of objectives for inclusion in the NSW competitive neutrality policy

The aim of NSW's competitive neutrality policy is to eliminate any net competitive advantages that government businesses in NSW have because of their public sector ownership. The principles in this policy are designed to promote an efficient allocation of resources between government and private businesses.

By helping develop effective competition, competitive neutrality gives all businesses incentives to innovate, improve their products and become more efficient. It also gives non-government businesses, particularly small businesses, confidence that they will not be disadvantaged due to a government owned competitor operating in the same market. Competitive neutrality does not prohibit subsidies for government business activities where the subsidies are deliberate, considered and in the public interest.

Competitive neutrality policies are important to achieving a prosperous economy in NSW that meets the demands of the future. The outcomes from a well-functioning competitive neutrality policy include:

- opportunities for businesses to grow
- opportunities for businesses to enter new markets (including in regional areas)

Box 3.1 Proposed statement of objectives for inclusion in the NSW competitive neutrality policy

- incentives for all businesses to innovate, improve their products and become more efficient
- better understanding of the costs of having governments provide goods and services.

Competitive neutrality principles aim to promote efficient competition between businesses without interfering with differences in size, assets, skills and organisational culture which are present in the economy. Competitive neutrality does not guarantee that private businesses will not fail. Nor is it about removing government businesses or promoting privatisation so the private business doesn't have any competition from government.

The principles in this policy apply to significant government business activities where it is in the public interest to apply them.

Source: IPART

3.3.3 We recommend the objective focuses on efficiency rather than equity

The proposed objectives statement emphasises the efficient allocation of resources between government and private businesses as the objective of competitive neutrality. This is consistent with the current NSW policies and the approach taken by the Australian Government.³¹

On the other hand, some other jurisdictions explicitly refer to equity and fairness as an objective of competitive neutrality policy. For example, the Victorian policy states:

"It is common for private businesses (both for profit and not-for profit entities) to coexist with government businesses in a variety of markets. They do not always compete on equal terms. Such inequalities arise from a variety of circumstances and it is the goal of competitive neutrality policy to offset these where appropriate."³²

Efficiency and equity objectives are largely consistent – for example, it is both efficient and fair for a government business to pay the same taxes as its private sector equivalent, unless this would not be in the public interest.

There are, however, differences when government business activities use resources that are owned by general government sector entities. If a general government sector entity has a set of resources with spare capacity, a private business will need to invest in another set of resources to compete. It is generally more efficient for the government entity to make use of this spare capacity.

The Australian Productivity Commission has found that avoidable cost pricing will generally promote the efficient use of any spare capacity, because it reflects the resources used to provide the product.³³ Avoidable costs are the costs that could be avoided if a good or service was no longer provided by an entity. This means in many cases that the cost of the resource with spare capacity will not be included in the competitively neutral price charged by the government business activity. This may be perceived as unfair by private businesses, even though it is economically efficient.

In some circumstances, the use of the spare capacity at avoidable cost may be inefficient. For example, the spare capacity may arise from a poor investment decision, a change in government policy or a change in demand for the services. In this case, it may be efficient for the entity to sell the resource, thereby avoiding the associated capital costs. If the entity opts instead to allow the business unit to use the resource, a fully distributed cost approach^c is efficient.

A focus on equity, on the other hand, suggests that a government business should adopt a fully distributed cost approach to this spare capacity in the long term even if the spare capacity is unavoidable, so that they compete on a level playing field with private competitors.

We are proposing to focus on efficiency, even if this comes at the expense of equity in limited circumstances. When a government business is more efficient than some of its rivals, fairness should not be invoked to hold the government business back in case it damages a competitor. Enabling competition supports efficient competitors, which ultimately delivers better outcomes for consumers and society.

3.3.4 The objective should reference the public interest, net advantages and also identify what competitive neutrality is not


The Competition Principles Agreement is clear that competitive neutrality principles should only be applied to the extent the benefits outweigh the costs.³⁴ That is, implementation of competitive neutrality principles needs to be in the public interest. This should be acknowledged in the objectives of the policy.

Likewise, the inclusion of the phrase 'net competitive advantage' in the Competition Principles Agreement implies there is a weighing up process and that an adjustment is only made if the sum of the advantages from government ownership outweighs the disadvantages.

The objectives section also outlines what competitive neutrality does not seek to achieve. It clarifies that competitive neutrality does not correct for characteristics such as business size or scope of a business's activities – for instance, it does not seek to ensure that small businesses can compete with large businesses. Nor does it operate to prevent private businesses from failing.

^c Fully distributed costing is where the total costs of an agency or business are allocated across all commercial and non-commercial outputs. In the case of indirect costs, such as corporate overheads and joint costs, these are allocated between activities typically on a pro-rata basis.

Draft Recommendation

-  3. Include a clear statement of objective and scope up-front in the policy. We recommend the objective is framed around achieving an efficient allocation of resources through the economy and clearly articulate the benefits of applying the policy. The suggested technical wording is provided in Box 3.1.

Seek Comment

-  2. Do you agree with the proposed objective statement and its inclusion in the policy?

3.4 Competitive neutrality should continue to apply to significant government business activities

NSW's current policies require competitive neutrality principles to be applied to significant government business activities, where it is in the public interest to apply them. As part of our review, we have been asked to consider the benefits and costs of expanding the scope of competitive neutrality policies to a broader range of activities where government and other service providers operate in the same market (including human services).

This follows the findings of the 2015 Harper Review, which found that there is scope to extend competitive neutrality principles to markets where governments and other providers are supplying services, including human services (see Box 3.2).

Box 3.2 Harper review of competition policy

The 2015 Harper Review found that there is scope to extend competitive neutrality principles to human services in an appropriate manner that would facilitate choice for users and secure the benefits of a diverse range of service providers. The review panel found the case for extending competitive neutrality principles is strongest when:

- there are different arrangements for government providers operating in the same market as alternative providers; and
- the differential treatment is not justified on net public benefit grounds.

The main challenges in securing competitive neutrality in human services include:

- structural separation
- determining the operational form for government business activities, particularly when the activities sit within a broader range of government functions

Box 3.2 Harper review of competition policy

- transparent costing and funding of CSOs.

The final report also noted that implementing changes to human services needs to be well considered, staged and piloted. Human services have a lasting impact on people's lives and wellbeing. As a result, it is critical to get policy changes right.

Source: Harper et al, *Competition Policy Review – Final Report*, March 2015, pp 253-267.

There is no well accepted definition of human services. However, we consider that they would generally consist of 3 main groups – welfare services, education services and health services. They may include (but are not limited to) health care, childcare, counselling, housing services, disability care, aged care, employment assistance, correctional services and education.

The current competitive neutrality policies do not explicitly exclude human services and we consider that some of these services would be within the scope of the current policies. However, there is no clear reporting of which government activities have been assessed as within scope and it is not possible to determine from examining their prices, as services within scope may still be priced below the competitively neutral price where it is in the public interest. In some cases, human services provided by government entities are subject to competition from non-government providers (for example, private hospitals and private schools). It is the nature of the activity that determines whether it is within-scope and not the contestability of the market.

Some types of human services are likely to fall into a broader category of activities carried out by government entities that will clearly sit outside of the business activity test. For example, public hospitals and public schools in NSW have a statutory duty to provide certain health care or education services free of charge. The entities providing the services have little influence over the nature of their services and their price. These types of government activities would not be subject to competitive neutrality policy unless the scope was explicitly broadened to capture them. Other human services may also be considered "non-business, non-profit activities", and as a result, will sit outside the scope of the current policies as well.

In addition to human services, there are other government activities which may impact competition where competitive neutrality does not currently apply, including:

- contracting out service provision to a private operator (e.g. bus, ferry and light rail)
- taking a minority ownership stake in a business (e.g. by selling a majority stake in a previously government owned business)
- providing grants, concessional loans, tax advantages or equity stakes to particular private businesses to achieve policy outcomes, such as greater employment innovation or industry development.

We considered whether there is a public interest argument for expanding the scope of the policy to capture government activities that would fall outside the definition of 'significant business activities'. In considering this issue, we had regard to the core focus of competitive neutrality, which is on fully identifying the costs of government activities, adjusting for advantages and disadvantages of government ownership and ensuring that prices reflect these, where it is in the public interest.

We also had regard to the appropriate objectives of competitive neutrality. In section 3.3 of this report we outlined our recommendations for clarifying the objectives of the competitive neutrality policy in NSW. We consider that the scope of the revised competitive neutrality policy should be aligned to its objectives. That is, to promote an efficient allocation of resources between government and private businesses (see Box 3.1).

We do not propose to recommend expanding the scope of competitive neutrality policies beyond significant government business activities at this stage. We note that:

- Competitive neutrality policy is likely to deliver the greatest benefits when applied to activities that have a commercial focus and that compete, or could compete, with the private sector.
- There may be limited value in applying competitive neutrality where there is an overriding policy objective to not charge for services, or to provide them well below cost, for the purpose of ensuring people can access essential services. Where there is an explicit objective to provide universal access to some services (such as school education and healthcare) or to provide heavily subsidised services to targeted groups (such as social housing), the benefits of competitive neutrality are unlikely to justify the costs, since many of the benefits come from a shift towards full cost pricing. This is likely to be the case even where these services notionally compete against private providers.
- There was not strong stakeholder support to broaden the scope of the policies and the current barriers to making a complaint in NSW mean there is limited to data that can be used to identify areas of concern. Where specific issues were raised through our consultation that sit outside the recommended scope, we consider that they can be appropriately dealt with via other processes.

As the competitive neutrality policies have not been reviewed for 20 years, we recommend retaining the current focus on significant government business activities in the revised policy and making changes that deliver a clearer and more consistent policy with a more accessible complaints process and stronger reporting obligations. This will provide better information on which activities are currently determined to be within scope and identify any areas of concern that can be considered in future reviews.

Draft Recommendation



4. Retain the current scope of competitive neutrality policy, which focuses on applying competitive neutrality principles to significant government business activities where it is in the public interest.

While we are not recommending any fundamental changes to the policy scope, we are proposing revised tests for determining whether an activity is undertaken by a government entity, is a business activity and is significant. The proposed tests are designed to remove the ambiguities and inconsistencies in the current tests. Revising these tests will alter the scope of competitive neutrality policy to some extent. It is difficult to determine whether certain activities are captured by the current tests, and it is likely that different government entities have interpreted the tests differently.

For more information on issues related to this discussion:

- Chapter 4 provides our recommended definitions for each of the 'government ownership', 'business activity' and 'significance' tests.
- Chapter 6 sets out our recommendations in relation to the 'public interest test'.
- Chapter 9 identifies some of the concerns raised by stakeholders that relate to other government activities and our response to them.

Chapter 4 »

Which activities are subject to competitive neutrality?

The 3 tests to determine whether an activity is required to have competitive neutrality obligations applied to it

04

It is important that the revised competitive neutrality policy clearly sets out the scope of activities that fall under the policy so that government entities can identify which activities they need to apply competitive neutrality principles to.

As set out in Chapter 3, we consider that the current scope of competitive neutrality policies should be retained. This means that competitive neutrality principles should continue to be applied to significant government business activities.

In NSW, the current competitive neutrality policies discuss the definition of 'significant government business activities' in various documents. They make a distinction between state government businesses and local government businesses, and while there is some overlap between the way the tests are specified, there are also notable differences.

This chapter discusses our draft recommendations in relation to each of the following tests:

- The government ownership test
- The business activity test
- The significance test.

4.1 Overview of the draft recommendations

We are recommending that the revised policy should be clearer on which activities are considered 'significant government business activities' and therefore, which activities are required to have competitive neutrality applied to them.

We have developed 3 tests that will need to be applied for each activity to determine whether it needs to have competitive neutrality principles applied to it. Our general approach to these tests is that they should be consistent between state and local government, should be principles-based, taking account of relevant precedents and consistent with the tests applied in other states where we consider these are best practice.

The Competition Principles Agreement specifically requires the application of competitive neutrality principles to public non-financial corporations and public financial corporations where their business activities are significant and it is in the public interest.^d This requirement is reflected in current NSW competitive neutrality policies and we recommend retaining this approach in our government ownership and business activity tests.

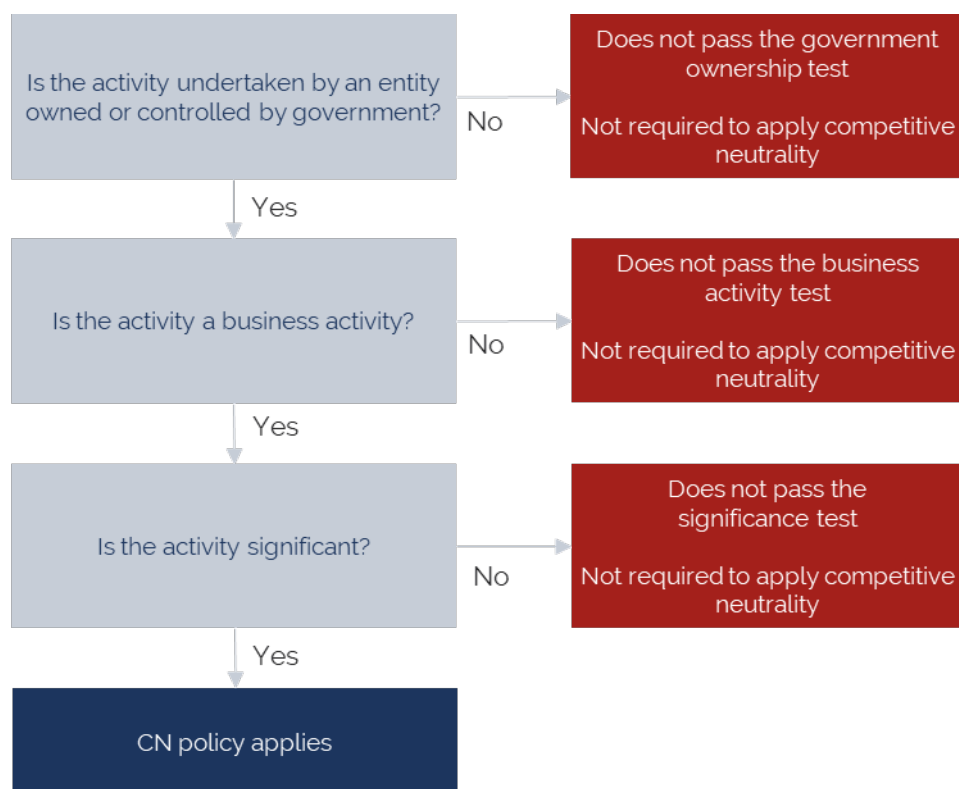
^d Clause 3(4) of the Competition Principles Agreement requires the application of competitive neutrality principles to significant government business enterprises that are categorised as "Public Trading Enterprises" or "Public Financial Enterprises" under the Government Financial Statistics Classification. The Australian Bureau of Statistics (ABS) Government Finance Statistics has replaced these terms with Public Non-Financial Corporations and Public Financial Corporations, respectively: Australian Bureau of Statistics (2015), [Australian System of Government Finance Statistics: Concepts, Sources and Methods](#), ABS Website, accessed 18 October 2022.

We recommend that the policy include the following 3 tests:

- **The government ownership test** – An activity carried out by an entity that is owned or controlled by the NSW state or local government. Examples of entities that are owned or controlled by government include departments and agencies, SOCs, local councils; and any entities they own or control. See the full test proposed in Box 4.1.
- **The business activity test** – An activity may be a business activity if it involves regular, systematic supply of goods or services with a commercial or business-like character (subject to some exclusions for policy or regulatory functions). It is not necessary that payment is charged for the goods and services produced. An activity will be a business activity if the activity is undertaken by a public non-financial corporation, including a SOC, or public financial corporation, even if it would not otherwise pass the business activity test. See the full test proposed in Box 4.2.
- **The significance test** - An activity will be significant unless it has an annual turnover of less than \$3.7 million (which will be indexed over time), a market review shows it's not significant, or if there is no possibility of a competing business (for example, the activity is legislated as a monopoly service). We are also recommending that in certain circumstances the Minister may declare an activity significant that would not otherwise pass the test. See the full test proposed in Box 4.3.

If any of these tests are not satisfied, then competitive neutrality policy does not need to be applied to the activity (Figure 4.1).

Figure 4.1 Determining whether an activity must have competitive neutrality applied to it



Each of the 3 tests is set out in more detail below.

4.2 The government ownership test

The 'government ownership test' in the current competitive neutrality policies is uncertain, inconsistent and unclear. The definition of government ownership is inconsistent between state and local government services, does not include key definitions and does not provide guidance on how to apply it. The current policies also do not clearly distinguish between the 3 different tests, combining the government ownership element with the business activity element.

To ensure that these issues are resolved in the revised policy, we have constructed the proposed test using established categories of government entities and/or language that has a clear meaning or definition. This will ensure that a government entity and its competitors can determine whether it falls under the definition with sufficient certainty and consistency.

We recommend a government ownership test that has 2 limbs – one that considers ownership of the entity and one designed to capture other entities that are controlled by government. We recommend that the test is based on the entity that is undertaking the business activity meeting the test for either government ownership or control.

Draft Recommendation

5. The 'government ownership test' be revised to improve clarity and make it easier to apply. The proposed test focuses on whether the activity is undertaken by an entity that is government owned or is controlled by government. The proposed government ownership test is set out in Box 4.1.

Box 4.1 Proposed government ownership test

1. Each of the following entities, and organisational units within those entities, are government owned:
 - a. general government sector entities^e, including:
 - i NSW Government agencies and departments
 - ii councils, county councils or joint organisations or any person exercising the functions of a council, county council or joint organisation^f
 - b. public non-financial corporations, including SOCs^g

^e With the meaning given by the Australian Bureau of Statistics' Australian System of Government Finance Statistics: Concepts, Sources and Methods (2015) (GFS), as updated or amended from time to time.

^f Council, county council and joint organisation have the meaning given by the *Local Government Act 1993*.

^g Within the meaning given by the *State Owned Corporations Act 1989*.

Box 4.1 Proposed government ownership test

- c. public financial corporations^h
- d. an entity (whether incorporated or unincorporated) owned (in whole or part) and controlled by the State or any of the entities described in paragraphs (a) to (c).

For purposes of paragraph 1(d), the State includes the Government of NSW or a Minister.ⁱ

2. The State or a government owned entity described in paragraphs (a) to (c) of paragraph 1 controls another entity if:
 - a. it holds more than half of the issued share capital in the other entity or
 - b. alternatively, it can do any one or more of the following things – based on legislative powers (e.g. Ministerial powers of direction), the other entity's constitution or rules, or contractual or other arrangements (such as a shareholder agreement or loan agreement):
 - i cast, or control the casting of, more than one-half of the maximum number of votes that might be cast at a general meeting of the other entity
 - ii control the appointment or dismissal of a simple majority of the board or other governing body members, or can veto appointments
 - iii control the appointment or dismissal of a simple majority of a key committee or subcommittee, or can veto appointments
 - iv appoint or remove, or determine the remuneration of, key personnel (such as the chair, chief executive officer or finance director)
 - v direct the other entity to enter into transactions, or veto changes to transactions for the benefit of the government owned entity or the State
 - vi direct the other entity to acquire, manage or dispose of assets, or veto such decisions.
3. Where there is more than one government owned entity with rights of the kind described above, those rights should be considered in aggregate. For example, 2 government owned entities who can jointly, but not independently, control a third entity, should be taken to each control the third entity. The 2 government owned entities would both be required to ensure the third entity applies competitive neutrality principles to its significant business activities.

Source: IPART

^h With public non-financial corporation and public financial corporation having the meaning given by the GFS, as updated or amended from time to time.

ⁱ This meaning is consistent with section 21(1) of the *Interpretation Act 1989* (definition of "the State") and Part 4C of the *Independent Pricing and Regulatory Tribunal Act 1992* (definition of "State" in section 24GA).

4.2.1 We propose a consistent test for government ownership for state and local government activities

Current competitive neutrality policies give very limited guidance on how to determine government ownership. They take different approaches to determining 'government ownership' for state and local government entities:

- **State government:** competitive neutrality policies apply to 'Government businesses'. The NSW competitive neutrality policy statement definition of government business includes elements relating to both government ownership and business activities — some form of public sector ownership, trading in goods and/or services, a large measure of self-sufficiency and being subject to 'Executive control'.³⁵ Public sector ownership and being subject to Executive control are the relevant criteria for government ownership. However, the policy does not define public sector ownership or Executive control.
- **Local government:** competitive neutrality policies applying to local government provide no guidance on government ownership. The test for 'government business activity' in the local government policy statement³⁶ and local government pricing guideline³⁷ focuses only on the 'business activity' component of the test. It appears to be assumed that council business activities will always be government owned.^j

Competitive neutrality policies for state and local government would benefit from increased clarity about how government ownership is to be ascertained. Further guidance is likely to be useful for entities engaged in business activities that are partially government owned or where there is more than one government owner, where the application of competitive neutrality policy is currently less clear. Even where government ownership is likely to be straightforward (e.g. business units within a council or government department) we consider there is merit in providing greater clarity in competitive neutrality policies. We consider that aligning the government ownership test between state and local government is also appropriate in line with our general approach that a single policy should apply as far as possible.

4.2.2 We propose using established categories of government entities to designate government ownership

All other Australian jurisdictions specify particular categories of entities as government owned in their competitive neutrality policies. Our recommended test would adopt a similar approach for the revised NSW competitive neutrality policy. We propose using the classifications in the Australian Bureau of Statistics (ABS) Government Finance Statistics Concepts, Sources and Methods classification (Government Finance Statistics), which categorises the public sector in Australia as comprising:

- the general government sector
- public non-financial corporations
- public financial corporations.

^j Councils can form a corporation or other entity, or acquire a controlling interest in a corporation or other entity, with the consent of the Minister or as provided by the *Local Government Act 1993* (section 358).

These classifications are applied across all levels of government in Australia, are well understood within the government sector and should be straightforward for government entities to apply. Classification of an entity into each of the above categories requires an assessment of the level of control exercised by government, so it can be assumed that an entity classified as such is controlled by government.

4.2.3 We propose that competitive neutrality policy should apply to partially owned entities, where they are controlled by government

Partially government owned entities engaged in business activities may derive competitive advantages from their government ownership, for example, through access to more favourable borrowing terms or subsidies.^k Going forward, we recommend that the revised competitive neutrality policy provides clear guidance on when competitive neutrality principles apply to partially government owned business activities.

The current competitive neutrality policies do not expressly address how competitive neutrality principles should be applied to entities that are partially government owned. The concepts of 'some form of public sector ownership' and being 'subject to Executive control' in the NSW competitive neutrality policy statement are ambiguous in their application to partially government owned entities. Arguably they do cover partial ownership as:

- there is no requirement in the NSW competitive neutrality policy statement for business activities to be wholly government owned — the reference to 'some form' of public sector ownership could be intended to capture partial or minority government owned entities
- the requirement for Executive control appears to contemplate scenarios where the business activities may not be wholly controlled by government (e.g. the NSW competitive neutrality policy statement refers to universities as not being subject to Executive control).³⁸

However, the lack of clarity in the current competitive neutrality policies means it is likely extremely challenging for a partially government owned entity engaged in business activities to determine whether and to what extent competitive neutrality policy applies. The Australian Diagnostic Imaging Association (ADIA) raised concerns about the ambiguity of the meaning of 'Executive control' and its application in its submission to the Issues Paper: "Some government enterprises may dispute the degree of 'executive control' of their operations, which might be used to argue that they are excluded from 'government business' criteria in competitive neutrality tests."³⁹

We have reviewed other Australian jurisdictional approaches to partial ownership and consider that the South Australian approach to applying competitive neutrality principles to joint ventures, public private partnerships, equity partnerships and other similar arrangements is an example of best practice. The South Australian policy:

^k NSW Treasury identified other possible advantages of minority government ownership, including access to cheaper insurance premiums, in its submission to the IPART Issues Paper, pp 17–18.

- states that for competitive neutrality to apply, "the role of the Government must satisfy the 'business activity' criteria ... (in particular, being an activity whose purpose is to generate a commercial return or profit for the Government); and the Government must have control over the activity".⁴⁰
- includes some guidance on government control depending on the type of entity. For example, for an incorporated association it is relevant to consider whether the entity's constitution or rules enable the Government, the Minister, or another instrumentality of the Crown to control the appointment or dismissal of a simple majority of the directors or board members, or to give directions to board members or exercise control over the body.⁴¹

Competitive neutrality policies for other Australian jurisdictions do not expressly address or provide very little guidance on the application of competitive neutrality principles to entities that are partially government owned. Sometimes the application of competitive neutrality principles to such entities can be implied. For example, the Commonwealth policy specifies some entities that are partially government owned as being subject to competitive neutrality.⁴² Tasmanian competitive neutrality policies use terminology such as 'owned or controlled', but do not provide guidance on how control or ownership is to be ascertained.⁴³

4.2.4 The test for government 'control' of an entity should be principles-based

Entities that are not wholly owned by government can take a variety of forms. For example, they could be incorporated (such as a company established under corporations law) or unincorporated (such as an unincorporated corporation). The manner and degree of control exercised can also vary significantly depending on the rights conferred on the government owner and the proportion of their ownership stake. It is not as simple as setting a percentage ownership threshold. For example, a government entity might own 20% of the share capital of a corporation but control the majority of the voting rights. In another case, a Minister might have the statutory authority to control the composition of an entity's board, the body responsible for taking decisions about the entity's business activities.

Given the variety of legal structures and ways in which control could conceivably be exercised by government, we recommend adopting a principles-based test for determining government control of an entity. The principles-based test would focus on the rights and ability of the government owner to determine decisions affecting the business activities of the entity, rather than the legal form of the entity.

In developing the test for government ownership we have considered tests for control in other frameworks, such as corporations law, the Australian Accounting Standards, the Government Finance Statistics, and competition law (in relation to merger control).

We consider there is benefit in adopting an approach to control that is consistent with other NSW and Commonwealth legislation, policies and standards. Each of these laws, standards and policies takes into account similar considerations when ascertaining control, and we consider these considerations to be best practice. Those considerations include:

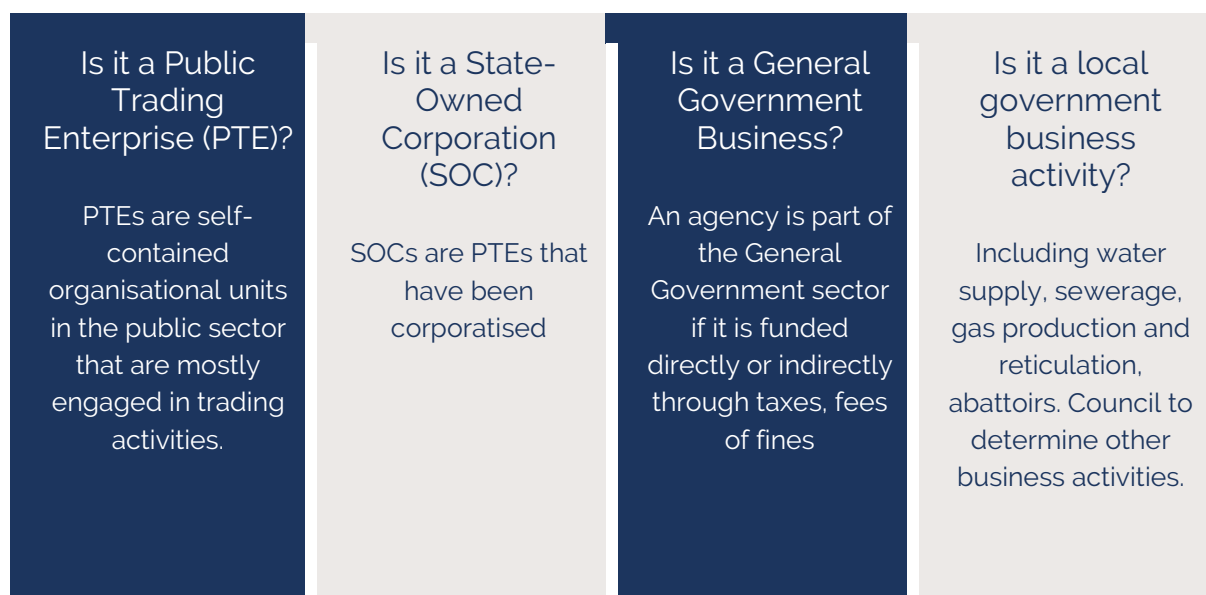
- having a majority of the voting interest

- the ability to control the composition of the board or governing board (e.g. under the *Corporations Act 2001* (Cth), this is the power of one body to appoint or remove all or the majority of the directors of another body⁴⁴)
- rights to appoint and determine the remuneration of key personnel
- rights to direct the entering into, or veto changes to, transactions
- rights in relation to the acquisition, management or disposal of assets (including veto rights)
- rights attaching to loans and other contractual arrangements.

4.3 The business activity test

The current business activity test is complex and unclear. There are different approaches to defining government businesses activities for state and local government. The current policies include tests that mix elements of government ownership, business activities and significance within the one assessment. In our view these make the tests for whether competitive neutrality should be applied to a business activity more complex than they should be. Figure 4.2 summarises the different approaches to the business activity test in the current competitive neutrality policies.

Figure 4.2 Classifications of business activities under the current policy



Source: IPART

Instead of this approach, we propose a single, principles-based business activity test that is consistent between state and local government. We consider that the test should focus on commercial character rather than on profitability or user charging. This is particularly important given that failure to make a profit or recover costs may be an indication that competitive neutrality is not being adequately applied. As such, this should not be relied on as justification for not needing to apply competitive neutrality to an activity. The test we have proposed is derived from relevant legal precedent and approaches in other jurisdictions where we consider they are best practice. The proposed test also reflects the requirements of the Competition Principles Agreement.

In developing our test, we have also considered the competitive neutrality policies of other jurisdictions in Australia. Particular areas of best practice that we have incorporated into our proposed test include:

- aligning the tests for state and local governments
- specifying exclusions from the meaning of 'business activity' for:
 - regulatory and policy activities, taxation, levies and licence fees
 - in-house service provision where provision is not contestable
- consideration of CSOs through the public interest test, rather than excluding them through the 'business activity' test (see section 4.3.8).

The proposed business activity test is set out in Box 4.2.

Box 4.2 Proposed business activity test

An activity is a business activity if it meets any of the following 3 criteria:

1. the activity is undertaken by a public non-financial corporation or public financial corporation, or
2. the activity:
 - a. involves the supply of goods and/or services, with system and regularity, and
 - b. has a commercial character (whether or not it is profitable), or
3. the activity is bidding to provide goods and/or services.

The following activities should be excluded from the meaning of 'business activity':

- activities of a policy or regulatory nature, such as: carrying out functions to perform a statutory duty, such as imposing taxes, levies, licensing or other regulatory fees; granting, refusing to grant, revoking, suspending or varying licences or approvals; a statutory duty to provide services for free with no discretion to refuse provision; policy development.

Box 4.2 Proposed business activity test

- procurement of goods and/or services by a government entity for the purposes of carrying out policy or regulatory functions (e.g. the procuring of consultancy services by a government department)
- the supply of goods and/or services by a government entity for its own in-house use where external providers have not been invited to tender to supply the goods and/or services.

Source: IPART

We explain each of the 3 principles-based categories below.

4.3.1 The test captures all activities undertaken by a public corporation

As described in section 4.1, we recommend that public non-financial corporations and public financial corporations be taken to be engaged in business activities. This is consistent with the Competition Principles Agreement which requires the application of competitive neutrality principles to significant public non-financial corporations and public financial corporations where it is in the public interest.

All NSW SOCs are public non-financial corporations (e.g. Sydney Water and Hunter Water). We understand that council water and sewerage businesses are also public non-financial corporations.¹⁴⁵ Examples of public financial corporations include icare and TCorp.

4.3.2 The test captures activities that involve the supply of goods and/or services, with system and regularity, with a commercial character

Competitive neutrality policy is not the only reason that government entities need to consider whether their activities would constitute business activities. A similar assessment is required when determining whether a government entity is 'carrying on a business' and so is subject to relevant prohibitions in the *Competition and Consumer Act 2010* (Cth) (Competition and Consumer Act). The concept of 'carrying on a business' for the purposes of the Competition and Consumer Act is partially defined in that Act, and has evolved through case law over time. We consider that a best practice approach would be to adopt a set of principles for this test that are broadly consistent with that concept under competition and consumer law. The 2 key elements we identified are that the supply of goods/services is undertaken with system and regularity and that the activity has a commercial character. These elements are discussed further below.

¹ This classification aligns with our understanding of the ABS Government Finance Statistics.

Supply of goods/services with system and regularity

- The activity must involve providing goods and/or services with repetition, system and regularity.
- The entity may provide the goods/services to individuals, non-government entities (such as private businesses or not-for-profit entities) or other government entities. For example, the activity of a state government entity that provides services to councils could be a business activity.
- Engaging in an activity on a single occasion or only as an ad hoc response to an infrequent occurrence or circumstances will not normally be a business activity, as it is not carried on with system and regularity.

The activity has a commercial character, but need not be profitable

- The activity must be carried on in a business context and have a business character
 - this could include, for example, activities involving the marketing of goods and/or services (but not promotion of government policy, such as advertising encouraging utilisation of public transport)
 - there must be an element of trade or commerce such as a private citizen or trader would undertake. For example, the provision of gym and leisure facilities (with system and regularity) by a council is the type of activity that a private trader would undertake
 - 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.
- Activities intended to maximise revenue or profit, or to expand or protect market share, will be more commercial in nature. However, profitability is not required for an activity to have a commercial character — revenue from the activity does not need to be commercially adequate to cover the cost of providing the activity. Systematic, regular supply of goods and/or services for free or below cost may constitute business activities where the activities are carried on in a business context and with a business character.

4.3.3 The activity is a business activity if it is bidding to provide goods and/or services

Bidding to provide goods and/or services for remuneration involves the supply of goods and/or services, with system and regularity, and has a commercial character. It does not matter whether the government entity is the only bidder, provided the bid is made in response to an open tender that other bidders (or a shortlist of bidders) could respond to.

This would include circumstances where a government entity is competing with external suppliers to provide services to another government entity (whether or not those entities are separate organisational or business units within the same broader entity). For example, a tender proposal by a business unit of a government department to provide ICT services to another government entity would constitute a business activity.

4.3.4 The test should clearly exclude some activities from the meaning of business activity

Governments undertake a broad range of activities as part of their core government functions. We recommend that the business activity test is clear that these core government functions are not business activities. We propose that the following activities be excluded from the meaning of 'business activity':

- activities of a policy or regulatory nature, such as:
 - carrying out functions to perform a statutory duty, such as:
 - imposing taxes, levies, licensing or other regulatory fees
 - granting, refusing to grant, revoking, suspending or varying licences or approvals
 - a statutory duty to provide services for free and with no discretion to refuse to provide the service (e.g. public hospitals in NSW have a statutory duty to provide certain health care services to patients free of charge, as do public schools)
 - policy development
- procurement of goods and/or services by a government entity for the purposes of carrying out policy or regulatory functions (e.g. the procuring of consultancy services by a government department)
- the supply of goods and/or services by a government entity for its own in-house use where external providers have not been invited to tender to supply the goods and/or services.

These exclusions are discussed further section 4.3.8.

Draft Recommendation

6. The 'business activity test' be revised to improve clarity and make it easier to apply. The proposed test focuses on whether the activity is: undertaken by a public corporation; it involves the supply of goods and/or services with system and regularity and has a commercial character; or is bidding for goods and services. The proposed business activity test is set out in Box 4.2.

4.3.5 The same test should apply to state and local government business activities

As discussed in section 4.2.1, current competitive neutrality policies impose different tests for what constitutes a 'government business activity' for state and local government entities.

We do not consider that there is a justification for maintaining different tests at the state versus local government level. While the business activities that may be undertaken by state and local government entities may differ, the characteristics that give those activities a business-like nature are likely to be the same.

Some submissions expressed support for aligning the application of competitive neutrality policy to state and local government entities. Local Government Professionals Australia said, "it is unclear why there are more onerous requirements for councils compared to the NSW Government".⁴⁶ The NSW Productivity Commission recommended that "state and local government definitions of a business activity could be aligned to promote consistency".⁴⁷

This approach is consistent with competitive neutrality policies in other states. Only Queensland adopts different tests for what constitutes a 'business activity' for state and local government entities.

4.3.6 The proposed test should be principles-based

We recommend that a principles-based approach be adopted for the 'business activity' test.

A submission proposed expressly adding the provision of free and low-cost camping sites to the list of activities stated to be business activities for local government, in addition to commercially operated government owned caravan parks and camping grounds.⁴⁸ We do not recommend attempting to specify a list of entities or specified industries which are deemed to be carrying out business activities because:

- Competitive neutrality policy applies across all industries in which government owned entities engage in business activities. The breadth of potential application means that adopting such a prescriptive approach would likely result in inadvertent over- or under-capture.
- Government business activities are likely to evolve over time. The range of activities undertaken by local governments is now quite different to when competitive neutrality policies were first introduced. The local government pricing guideline currently specifies water and sewerage services, abattoirs, gas production and reticulation as local government business activities.⁴⁹ The submission from Local Government NSW indicates that, of these, councils currently only provide water and sewerage services.⁵⁰

A principles-based approach will enable competitive neutrality principles to be applied consistently by state and local government entities regardless of the industry or evolving nature of the activities. A principles-based approach does not preclude the policies from providing more specificity where appropriate. For example, we propose:

- expressly stating that public non-financial corporations and public financial corporations are presumed to be engaged in business activities, as this is consistent with the requirements of the Competition Principles Agreement
- expressly excluding certain policy and regulatory activities from the meaning of business activity, to avoid capturing non-business activities of government entities (such as those of a regulatory or policy nature).

A principles-based approach is consistent with the tests in most other Australian jurisdictions for activities carried out by government entities that are not public non-financial corporations or public financial corporations or otherwise corporatised under state/territory law. Only the Northern Territory adopts a different approach, where the Treasurer can determine that an agency, or part of an agency, is a 'government business division' if it recovers a significant proportion of its operating costs through charges on users.⁵¹

4.3.7 The proposed test should focus on commercial character and not on profitability or cost recovery through user charging

Several other jurisdictions impose requirements for profitability or cost recovery in their 'business activity' tests. In Western Australia, the entity supplying the good or service is required to recover all costs (possibly including a margin for profit) or a significant proportion of these costs from the supply of the good or service (whether or not full cost recovery or profits are actually achieved).⁵² South Australia requires the activity to have a commercial or profit making focus.⁵³ Queensland requires the entity to meet a substantial part of their operating costs or earn a substantial part of their operating revenue from user charges for the activity and to have a predominantly commercial or profit-making focus.⁵⁴ Victoria requires the costs of providing the goods or services by the entity to be predominantly met by users.⁵⁵

We consider the commercial character of the activity to be a critical feature that distinguishes the business activities of an entity from its non-business activities. However, we do not consider focus on profitability or predominate/full cost recovery to be best practice. Government entities may engage in business activities, not for the purpose of profit or for full cost recovery, but to achieve a policy objective. This doesn't necessarily detract from the business-like nature of the activity.

A focus on profitability or full cost recovery could also act as a perverse incentive for government entities that may choose not to pursue profitability or full cost recovery as a means of avoiding competitive neutrality policy application.

Additionally, government businesses may choose to adopt strategies such as loss-leader pricing for particular products or services to attract customers or to increase market share. There will be circumstances where this is an appropriate business strategy, particularly in the short-term or for a new business. Adoption of these business strategies should not result in business activities of government entities failing to be captured by competitive neutrality policies.

4.3.8 Proposed exclusions from the 'business activity' test

Proposed exclusion of policy and regulatory functions

The Competition Principles Agreement makes clear that competitive neutrality principles are not intended to apply to the 'non-business, non-profit activities' of government entities.⁵⁶ The current NSW competitive neutrality policies for state government entities include only limited express exclusions for taxes, fines and regulatory fees.⁵⁷ There are no express exclusions in competitive neutrality policies for local government.

In our view, the current NSW approach is not best practice. In contrast, several other Australian jurisdictions expressly exclude regulatory and policy functions:

- **Regulatory activities and policy development:** Queensland and South Australia both exclude activities that have a predominantly regulatory or policy making role.⁵⁸ Tasmania and Western Australia exclude regulatory and policy functions and the imposition of fees and charges in connection with those functions.⁵⁹

- **Taxation, levies and licence fees:** Tasmania excludes taxing and licensing activities excluded under Part IV of the *Competition and Consumer Act 2010* (Cth) (Competition and Consumer Act).⁶⁰ These are imposing or collecting taxes or levies or fees for licences granting, refusing to grant, revoking, suspending or varying licences (whether or not they are subject to conditions).⁶¹ Western Australia also excludes taxes, levies and fees for licences.⁶²

These activities are not business activities, but functions inherent to government or carried out in performance of a statutory duty (e.g. the granting of a licence subject to a fee).

We have proposed similar exclusions consistent with the other states' express exclusions set out above to align with best practice. Our proposed approach is also consistent with the approach under the Competition and Consumer Act for the application of competition and consumer laws to Commonwealth, state/territory and local government entities.

We have proposed excluding procurement activities of state and local government activities, where the government entity is procuring goods and/or services for the purposes of exercising its policy or regulatory functions. While a government entity may acquire goods and services systematically and with regularity to assist it to carry out its policy or regulatory functions, it is not engaging in a business activity when doing so.

This exclusion should not apply to the procurement of goods and/or services for the purposes of engaging in business activities. For example, the purchase of inputs to production of goods or services or the purchase of goods for resale.

Exclusion of in-house service provision where provision is not contestable

We have proposed excluding the supply of goods and/or services by a government entity for its own in-house use where external providers have not been invited to tender to supply the goods and/or services. This proposed approach aligns with the policies of Queensland and Western Australia, which have similar exclusions.⁶³

South Australia and Tasmania go further, extending the exclusion to certain types of government-to-government service provision. South Australia limits this to any government-to-government service provision where, by reason of policy or law, there is no competition with the private sector.⁶⁴ Tasmania is broader and excludes services provided and used solely by state government departments, whether or not under a tied contract arrangement.⁶⁵

We do not consider that government-to-government service provision should be excluded where it is contestable. Accordingly, category 3 of our proposed test for 'business activity' makes clear that competitive neutrality policy should apply where a government entity is competing with external suppliers to provide services to another government entity (whether or not those entities are separate organisational or business units within the same broader entity).

We consider the appropriate place to deal with community service obligations (CSOs) is in the public interest test

We considered whether activities related to the provision of CSOs should be excluded from the meaning of 'business activity'. We think it is more appropriate to consider CSOs when applying the public interest test.

For state government, a CSO is an activity that satisfies the following criteria:

- it would not be pursued by a government business operating on a purely commercial basis
- it has a specified policy objective
- there is an explicit government agreement, as in either a portfolio Minister directive or government department agreement, with the business that the activity should be pursued, and
- there is funding from the responsible government department.⁶⁶

All proposed CSOs at the state government level must comply with the NSW Treasury CSO guidelines. There are no equivalent guidelines for local government in NSW.

Some jurisdictions have chosen to exclude CSOs from the meaning of 'government business activity', utilising the flexibility given to each jurisdiction as to the implementation of competitive neutrality principles. For example, Queensland competitive neutrality policies expressly exclude activities that have, as their prime function, responsibility for providing a CSO or social policy function.⁶⁷ Victoria competitive neutrality policy requires there to be actual or potential competition for an activity to be considered a business. A government entity exclusively responsible for delivering a CSO is identified as one circumstance in which there is no actual or potential competition.⁶⁸

All other jurisdictions consider CSOs as part of applying the public interest test. This approach aligns with the framework of the Competition Principles Agreement. Clause 1(3)(e) of the Competition Principles Agreement requires social welfare and equity considerations, including CSOs, to be taken into account when applying the public interest test. The application of competitive neutrality principles does not prevent the pursuit of CSOs — it requires that they are made and costed transparently. We consider this objective can be better achieved by considering CSOs as part of the public interest test.

Further, attempting to incorporate an exclusion for CSOs from the meaning of 'business activity' would present 2 risks given the divergent regimes in place for state and local government entities in NSW:

- Codifying the requirements for CSOs from the NSW Treasury CSO guidelines could mean competitive neutrality policy diverges from state policy in relation to CSOs if changes are made to the CSO guidelines in the absence of corresponding changes to competitive neutrality policy (or vice versa).
- While it would be possible to cross-refer to the CSO guidelines for state government entities, it would be necessary to adapt the criteria to make them workable for local government (e.g. to reflect that the CSOs is provided by the same entity that requires it).

In developing the proposed 'business activity' test we had regard to case law about when a Commonwealth, state/territory and local government entity will be taken to 'carry on a business' and so be subject to competition and consumer law. This line of cases is persuasive and analogous, as it identifies and explains relevant indicators of government entities carrying on a business, recognising characteristics of the business activities of government entities that are unique or distinct from those of non-government entities. The policy objective of ensuring that the Commonwealth, State/Territory and local governments are, in their commercial activities, subject to the same regime as other corporations — is similar to (although not the same as) the objective of competitive neutrality policy.

We have not sought to codify or replicate the current case law position. Rather, we have drawn on the case law to identify key factors that indicate an activity is business-like, with the aim of developing principles relevant to this context that are clear and easy to apply.

In developing our test, we have also considered the competitive neutrality policies of other jurisdictions in Australia. Particular areas of best practice that we have incorporated into our proposed test include:

- aligning the tests for state and local governments
- specifying exclusions from the meaning of 'business activity' for:
 - regulatory and policy activities, taxation, levies and licence fees
 - in-house service provision where provision is not contestable
- consideration of CSOs through the public interest test, rather than excluding them through the 'business activity' test.

4.4 The significance test

Our terms of reference require us to assess the level and relevance of the threshold for a 'significant' business activity, and recommend a best practice approach. The significance test recognises that in some cases a government business will not be large enough or have enough impact in the market for the benefits of applying competitive neutrality to outweigh the costs.

To ensure that competitive neutrality principles are only required to be applied where it would be cost-effective to do so, the significance test should be designed to:

- approximate when the scale of a business activity is large enough to bear the burden of the administrative costs of applying competitive neutrality principles
- approximate when the business activity has a market impact that is large enough that applying competitive neutrality principles will deliver a benefit
- be simple enough that government entities can apply the test themselves for each business activity, with a sufficient degree of confidence that they will do so correctly, and without imposing substantial cost.

We are proposing an updated significance test that we consider better reflects the proposed content/obligations of the revised policy (see Chapter 5) and provides a good balance between simplicity, accuracy and regulatory burden. We consider that a best practice approach would align the key elements of the competitive neutrality policies between local and state government and as a result, we propose the same test would apply to both state and local government business activities.

We recommend that the significance test:

- include both a monetary threshold and where business activities exceed the monetary threshold, a market assessment

- exclude business activities where there is no potential for competition from non-government providers, which recognises that there are unlikely to be net benefits from applying competitive neutrality to those activities
- include business activities which the Minister has declared significant following a recommendation from IPART.

Retaining a monetary threshold is a simple to apply, low-cost way of ensuring that government entities do not need to apply competitive neutrality principles to business activities where their administrative costs would be high relative to the overall revenue from the business activity. In our view, requiring entities to undertake a market assessment for very small business activities where there is little prospect that it would show a significant market presence would be out of proportion to the administrative cost of applying competitive neutrality principles (one of the aims of the test).

Draft Recommendation

7. The 'significance test' be revised to better target activities where competitive neutrality is likely to be cost effective. The proposed significance test is set out in Box 4.3. An activity would not pass the significance test where:
- a. the activity has an annual turnover below \$3.7 million (indexed over time)
 - b. the entity undertaking the activity has assessed it as having a low market impact, or
 - c. there is no prospect of competition.

Box 4.3 Proposed significance test

An activity is significant unless one or more of the following applies:

1. The annual turnover from the business activity is less than \$3.7 million, which is to be indexed in accordance with the policy. To be excluded based on this criterion, the turnover threshold must not be exceeded if the price of the business' goods and services was set in line with the market price of non-government providers in the same or similar area.
2. The government entity undertaking the business activity has conducted a recent market review that shows that the activity does not have a significant impact on the market

Box 4.3 Proposed significance test

3. The activity is a legislated monopoly where there is no potential for competition from other providers.

The Minister has the power to declare an activity significant that would not otherwise pass the significance test, following a recommendation from IPART.

Source: IPART

4.4.1 The current test in NSW

The current competitive neutrality policies have different significance tests for state and local government businesses. For NSW state government business activities, the test for significance is applied on a case-by-case basis by considering whether the business activity has a significant impact on a market. Relevant considerations include:

- the business activity's size
- the business activity's influence on the market
- the resources the business activity commands
- effect of poor performance.⁶⁹

Currently in NSW there is limited guidance on how to complete a market assessment and how government entities should consider these factors.

The test in the local government policy statement is based on a monetary threshold using annual turnover:

- Business activities with turnover above \$2 million are deemed to be significant (Category 1 businesses). The \$2 million threshold was set in 1996. It was chosen after consultation with local governments on the basis that it was likely to capture most local government businesses that have a significant economic impact.
- Business activities with turnover below \$2 million (Category 2 businesses) should be considered on a case-by-case basis. They are "anticipated to have an insignificant distortionary impact on competition at either State or national level...[but] may be considered quite significant at the local level."⁷⁰ The local government policy statement explains that the scope and nature of these businesses can vary widely:

"At the smallest scale, the business might be a minor adjunct to a mainstream, non-business council function such as photocopying sales at the administrative headquarters or sale of compost bins. At the larger scale, the business activity might involve land subdivision and development, operation of significant entertainment and recreation centres, hire of major items of plant and machinery etc."⁷¹

For Category 2 businesses, there is no guidance on what the 'case by case' consideration means. The local government policy statement appears to give considerable discretion to councils to determine whether or how to apply competitive neutrality to their activities. This policy says that councils should apply full cost attribution to as many Category 2 business activities as is practicable and that councils can determine the extent to which business activities in this category are to be separate from their associated mainstream activities.⁷²

Some councils explicitly state their Category 1 and Category 2 businesses in their annual reports, but others do not. The Camping and Caravan Industry Association (CCIA) noted that councils operating camping and caravan facilities as 'significant business activities' generally do address competitive neutrality principles in their annual reports, but the information provided is minimal.⁷³

4.4.2 Stakeholder views on improvements to the current test

While stakeholders felt that the current test was outdated and potentially difficult to apply, there were mixed views on what a better test would look like.

Some stakeholders argued that the threshold for significance should be decreased to capture more services. For example, the NSW Productivity Commission submitted that a relatively low threshold for significance^m may encourage a more robust application of competitive neutrality than the current multi-criteria threshold for state government businesses.⁷⁴ The NSW Productivity Commission recommended lowering the significance threshold as well as providing clearer guidance around market definition and impact.

Other stakeholders argued that monetary thresholds should be increased to capture fewer services. For example, Local Government NSW argued that the current local government threshold of \$2 million was determined in the mid-1990s and is unrealistically low 25 years later. This should be brought into line with the thresholds in place in Queensland, Western Australia (for state government), and the Commonwealth of \$10 million.⁷⁵ This would remove activities that are not material and reduce the overall regulatory burden.

In the consultation workshops there was clear indication that local government staff find it difficult to determine when they need to apply competitive neutrality to their activities and would like clearer guidance on what they need to do and when.

4.4.3 Significance tests in other Australian jurisdictions

Other Australian states and territories have developed their own approaches to assessing significance and there is considerable variation in these approaches. In submissions to the Harper Review, several stakeholders, including the NSW Government, pointed to the need for a consistent definition of 'significant' and common understanding between jurisdictions on what is covered by competitive neutrality policies and what is not.

Across Australia there are typically 3 different elements that are used to determine whether a business activity is significant:

^m Based on the government entity having a competitive impact or being of a size that is "more than nominal or trivial".

- **Deeming** specific entities significant – used in the Commonwealth and Queensland.⁷⁶
- **A size-based approach** – most jurisdictions use some form of size test to estimate significance. Size-based tests are more likely to be applied to local government activities. Size may be determined by annual turnover, asset base, customer numbers (for water and sewerage in Queensland) or market share (applied to camping in Tasmania).⁷⁷
- **A case-by-case assessment** of market impact – Victoria, Tasmania, ACT and NT use a case-by-case assessment to determine the significance of all business activities.⁷⁸ Other jurisdictions use it in combination with other tests. Queensland is the only jurisdiction not to use a case-by-case assessment at all.

Some jurisdictions combine a case-by-case assessment with a size-based test, but they do so in different ways. SA and WA require the case-by-case assessment to determine whether activities that are below the size threshold are significant (activities above the threshold are deemed significant). The Commonwealth Government uses the case-by-case approach to determine whether activities that are above the size threshold are significant (activities below the threshold are deemed not to be significant).

4.4.4 An activity is not significant if its annual turnover is below \$3.7 million

Applying competitive neutrality principles to an activity will have an administrative cost. In our view, applying competitive neutrality to businesses with low turnover is unlikely to be in the public interest. Including a threshold for significance based on business turnover can be used to identify businesses for which the administrative costs of applying competitive neutrality would be too high.

There was stakeholder support for continuing a simple process to exclude low revenue business activities from being subject to competitive neutrality or from having to apply a more complex significance test. Wollongong City Council stated that "... we apply a simple process of categorising commercial activities as anything over \$2 million. Our ability to apply accurately any other requirements would be very difficult due to staff expertise and availability in the current setting."⁷⁹

In our Issues Paper we noted our concerns with relying too heavily on monetary thresholds, as they may not capture some activities with significant market impact. Nevertheless, to lower the regulatory burden and ensure that government entities with low revenue activities are not subject to the administrative costs of applying competitive neutrality principles for small business activities, we propose to continue to include a revenue threshold in the significance test.

Setting a minimum revenue threshold runs the risk of excluding some business activities from the revised competitive neutrality policy that could be locally significant. We consider that on balance, the revised policy should not impose the cost of competitive neutrality obligations or undertaking a market-based assessment of significance on small business activities. However, this needs to be balanced with the potential for even these small activities to adversely impact local small business competitors.

What is an appropriate value for the monetary threshold?

The current threshold for local government businesses is \$2 million annual turnover. This threshold was set in 1996 and has not been updated since then. As a result, the number of businesses that are being required to apply competitive neutrality is likely to have been increasing over time.

There was support from local government to raise the threshold to reset it back to the value it would be if it had been indexed to keep pace with the change in inflation over the past 25 years. However, there was also concern from competing businesses that raising the threshold would fail to capture some activities that were having a significant impact on them.

We agree that it is best practice to index monetary amounts (such as, the significance threshold) regularly to prevent an inadvertent change in the scope of the policy.

As a result, we recommend that the monetary threshold for significance be set at \$3.7 million annual turnover for both state and local government business activities, consistent with the current threshold for local government (\$2 million) updated to reflect changes in inflation since the threshold was set and indexed over time in line with the change in the Consumer Price Index (CPI).ⁿ

We are recommending the turnover threshold initially be set at \$3.7 million on the basis that:

- It is difficult to quantify the administrative costs of applying competitive neutrality in a meaningful way. It is likely to vary depending on existing accounting systems, and the activities undertaken. As a result, we consider that the threshold initially determined, which has been applied for over 20 years is likely to provide a reasonable approximation of the size of a business that can absorb these costs.
- The administrative costs of competitive neutrality are likely to have risen over time since the \$2 million threshold was set and updating based on the change in the CPI^o provides a simple, easy-to-apply update which is likely to approximate the change in those costs.
- The increase would reduce the regulatory burden on local government. At the same time, it does not fundamentally change the scope of activities for which competitive neutrality needs to be considered.

We consider that the value of the annual turnover threshold should be indexed annually by the change in the CPI to ensure that it keeps pace with inflation. The revised policy should set out the process for calculating the inflator. We propose that the [Reserve Bank of Australia Inflation Calculator](#) be recommended as a tool to help users to update the threshold.

ⁿ The Issues Paper said the threshold was set in 2002 (p 41), but we have since found that it was likely set in 1996 and have done the CPI adjustment accordingly.

^o We used the [Reserve Bank of Australia Inflation Calculator](#) to derive this threshold, comparing between the 1996/97 and the 2021/22 financial year.

What guidance needs to be provided for applying the turnover test?

Setting a minimum revenue threshold for the application of competitive neutrality principles may perversely incentivise government entities to lower their prices (or even provide free services) to ensure their revenue is under the threshold. As undercharging relative to the full cost of supply is one of the key problems that competitive neutrality policy is designed to address, this would not be a good outcome. To address that concern, we recommend that for a business to be considered as non-significant, the turnover test must also be passed if its turnover would be below the threshold if it were to charge a market price for its goods and services.

We expect that very small government businesses will not need to undertake any additional assessment to assure themselves that their revenue is below the threshold. However, for some government businesses, particularly those who are charging well below market price for their products or whose revenue is approaching the turnover threshold, it would be prudent to review the prices of competing products offered by non-government providers in the same, or similar, market in order to demonstrate that this condition is met.

There should be some flexibility for the government entity undertaking the business activity to determine what constitutes a market price. It is difficult to establish criteria upfront, as the markets are likely to be quite diverse. For example, a local council may be the only seller of a product in a small town. In other cases, there may be a large number of other sellers. Nevertheless, it does impose some discipline on the government entity to ensure that it is not pricing below its competitors to avoid applying competitive neutrality.

In the event that a complaint is made in relation to the government business, we will request evidence to show that the government entity has appropriately applied the significance test. If a government entity is relying on low turnover to demonstrate that an activity is not significant, and they have not calculated their turnover using market prices, we may require them to do so. If that assessment shows that their turnover would exceed the threshold if they were to charge market prices, we would recommend that they apply competitive neutrality principles to the activity (or undertake a market based assessment to demonstrate that they are not significant).

Local councils already publish the basis for their fees and charges. In many cases this information sets out key information that is relevant to competitive neutrality, including whether prices are set to recover costs, partially recover costs, or set with reference to a market price. As a result, we expect that most local councils would be able to identify when they need to apply the market price test and be able to do this in-house at low cost. We are seeking feedback on whether this is the case and if not, what alternative approach would be suitable.

4.4.5 An activity is not significant where a market-based assessment shows that it does not have a significant impact on the market

Market-based assessments are a feature of many Australian competitive neutrality policies. Market assessments are likely to provide a more accurate indicator of significance but are more costly to apply and can be subjective. Government entities may not always get them right.

Without sufficient guidance on how to do a market-based assessment, government entities may either find it too costly to engage relevant expertise to conduct such an assessment, or may do a poor job. As a result, we recommend that the revised competitive neutrality policy includes clear and practical guidance on how to do the assessment. This guidance is based on relevant policy in Victoria and Tasmania, which both require a market assessment to be done for all government business activities, regardless of size.⁸⁰

We propose defining a minimum market share of 10% as a rough approximation of significance. We would provide guidance to government entities that business activities with less than 10% market share are not significant. If a business activity has a market share greater than 10% they will need to consider other elements to determine if they are significant. We based this value on available information from previous competitive neutrality complaints investigations across Australia - 10% was the lowest market share threshold we were able to find, where a business activity was considered significant.^P

Under our proposed approach, a business activity with more than 10% market share would be significant if:

- the market share is comparable in size or larger than the business activity's competitors (based on turnover or customer numbers); or
- the business activity has a significant influence or competitive impact in the relevant market.

Because we have tried to ensure that each question in the test will yield a yes or no answer rather than needing to form a judgment based on complex factors, there is a risk that the test could under-capture some significant business activities. We have sought to balance accuracy of the test without requiring businesses to undertake sophisticated costing analysis. We therefore consider that it is better to provide specific guidance on what market share would be enough than to ask the government entity to make its own judgment as to whether a particular share of the market is significant. Without clear guidance that government entities can apply to decide if their market impact is significant, they may feel the need to obtain costly expert advice to determine significance, which we consider is unlikely to be warranted in most cases.

We are interested in feedback from stakeholders on the proposed market-based assessment. In particular, we are seeking views on whether:

- government entities (particularly councils) consider they could complete a market assessment for their business activities in-house using this guidance material at a reasonable cost
- providing guidance on a minimum market share threshold of 10% is likely to approximate significance in the range of markets that governments operate in.

^P A CN complaints investigation of Hobsons Bay Council Childcare centres in Victoria found that the council's childcare centres were significant based on its market share of 14% in the localised geographic area and 8% in the municipality. See: Victorian Competition and Efficiency Commission, *Competitive Neutrality Investigation Final Report Hobsons Bay City Council - Child care centres*, January 2015, p 8. The Tasmanian Government established a Steering Committee to review and establish a new policy on public camping. The review concluded that 10% was the market share threshold for significance for public camping facilities based on number of unpowered camp sites in a geographic area of 60km. See: Tasmanian Government, *National Competition Policy: Applying Competitive Neutrality Principles to public camping in Tasmania*, January 2019.

Proposed guidance on how to do a market-based assessment

Government entities should complete the below template to determine whether the business activity is significant.

Question	Significance determination
1. Does the business activity have market share greater than 10% in the relevant market? (see Box 4.4 for guidance on how to identify the relevant market and estimate market share)	If yes, continue to Question 2. If no, the business activity is not significant.
2. Is the market share of the business activity (based on turnover or customer numbers) larger than or comparable to its competitors?	If yes, the business activity is significant. If no, continue to Question 3.
3. Is there evidence that the business activity has a significant influence or competitive impact in the relevant market? (see Box 4.5 for factors indicating the level of influence or competitive impact)	If yes, the business activity is significant. If no, the business activity is not significant.

Box 4.4 Guidance on how to estimate market share

To identify the relevant market for a business activity, the government entity will need to consider:

- What is the product or service category in which competition does, or could, exist? For example, what substitutable products or services would consumers switch to if the price of the good or service increased?
- What is the geographic area in which competition does, or could, exist? For example, what is the geographic area where consumers would be able to find substitutes for the good or service?

To estimate the business activity's share of the market the government entity will need to consider:

- What is the number of actual or potential competitors in the relevant market?
- What is the volume of sales or customer numbers generated by the business activity compared to its competitors?

If in doubt, the government entity should err on the side of assuming they have a larger market share. Where there is doubt about the extent of the market, a smaller, rather than larger product and geographic market should be used. The government entity should also use the volume indicator (sales/customer numbers) that yields the largest market share.

Note: To determine market impact, the government entity should consider, at a minimum, product and geographic dimensions of the market. Other dimensions include the functional dimension (the different levels in the supply chain such as production, wholesale or retail) and the temporal dimension (the timeframe over which substitution possibilities should be assessed). A government entity may also consider these if it wishes.

Box 4.5 Guidance on how to assess market impact

If the market-based assessment has shown that a business activity has a market share above 10% but that the market share is less than its competitors, the presence of one or more of the following factors may still suggest that the business activity has a significant influence or competitive impact:

- the business activity has the financial capacity to sustain loss-making activities
- the business activity has the potential to influence a competitor's access to customers
- the business activity has high visibility (i.e. through cross-promotion of the product/service by other activities).

Proposed guidance on when to review the market-based assessment

Government entities should review a market-based assessment of their business activities at least every 5 years, or when circumstances change materially. This would ensure that changes in the market circumstances are taken into account. For example, government entities may provide goods or services in markets that are small and undeveloped (and, therefore, unprofitable for private firms). This could change as the market matures and grows (e.g. due to population growth, technological change and/or demand growth).

We recommend that the guidance sets out the following trigger points which recommend that a market-based assessment should be reviewed:

- Change of government policy. The business status of a government activity might change if government policy changes to increase contestability or remove a statutory monopoly.
- Changes to the activity. A government entity primarily undertaking non-commercial activities may expand an existing commercial activity or expand into a new commercial activity where competitive neutrality applies.
- Contact or complaint about the entity's approach to pricing the good or service.

4.4.6 An activity is not significant if there is no prospect of competition

The significance test is aimed at identifying circumstances where the market impact of an activity is such that there is likely to be a benefit in applying competitive neutrality principles. We consider that competition or potential for competition should be a key requirement for the application of competitive neutrality principles. There are situations where legislation specifies that goods and services in a particular market may be provided only by one entity (a statutory monopoly). For example, certain postal services may only be provided by Australia Post.⁸¹ It has a statutory monopoly for these services.

We consider that business activities where there is no prospect of competition from other providers should not be subject to competitive neutrality policy because there will likely be little to no benefit from applying competitive neutrality principles.

Excluding activities that are legislated monopolies as part of the significance test it is the simplest way of excluding these activities (they would still pass the government ownership and business activity tests). Activities undertaken by a government entity outside of any statutory monopoly activities would not qualify for this exemption.

As markets develop and technology changes, it is possible that even activities that are legislated as monopolies may have the potential for competition from substitute products in a different market. In this case, the activity would no longer qualify for this exemption. If the government entity considers that this is the case and does not consider that its activities should be subject to competitive neutrality, it will need to do a market-based assessment that recognises these substitute products within its identification of the market.

4.4.7 The Minister should have the power to declare an activity significant

There are situations where business activities that may not be considered significant individually may have a significant impact on a market when viewed collectively. It is difficult to capture these within the significance test because government entities undertaking business activities are unlikely to have access to the information required to examine their impact collectively with other government entities (such as neighbouring councils or state government business activities).

We support continuing the current practice of requiring government entities to assess the significance of their own business activities rather than centralise this process through NSW Treasury, the Office of Local Government or IPART.

The issue of systemic significance was raised by the Australian Diagnostic Imaging Association (ADIA) which submitted that:

“Public hospital radiology departments undertake a relatively small level of activity (...) However, when these activities are aggregated, the market share of public hospitals in the outpatient radiology market is substantial and has a significant impact on the operation of that market. Accordingly, the significance test should be sufficiently flexible to enable government business activities to be considered in aggregate. In the case of radiology, this would allow IPART to consider the outpatient services provided by all public hospital radiology departments in NSW in a competitive neutrality assessment.”⁸²

The Caravan and Camping Industry Association (CCIA) indicated a preference for IPART to be able to issue a policy statement and guideline, similar to the approach taken in Tasmania.⁸³ The Tasmanian Department of Treasury and Finance issued a new competitive neutrality policy statement setting out the application of competitive neutrality principles to public camping in Tasmania. This policy statement provides that more than 10% of the total number of non-powered camping sites within the geographic market is considered a significant business activity (see Box 4.6).

To address this issue, we propose to recommend that the Minister have the power to make a declaration that a particular business activity is significant for the purpose of competitive neutrality policy. We propose that the Minister would do this after receiving a recommendation from IPART. IPART would be able to make such a recommendation where we consider it appropriate and only after conducting public consultation on the matter. For example, this may be in response to:

- one or more complaints received about government involvement in a particular industry
- a competitor or potential competitor requesting that IPART undertake an independent assessment of the significance of collective government business activities
- information that IPART has obtained through other reviews or investigations.

The exercise of this power, such as the grounds for declaration, could be codified in legislation, including the circumstances in which IPART may make a recommendation. Another option could be requiring IPART to publish binding guidelines on its approach to making recommendations to the Minister.

Box 4.6 Tasmania's approach to defining public camping facilities as significant business activities

In 2017, the Premier's Local Government Council (PLGC) agreed to establish a stakeholder group, comprising representatives from local councils, relevant State Government agencies, the Local Government Association of Tasmania and industry, to provide advice to the Government on the practical implementation of competitive neutrality principles to council-provided recreational vehicle parking and camping facilities. A Steering Committee conducted a review and established a new Policy Statement, National Competition Policy: Applying Competitive Neutrality Principles to public camping in Tasmania.⁸⁴

Under the new policy, the government body must assess, for each public camping facility, the total number of non-powered camping sites within a geographic market area of 60 km drive from the public camping facility (the relevant market). If the facilities are in separate locations within the relevant market, the government body must aggregate the total non-powered public camping sites.

If the total number of non-powered public camping sites provided by the government body is more than 10% of the total number of non-powered camping sites within the relevant market, the government body must declare it a significant business activity and *prima facie*, apply full cost attribution principles.

Source: Tasmanian Government, [Competitive Neutrality Policy](#).

Seek Comment



3. When applying the tests to current government activities:
 - a. Is it clear what activities are and are not captured by the tests?
 - b. What further guidance might be needed to help apply these tests?
 - c. What are the pros and cons of allowing for the Minister to declare an activity significant?

Chapter 5 >>

Competitive neutrality obligations

Principles for structuring business activities, estimating costs and adjusting for advantages and disadvantages of government ownership

05

Once an activity has been identified as being subject to competitive neutrality by applying the tests set out in Chapter 4, the revised policy should clearly set out what the entity undertaking that activity needs to do to implement competitive neutrality.

This chapter discusses the competitive neutrality obligations that we are proposing would apply to all significant government business activities.^a The obligations fall into the following categories:

- identifying the costs incurred by the government business in providing the activity, including what costing approach(es) should be adopted
- identifying any cost advantages and disadvantages of government ownership and making an adjustment for them
- identifying and addressing non-cost advantages.

The first 2 categories of obligations together will allow government entities to estimate a price for the business' products or services that would be competitively neutral. Once government entities have estimated a competitively neutral price and identified any outstanding non-cost advantages, they can then either factor these into their pricing and supply decisions or undertake a public interest assessment to demonstrate that it would not be in the public interest to do so (Chapter 6). Reporting obligations are discussed in Chapter 8.

5.1 Overview of the draft recommendations

We recommend that the current policy is amended to include a clear, consistent set of obligations that apply to all significant government business activities. Those obligations include estimating the costs of providing the business activity, and consideration of cost and non-cost advantages and disadvantages that arise from government ownership.

Having regard to the proposed objective of the revised competitive neutrality policy, we have made draft recommendations that would clarify and clearly set out the approach a government entity should take to measure its own costs. The current competitive neutrality policies do not provide much guidance as to when a government entity should use an avoidable cost approach and when to adopt a fully distributed costing approach. As well as providing information on how to apply each of these approaches, we recommend that the policy more clearly set out the circumstances where business should consider adopting one over the other.

There is also a need for the revised competitive neutrality policy to provide guidance on adjusting for cost advantages and disadvantages that is easier to implement and clearer. For example, the current approach to calculating the rate of return on capital is either overly simple or overly complex, depending on the amount of capital that the government business activity uses. We have made a number of draft recommendations aimed at providing more guidance to government entities to make these adjustments.

^a As discussed in Chapter 3, we propose to recommend that the current competitive neutrality policies and guidelines are brought under a single policy and that this policy covers all significant government business activities in a clear and consistent way. Consequently, we have made a draft recommendation that the policy requires all significant government business activities to be subject to competitive neutrality obligations (see draft recommendation 2).

The current competitive neutrality policies do not provide any guidance on how to deal with non-cost advantages and disadvantages. Non-cost advantages and disadvantages can have considerable competitive impacts and should be accounted for when applying competitive neutrality. We have therefore proposed that the revised competitive neutrality policy include guidance on dealing with non-cost advantages and disadvantages that are not experienced by private competitors.

The obligations that we are recommending can be applied to all significant government business activities, irrespective of their sector or business structure. However, what government entities would need to do to satisfy these obligations is likely to vary depending on their business structure and the nature of their activities. Structural separation of business units comes at a cost but also has the benefit of allowing government entities to comply with competitive neutrality obligations more easily. We consider business activities that are commercialised or subject to Treasury's Commercial Policy Framework should have little problem demonstrating compliance with competitive neutrality policy. This is because the obligations imposed by these frameworks remove most, if not all, of the major advantages of government ownership by imposing commercial objectives, dividends and tax equivalents.

5.2 Identifying the costs of undertaking the business activity

The first type of competitive neutrality obligation is ensuring that the government entity undertaking the business activity is adequately estimating the cost of providing the activity. One of the concerns with having government entities run businesses, particularly those entities that also undertake non-business activities, is that the costs of being in business may not be adequately accounted for.

The Competition Principles Agreement requires the prices set by significant government business activities to reflect 'full cost attribution' and account for other potential cost advantages of government ownership, such as not having to pay certain taxes or benefiting from government guarantees.⁸⁵ Taken together, these comprise the competitively neutral price.

There are different approaches a government entity undertaking a business activity can use to estimate its own cost of providing goods and services. Where government entities do not also provide non-commercial activities, accounting for these costs is straightforward. However, if the government business activity shares joint resources with other non-commercial activities, the approach it takes to measure its costs can give very different outcomes.

The current competitive neutrality policies focus on 2 main approaches that can be used for costing:

- **Avoidable cost** includes the increase in the entity's costs associated with providing the significant business activity, i.e. the costs that the entity would avoid if the significant business activity did not exist. It does not include a share of joint costs or overheads.

- **Fully distributed cost** includes direct costs of the business unit as well as a share of the entity's overheads and capital costs.^b

We consider that these are the appropriate approaches to include in the revised policy. Table 5.1 shows how some common cost categories are treated under these costing approaches.

Table 5.1 Treatment of different categories of cost under fully distributed cost versus avoidable cost approach

Cost category	Fully distributed cost	Avoidable cost
Direct costs (e.g., direct labour, materials costs, sales tax)	Included	Included
Executive costs	Included	Not included
Overhead costs	Included	Included to the extent that they are avoided if the activity is not undertaken
Capital costs exclusive to the activity	Included	Included
Joint capital costs	Included	Included to the extent that they are avoided if the activity is not undertaken

Source: IPART

The current competitive neutrality policies do not have firm recommendations on when different costing approaches should be used. Additionally, the current recommendations differ between local and state government, provide limited guidance and are not internally consistent:

- The local government pricing guideline leaves it up to councils to choose the costing system that best suits their needs, although an activity-based costing approach^c is recommended.⁸⁶
- The NSW pricing guideline notes that avoidable costs can be a more efficient option but recommend using fully distributed costs in the medium to long term.⁸⁷ However, the NSW competitive neutrality policy statement states that competitive neutrality will be achieved if the prices charged at least cover avoidable cost.⁸⁸

We consider that depending on the circumstances either fully distributed costs or avoidable costs could be used to determine the cost of the business activity. The method to be adopted should depend on the characteristics of the activity and its required resources. The appropriate method may not change over time. As a result, we recommend that the revised competitive neutrality policy provides more guidance to government entities on factors to consider when selecting an approach.

The treatment of joint capital costs is a key area of interest, as it is important to ensure that a business activity operated by a general government sector entity is not implicitly subsidised by the entity, which would undermine competitive neutrality (unless it is in the public interest to do so, see Chapter 6). On the other hand, using the avoidable cost approach can help promote the efficient use of resources with spare capacity.

^b There are other costing approaches such as marginal cost and activity-based costing but a selection of the 2 most common costing approaches has been made to avoid complicating costing guidelines.

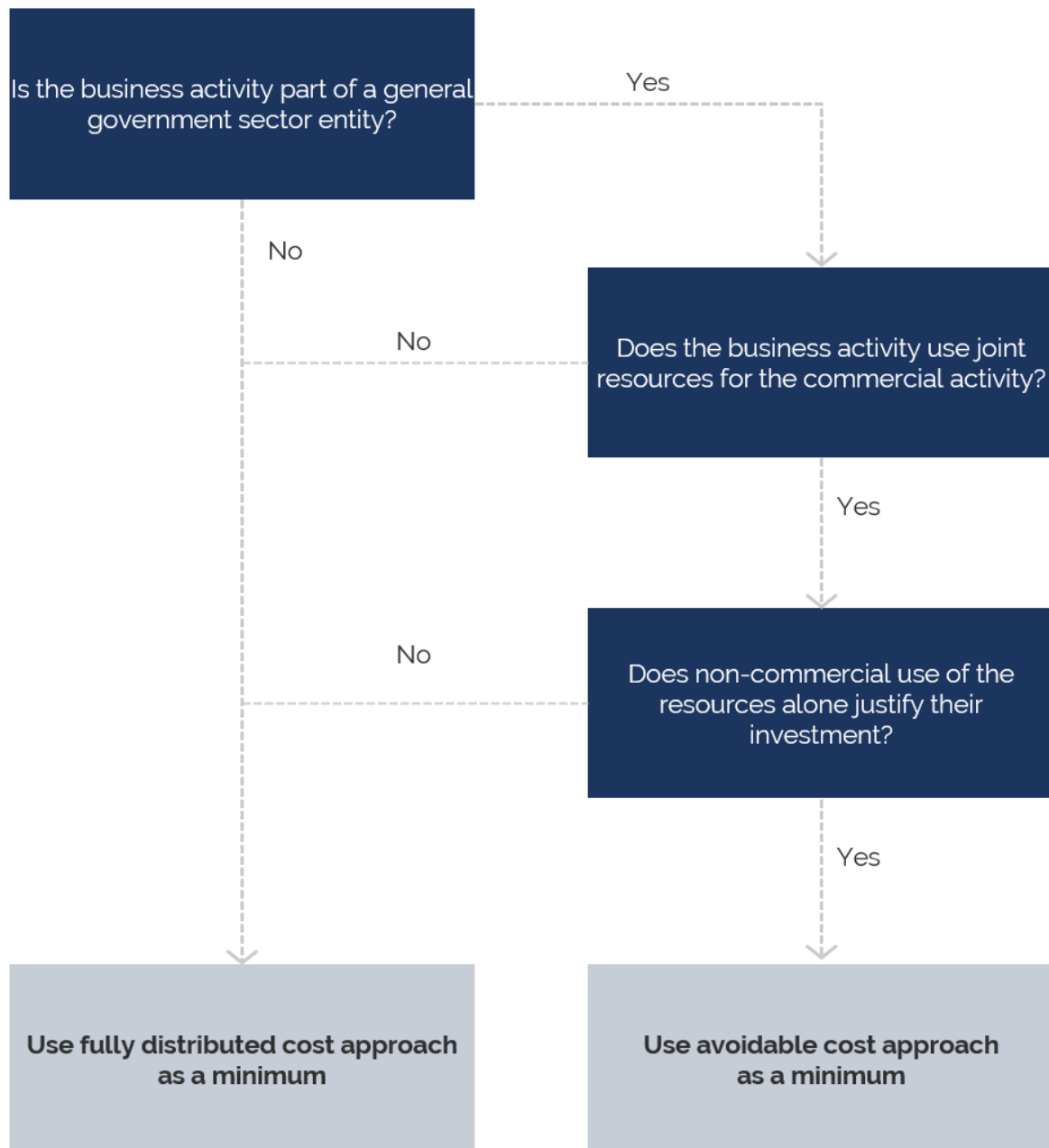
^c This is similar to a fully distributed cost approach.

We have developed our proposed costing guidance in line with the objective of efficiency recommended in Chapter 3. It is important to recognise that the pricing approach may differ if the objective was instead to ensure that non-government businesses were able to compete on an equal footing with government businesses even where government businesses may have access to assets that are shared with non-government activities (i.e. funded through the budget).

We have received submissions that raised concerns about the use of government assets to provide services at prices that are below the cost of non-government competitors, because they do not reflect the cost of shared assets. However, having considered the options and the proposed objective of the revised policy, we consider that if these assets have unavoidable spare capacity, it is most efficient to use this capacity for commercial purposes and cost the activity using an avoidable cost approach.

We are proposing the guidance set out in Figure 5.1 be included in the revised competitive neutrality policy to assist government businesses to identify which costing approach is appropriate given the circumstances they face.

Figure 5.1 Summary of proposed costing approach guidance



Source: IPART

Some examples of when the different approaches may be used are set out in Box 5.1.

It can be challenging to establish the basis for a government entity's investment decision. We propose that the government entity should consider what evidence there is available to it to characterise an investment decision. Where that information is not available, the government entity should consider whether options are available to it to sell or divest spare capacity, and whether it may be preferable to do that than to price at avoidable cost, having regard to the possible impact on competition. In a complaint investigation, IPART may request the evidence that a government entity has relied on to decide which costing approach was appropriate. For example, to justify using avoidable costs in the case of spare capacity the business would need to form the view that a smaller asset which would still sufficiently service non-commercial needs is not available.

Box 5.1 Cases when different costing approaches may be appropriate

Case 1: The business activity is undertaken by a public non-financial corporation or a public financial corporation – avoidable and fully distributed costs would likely be the same.

The entity types that this case applies to are stand-alone businesses. As such, they are unlikely to share any joint resources with general government sector agencies and so avoidable and fully distributed costs will likely be the same. Examples of this would be Forestry Corporation of NSW or TCorp.

Case 2: The business activity is part of a general government sector entity but does not share resources with its parent entity – avoidable and fully distributed costs would be the same

An example of this would be a large printing business owned and operated by a local council that has its own staff, IT systems and facilities but is not incorporated as a separate legal entity.

Case 3: The joint resources used by the business activity are not justified for non-commercial use alone – fully distributed cost would be appropriate

This case applies when:

- the business activity is a unit within a general government sector entity, and
- the business unit uses joint resources whose non-commercial use alone does not justify their investment. An indicator of this would be if the business unit uses joint resources that could have been acquired at a smaller scale if they were only to be used non-commercially.

Box 5.1 Cases when different costing approaches may be appropriate

An example of this would be a council purchasing a large building for a new library facility that includes several large unused spaces that it decides to rent out for events. Smaller buildings that would have fit the library were available to purchase at a cheaper cost. In this case the building would be a joint resource. If competitive neutrality principles apply, the council is recommended to use fully distributed cost to determine the cost of the event space hire.

Case 4: The business activity uses joint resources with unavoidable spare capacity

– avoidable cost would be appropriate

This case applies when:

- the business activity is part of a general government sector entity and the business activity uses joint resources for the commercial activity, and
- non-commercial use of the joint resources alone justifies their investment
 - for example, an indicator of this would be if the resources would not have been acquired at a smaller scale if they were only to be used non-commercially.

An example of this would be a single-track railway line to a rural community that is maintained for social policy reasons, and rail freight using the line is asked to pay only avoidable cost in access fees. A single track is the minimum possible unit of capacity, meaning that spare capacity is unavoidable.

Source: IPART

Where the costs of shared resources need to be allocated, it can be challenging to determine how to allocate them. The current policies include guidance on allocating shared resources, which we consider is appropriate. Box 5.2 outlines some considerations for this allocation.

Box 5.2 Allocating costs for joint resources

If a government business activity that uses joint resources has to allocate some of the costs of these resources to its business activity's cost of providing goods or services, there will likely be some estimation involved. The cost of these joint resources would likely be partially attributable to the government business activity. The most straightforward way is to allocate them using a ratio which is proportionate to its use. For example, if a staff member spends half their time on this business activity, 50% of their labour costs should be allocated to it.

Box 5.2 Allocating costs for joint resources

In some cases, allocation can be done using another proportion as a proxy. For example, costs could be allocated through:

- floorspace used by the activity as a percentage of total floorspace
- energy usage for the activity as a percentage of total energy usage
- the budget for the activity as a percentage of the total budget of the parent entity.

The proxy used has to be as reflective of the different activities' costs as possible. For example, it does not make sense to allocate costs based on floorspace if the business activity uses little floorspace but uses shared expensive equipment more frequently than the non-commercial activity.

Another approach is to use activity-based costing, where allocation is done using 'cost drivers', which quantify the resources used by each activity. This is similar to the approach described above, but the cost drivers make the calculation of costs more specific to the activity. Activity-based costing is therefore only more efficient if the cost drivers used can be clearly linked to activity.

In any case, allocation of costs is unlikely to reflect the exact expenditure on different activities. Getting this allocation right is key for achieving efficiency however, so government business activities should consider an approach that balances accuracy with administrative demands.

Source: IPART

We recommend that each government business activity reviews their costing approach when they make new investments, or once every 2 years at a minimum. As part of this review, the entity should firstly apply the costing approach guidelines to assess which case applies to them. In most circumstances the same case will apply, in which case the business activity does not have to reassess its costing approach unless it uses joint resources (cases 3 and 4 above). If the business activity uses joint resources, further consideration is required to ensure these resources continue to be costed efficiently. The further consideration applies to factors such as:

- demand, as if there is a significant shift in demand for the goods and/or services provided by either the business activity or the non-commercial activity this may change whether the investment in the resources is justified
- changes in government policy, as these could lead to changes in investment priorities.

Draft recommendation

- 8. The competitive neutrality policy continue to provide information on how to estimate both avoidable costs and fully distributed costs, as valid approaches for estimating a government entity's own cost of business. However, we recommend that the revised policy provide clearer guidance on how to select the most efficient approach. The guidance we are recommending is set out in Figure 5.1.

Seek Comment

- 4. Can government businesses easily identify and apply the relevant costing approach?
 - a. Does it reflect current practice?
 - b. How easily can it be integrated into existing systems and processes?
 - c. What improvements, information or tools could help?

5.3 Adjusting for cost-based advantages and disadvantages

A key premise of competitive neutrality is that government businesses should not experience net competitive advantages as result of their government ownership. This section outlines some of the possible cost-based advantages and disadvantages faced by government business activities. We have considered the current guidance on how to identify and correct for these and propose some changes in order to ensure that the policy is easy to apply. In making our draft recommendations we aimed to balance the administrative cost of estimating the adjustments with the benefits of having a more accurate estimate.

5.3.1 Advantages

There are certain costs that a government business may not face due to government ownership that would be faced by equivalent private sector organisations providing similar goods or services. These costs represent the competitive advantages of government ownership. The NSW pricing guideline notes that these should be added to the costs actually incurred by the entity to determine a competitively neutral price.⁸⁹ These notional costs fall into several main categories, which are outlined in Table 5.2.

Table 5.2 Adjustments to cost base for competitive advantages experienced by government business activities

Potential competitive advantage	Adjustments for competitively neutral cost
Exemption from taxes	Include the equivalent tax that would be paid by a private sector competitor in the cost of goods and/or services
Access to loans with more favourable terms and/or lower interest rates	Reflect equivalent lending conditions for a private sector competitor in the cost of goods and/or services
Access to insurance with more favourable terms and/or lower premiums	Assess the difference between current insurance rates and those that would be incurred as a private business, and incorporate cost adjustment for the difference in the cost of goods and/or services
No obligation to deliver a rate of return on investment	Calculate a notional rate of return and incorporate into the cost of goods and/or services

Source: IPART

Individual agencies are required to make their own assessments to determine any further categories of adjustments that may be specific to their own industry. For example, they may benefit from subsidised rents. These advantages should be reflected in the competitively neutral price.

Competing businesses may differ in size, assets, skills, experience and culture. These are characteristics which define each competitor's unique competitive advantages and disadvantages. Competitive neutrality principles do not require or encourage cost adjustments for any of these factors, which may apply equally to government or private sector companies.

We consider that the sections in the competitive neutrality policies on identification and adjustment to account for cost advantages are appropriate. However, we consider that improvements can be made to the sections that discuss adjustments to account for a return on investment. This is discussed further below.

A government business activity may also enjoy competitive advantages which are not directly related to their costs. The treatment of non-cost advantages is further discussed in the next section.

Cost of capital and required rate of return

A private sector business must price its goods and services to provide a profit to its owners as well as ensuring it covers the cost of any debts. This compensates the owners of the business for the opportunity cost of investing in the business, which is equal to the return they could have earned from the next best available investment.

While government businesses may not have the same impetus to earn a profit, the government is incurring a similar opportunity cost when it undertakes commercial activities. The NSW pricing guideline requires government businesses to explicitly account for this by including the opportunity cost of capital.⁹⁰ The opportunity cost of capital is a function of the value of the assets used by the entity to provide the goods and services and a required rate of return on those assets. The guidance on how to calculate the rate of return currently differs for state and local government entities (see Table 5.3).

Table 5.3 Current government approaches to calculating the target rate of return

Level of government	Approach
State government	<ul style="list-style-type: none"> Where a business activity's capital costs are insignificant: Commonwealth 10-year bond rate. Where a business activity's capital costs are significant: the activities' weighted average cost of capital (WACC) calculated in accordance with NSW Treasury guidance.
Local government	No prescribed approach but the rate of return should be comparable to rates of return for private sector businesses operating in a similar field.

Sources: Department of Local Government, *Pricing & Costing for Council Businesses: A Guide to Competitive Neutrality*, July 1997, p 23; and NSW Treasury, *Guidelines for Pricing of User Charges (TPP 01-02)*, June 2001, p 13.

Treasury's policy is that non-current assets (long-term investments that are not easily converted to cash) must be valued at the cost to replace the asset with a modern equivalent.⁹¹ This is not in line with the private sector however, where it is more common to use the historic cost (which is typically lower). The NSW pricing guideline therefore suggests that the cost of capital may need to be adjusted to ensure that the government business activity is not placed at a competitive disadvantage. We support maintaining this flexibility in the asset valuation method.

To estimate the opportunity cost of capital, government businesses need to be able to set an appropriate target for their rate of return on these assets. Compliance with competitive neutrality would require them to be able to demonstrate their performance in meeting these targets.

In the case of a complaint, an analysis of the government business activity's rate of return can be performed to test compliance, as demonstrated in the case study described in Box 5.3.

Box 5.3 Case study – rate of return analysis for PETNET

PETNET Australia Pty Limited was a wholly owned subsidiary of the Commonwealth Government's Australian Nuclear Science and Technology Organisation (ANSTO). It manufactured a type of nuclear medicine imaging called positron emission tomography (PET) radiopharmaceuticals, also known as PET imaging or PET scan (used to diagnose and detect the severity of or treat a variety of diseases).

A competitor claimed that PETNET was not pricing to cover its costs and was not generating commercially acceptable profits. The competitor alleged that this enabled PETNET to secure a competitive tender with NSW hospitals. The Australian Government Competitive Neutrality Complaints Office (CNCO) investigated the complaint.

Box 5.3 Case study – rate of return analysis for PETNET

To comply with Commonwealth competitive neutrality provisions, government businesses need to set appropriate targets for their return on assets and demonstrate that they can meet them. The targets should exceed the long-term government bond rate (4% at the time of the investigation) and include a margin for risk (3% for low risk, 5% for medium risk, and 7% for high risk, at the time of the investigation). Rate of return in the short term is likely to vary due to a wide range of economic and industry-specific factors so the commercial rate needs to be earned over the long-term.

ANSTO claimed that over the long term, the target rate of return for PETNET was between 18%-25%, which was aligned with expected returns within the radiopharmaceutical industry. ANSTO argued that PETNET's commercial rate of return was below the 13.5% return initially expected due to errors and omissions made in the original business case.

The competitor argued that PETNET would need to gain a monopoly position within NSW (claiming 190% of the available market) to achieve a positive longer-term return.

The CNCO considered the investment of \$17.228 million in PETNET and its expected net cash flow for each year from 2011-2021 and found that it would only be able to make a rate of return of around 5.3% over 10 years. The CNCO found PETNET's likely inability to achieve a commercial rate of return on the equity invested in it was an "ex ante" breach of competitive neutrality obligations.

Note: This case study is drawn from a different Australian jurisdiction, which is not subject to the policies and processes in NSW. A different decision might have been made if examined under the current NSW competitive neutrality framework
Source: Australian Government Competitive Neutrality Complaints Office, [PETNET Australia, Investigation No 15](#), 2012

There are different ways to estimate a business' target rate of return. It demands a trade-off between specificity and resources/data required to estimate the target.

Each government business could calculate its weighted average cost of capital (WACC), which quantifies the cost of the business' debt and equity while accounting for factors such as market risk. The WACC is essentially the average rate that a business pays to finance its assets. It is difficult to precisely calculate a WACC however, as it requires relatively detailed financial data and technical skills. Estimating the WACC could therefore be difficult for smaller government business units with limited in-house finance capability.

Another option is to use benchmarking, whereby the rate of return target is set in line with similar listed companies or industry averages. The information to use for benchmarking is publicly available, however it can be difficult to establish a unique target from this. While the returns of similar companies would be averaged over a several year period, it is still difficult to isolate the factors affecting a firm's return from the underlying market performance. If this isolation is done correctly, the target would have market risk incorporated into it. This method does however require comparators, which may not be available for more specialised government business activities.

A uniform target rate of return could be set to reduce the administrative burden on government business activities. On the other hand, this may not be flexible enough to reflect the diversity in levels of market risk faced by businesses. If risk is not adequately taken into account, then the adjustment may be inadequate, undermining the application of competitive neutrality.

The Commonwealth recommends smaller businesses set their target rate of return as the 10-year bond rate plus a number of percentage points depending on the perceived risk of the business activity (low, medium, or high risk).⁹² This has the simplicity of using a uniform figure, while still adding in a factor to reflect an individual business' market risk. The risk factor figures have not been updated since 1998 however, and it is unclear how they were calculated in the first place.

In NSW, entities covered by the Commercial Policy Framework will already make dividend payments to reflect a commercial rate of return on their business activities.⁹³ As a result, these businesses will not have to make an adjustment for this (as they do not have an advantage relative to a non-government competitor). There may be value in Treasury or a government business owner implementing a dividend policy for a broader set of entities as this would avoid the need for these entities to make an adjustment under the revised competitive neutrality policy and would have several efficiency advantages (Box 5.4).

Box 5.4 Paying dividends and tax equivalents to a business owner

The efficiency gains from competitive neutrality will be highest where a government entity undertaking a business activity has the obligation to pay dividends and tax equivalents to an 'owner' outside of the business. This imposes greater commercial discipline on government businesses to operate efficiently. Without this, the government business may have the opportunity to use additional revenue from pricing in dividends and tax equivalents to fund an inefficient business operation. Currently only SOCs and those under Treasury's Commercial Policy Framework have an obligation to pay dividends and tax equivalents.

Government entities with significant business activities should consider whether to impose such a requirement on their business activities. As an example, a council owned business could be required to incorporate a return on capital into its prices and to pay dividends to the local council. Part of this consideration is likely to be whether the business is operating on a commercial basis or is routinely pricing below the competitive neutral price, and therefore, receiving funding from the business owner. It would not be sensible to set up a formal transfer of dividends and tax equivalents from a loss-making business.

The government owner of the business activity could also allow the business to reinvest the profit and this would be consistent with principles of competitive neutrality if there is a good reason to do so, for example:

- greater efficiency
- improved outcomes for the public
- an ability to reduce costs in the medium to long term.

Source: IPART

For business activities undertaken by entities not covered by the Commercial Policy Framework, we recommend that government business activities estimate their target rate of return as a WACC, using IPART's publicly available WACC model^d with simplified parameters. This guidance is summarised in Box 5.5. Specifically, the beta (which reflects the activity's risk relative to the market and requires a detailed analysis to determine) would be set to one i.e. the average beta across the whole market. The split between debt and equity (known as gearing) would reflect the activity's actual gearing. With step-by-step instructions issued by IPART, we consider the WACC would be easy for business activities to calculate, while reflecting some of the risks specific to the activity.

^d More information on the model (including a working copy) can be found in the [Market update](#) section of IPART's website

The WACC will need to be updated to reflect changes in the business activity's debt and equity, as well as the market conditions. IPART updates its WACC model on a 6-monthly basis. Business activities would be expected to keep their WACC up to date, by adjusting it in the event of a significant shift in their gearing. Otherwise, the WACC should be revised in line with their changes to prices.

The competitive neutrality policy should also incorporate some flexibility regarding the rate of return method. If a business has limited assets, it may not be appropriate to determine the rate of return based on a WACC. This was in the finding in IPART's investigation of competitive neutrality complaints against the State Valuation Office. In that case, industry benchmarks were used to determine a reasonable profit margin.⁹⁴

Box 5.5 Summary of the proposed method for calculating target rate of return

Government agencies should estimate their target rate of return as a WACC, using IPART's publicly available WACC model with simplified parameters. Specifically, the beta (which reflects the activity's risk relative to the market and requires a detailed analysis to determine) would be set to one i.e. the average beta across the whole market. The split between debt and equity (known as gearing) should reflect the activity's actual gearing.

Where a government business' assets are limited, industry profit margin benchmarks may be used. The WACC or profit margin of a government business activity should be updated when there is a significant shift in gearing, or otherwise revised in line with changes to prices.

Source: IPART

5.3.2 Disadvantages

The NSW competitive neutrality policy statement requires material competitive disadvantages arising from government ownership to be considered when pricing goods and services.⁹⁵ This is consistent with the Competition Principles Agreement's focus on removing "net advantages" but discourages government entities from quantifying small or immaterial disadvantages.⁹⁶ The NSW competitive neutrality policy statement recommends that agencies first focus on revising the policies that give rise to the disadvantages if the policies are considered lacking in merit. The local government pricing guideline acknowledges disadvantages of government ownership but does not propose a method for dealing with them.⁹⁷

A government business activity's competitive disadvantages arising from government ownership could include:

- costs of higher reporting requirements
- more stringent regulations
- restrictions on importing materials (such as buy local policies)
- reduced flexibility in financing structure.

Wollongong City Council's submission to the Issues Paper provided another example, noting that government business activities need to consider social procurement policy (for example, a percentage of contracts must be awarded to small businesses) when selecting suppliers, whereas competitors do not have similar restrictions.⁹⁸

We recommend maintaining the position in the current NSW competitive neutrality policy statement. As shown by the examples above, it can be difficult to identify whether competitive disadvantages are cost-based or non-cost. This position would therefore apply to both types of disadvantages.

Draft recommendation

9. The approach to adjusting for net cost advantages in the current competitive neutrality policies be retained as it is appropriate. However, we recommend that the revised policy provide clearer guidance to assist government entities to estimate an appropriate rate of return.

5.4 Adjusting for non-cost advantages

Non-cost advantages or disadvantages occur when a government business enjoys advantages or disadvantages related to its government ownership that do not directly change its cost base but still provide it with benefits/drawbacks that are not experienced by private competitors. Non-cost advantages could include preferential access to information or customers, regulatory powers, and bundling of commercial and non-commercial products. Non-cost disadvantages could include more stringent regulation and restrictions on business.

Non-cost advantages and disadvantages are still a competitive neutrality concern, since they provide government business activities with advantages that are not available to private competitors. Since these advantages are not directly reflected in the cost, they may be more difficult to make competitive neutrality adjustments for.

The current competitive neutrality policies do not provide guidance on dealing with non-cost advantages and disadvantages. We are proposing that the revised policy includes some high-level guidance for government business activities that may need to adjust their practices or prices to reflect non-cost advantages and disadvantages.

We propose that the revised competitive neutrality policy provides that where possible, the advantage or disadvantage be removed altogether, for example by sharing advantageous information with the private sector, restructuring the government business activities to avoid regulatory conflicts of interest, or ceasing bundling of goods/services. In some circumstances, it may be possible to quantify the advantage or disadvantage and deal with it in the same way as cost-based advantages and disadvantages. For example, if the government business activity is subject to more stringent regulations than an equivalent private sector business, it should calculate the time and cost involved in complying with the more stringent regulations and make an adjustment to account for this. This is in line with the approach recommended by the NSW Treasury in its submission.⁹⁹

Box 5.6 shows a case study of a competitive neutrality investigation of a non-cost advantage.

Box 5.6 Case study – Non-cost advantage for South East Water Limited

In 2005 the state-owned water utility, South East Water Limited (SEWL), formed an alliance with 2 private sector contractors to optimise the delivery of its maintenance and capital works and manage the South East Water Priority Plumbing service (SEWPP) for emergency and general water and sewerage systems. An owner of a private plumbing business raised a complaint alleging that:

- SEWL defect notices promoted the use of SEWPP services over independent plumbers.
- SEWL cross-promoted SEWPP services through its website and uniforms worn by contracted employees
- SEWPP plumbing activities were exempted from processes that their competitors were required to follow, such as obtaining 'road opening permits' and a requirement to call 'dial-before-u-dig' to gain access to underground utilities asset maps.
- SEWPP had access to data and information collected by SEWL through its regulatory functions that SEWPP competitors could not access.
- SEWPP had access to Government-owned SEWL assets and expensive specialised equipment at no cost.

The complaint was investigated by the Victorian Competition and Efficiency Commission (VCEC). VCEC found that the plumbing activities of SEWPP were not exempt from processes that independent plumbing businesses are required to follow. It also found that there were no advantages with respect to information, data or assets available to SEWPP Plumbers.

However, the VCEC recommended that SEWL:

- review the formatting of its defect notices to enhance the neutrality of the information provided
- ensure that its call centre and website provided competitively neutral information to customers.

Note: This case study is drawn from a different Australian jurisdiction, which is not subject to the policies and processes in NSW. A different decision might have been made if examined under the NSW competitive neutrality policies
Source: Victorian Competition & Efficiency Commission, Competitive Neutrality Complaint Investigation. Final report, plumbing services provided by South East Water Limited, 21 December 2010, available [online](#) at web archive of the VCEC website, last viewed on 22 November 2022.

5.4.1 Which non-cost advantages and disadvantages are relevant to competitive neutrality?

It may not always be straightforward to determine when non-cost advantages and disadvantages arise from government ownership and when they arise from other factors. Because of this, we consider that any non-cost advantages or disadvantages that government businesses have that are not enjoyed by private competitors should be dealt with through competitive neutrality. This means that non-cost advantages or disadvantages that arise from a government business' market power would usually still be considered a competitive neutrality issue.

We consider the revised competitive neutrality policy should oblige government businesses to identify and account for any non-cost advantage or disadvantage that is not enjoyed by their private competitors.

These issues can sometimes be addressed outside competitive neutrality policy by introducing specific policies or obligations. For example, the Australian Energy Regulator has imposed ring-fencing guidelines in the electricity sector to prevent distribution network service providers from providing additional services that are cross-subsidised by their distribution services.¹⁰⁰ If a non-cost advantage or disadvantage is dealt with via another policy/obligation, like these ring-fencing guidelines, it does not need to be accounted for through competitive neutrality principles.

We recognise that non-cost advantages or disadvantages that arise from a government business' market power could usually also theoretically be enjoyed by a private competitor with the equivalent market power. However, we also recognise that the distinction between non-cost advantages or disadvantages that arise from a business' government ownership versus its market power can be difficult to determine in practice. A policy that specifically excludes non-cost advantages and disadvantages that arise from a government business' market power would therefore potentially be confusing to apply.

If the government entity is in doubt about whether the non-cost advantage/disadvantage is or could be enjoyed by private competitors, the advantage/disadvantage should be addressed as per the competitive neutrality policy.

Examples of non-cost advantages that are within the scope of competitive neutrality policy are provided in Box 5.7.

Box 5.7 Examples of non-cost advantages that are within the scope of competitive neutrality

Example 1 – access to customers as a result of non-commercial functions

A general government entity promotes revenue-raising goods and/or services while attending premises for a non-commercial reason (for example, to undertake a regulatory function such as, an inspection).

Box 5.7 Examples of non-cost advantages that are within the scope of competitive neutrality

The non-cost advantage is derived from its government ownership as the non-commercial activity could not be undertaken by a private entity. Therefore, methods to remove or mitigate the advantage should be considered as part of the application of competitive neutrality policy. For example, the officer could inform customers that other commercial providers can undertake the commercial service.

Example 2 – Access to customers through providing related services

A monopoly water utility owns and operates the water distribution network in a township. One of its maintenance functions is repairing damage to pipes upstream of customers' meters.

The repair of a pipe that is downstream from the meter on a customer's property, is the responsibility of the customer rather than the local utility. Without investigation, it is not initially known whether the issue is the responsibility of the utility or the customer to repair. If it is the customer's responsibility, the repair could be made by any qualified plumber. If the utility attends, investigates and decides the repair is the responsibility of the customer, they could offer to fix the problem on the spot for less than what it would cost the customer to search for and obtain quotes and have it fixed by another plumber.

Being onsite when offering a service could be seen as having advantageous access to customers. This advantage would still be considered a competitive neutrality issue, as the plumber representing the utility was onsite to perform a non-commercial service but was able to offer a commercial service as well. Therefore, methods to remove or mitigate the advantage should be considered as part of the application of competitive neutrality policy. For example, the utility could inform customers that other commercial providers can undertake the repair and should ensure that it charges the appropriate cost to the customer.

Competitive neutrality policy should not require the utility to act contrary to the public interest (for example, by refusing to fix the leak when they are able to).

Source: IPART

Draft Recommendations

- 10. Include guidance in the revised policy on dealing with non-cost advantages and disadvantages. We recommend that the guidance states that where possible, the advantage or disadvantage be removed altogether or converted into an adjustment that can be accounted for in the government entity's costs.
- 11. Non-cost advantages and disadvantages experienced by government business activities that are not experienced by competitors be treated as a competitive neutrality issue, unless the advantage/disadvantage is already addressed through another policy or obligation. Such advantages or disadvantages could arise from government ownership or market power.

Seek Comment

- 5. How easy will it be to account for the advantages and disadvantages of government ownership? What additional guidance would help?

5.5 Structuring a business activity to address competitive neutrality

The options for structuring government business activities fall on a spectrum from full structural separation (where an entity undertakes only business activities) to no separation from general government (where an entity undertakes a mix of business and non-commercial activities using the same set of resources).

Corporatisation and commercialisation sit at one end of the spectrum. Businesses that have been corporatised or commercialised are governed by NSW Treasury's [Commercial Policy Framework](#). The framework imposes commercial performance and reporting obligations, as well as some level of independence in the operation and management of the business activity.

We have grouped the options into 4 basic categories, described in the table below.

Table 5.4 Categories of business structure

Corporatisation	Commercialisation	Structural separation ^a	No separation
<ul style="list-style-type: none"> • Business activity undertaken by separate legal entity • Independent board of directors • Performance obligations • Legal obligations to pay taxes or tax equivalents • Same rules as private corporations • Requirement to pay dividends to 'owner' 	<ul style="list-style-type: none"> • Business activity structurally but not legally separate • May be subject to Treasury's Commercial Policy Framework, in which case has policy obligations to pay tax equivalents, dividends and debt guarantee fees to Treasury • Performance and costing obligations 	<ul style="list-style-type: none"> • Business activity structurally but not legally separate • May not have performance obligations • May share inputs but able to identify and attribute shared costs 	<ul style="list-style-type: none"> • Business activity does not have its own identity • Same inputs are used for business and non-business activities • May or may not separately identify costs of business activities • May be difficult to identify which activities are business and which are not

Corporatisation	Commercialisation	Structural separation ^a	No separation
<ul style="list-style-type: none"> Subject to Treasury's Commercial Policy Framework 		<ul style="list-style-type: none"> No obligation to pay dividends, tax equivalents or debt guarantee fees (though business 'owner' may require it) 	

a. In the current LG policy, this is referred to as 'applying a corporatisation model'

Source: IPART

Corporatising or commercialising a business activity removes many of the advantages that a government entity would otherwise have because it imposes:

- equivalent obligations and regulations to non-government corporations
- the payment of taxes or tax equivalents
- the payment of dividends
- commercial objectives
- accounting separation from 'non-commercial' activities.

The current competitive neutrality policies suggest that once an entity has been corporatised or commercialised it is not obliged to consider competitive neutrality any further (e.g. the current pricing and costing guidelines for state government businesses do not apply to these entities). However, corporatisation and commercialisation may not eliminate competitive neutrality concerns. As the OECD notes:

"it does not follow from this that concerns about competitive neutrality have wholly abated. For starters, where individual enterprises are engaged in a combination of public policy objectives and more conventional business activities, questions often arise about the market-consistency of the business activities. Furthermore, the degree to which government activity is considered "business" matters. Commercial undertakings operated by government departments or autonomous institutions can be a source of non-neutrality, but not all activities are suited for corporatisation."¹⁰¹

We are proposing that all significant government business activities be subject to the revised competitive neutrality policy where it is in the public interest. Where corporatisation or commercialisation has removed advantages of government ownership that the entity would otherwise have, the revised competitive neutrality policy would not require the entity to make further adjustments (see Chapter 3). As a result, corporatisation or commercialisation of a business activity may be a cost-effective way of addressing competitive neutrality, so discussion of business structure is a relevant inclusion in the revised competitive neutrality policy. The current discussion of business structure is static, assuming that the decision on structure has already been made:

- The NSW competitive neutrality policy statement highlights the program of corporatisation and commercialisation that has been undertaken as a key action that has helped deliver on NSW's competitive neutrality commitments. It outlines the requirements that apply to businesses that have been corporatised or commercialised and how these address competitive neutrality.¹⁰² The remainder of the competitive neutrality policy (*Guidelines for Pricing of User Charges*) apply to other significant government business activities, where they operate in a contestable market.
- The local government policy statement imposes what it refers to as 'corporatisation principles' on all significant government business activities (those over the threshold of \$2 million annual turnover).¹⁰³ Those principles are broadly in line with the 'structural separation' category in Table 5.4 above. The guidelines for pricing and costing local government businesses apply to these activities. Business activities below the threshold are also encouraged to adopt corporatisation principles where this is appropriate.

We recommend that the revised competitive neutrality policy includes a chapter that provides guidance on the different options for structuring government businesses, as a means of addressing competitive neutrality and when each option would be appropriate.

The guidance should set out some of the benefits, costs and considerations that are relevant to the choice of how to structure a government business activity to meet competitive neutrality obligations. Some suggested guidance is provided in Box 5.8.

We recommend that the revised competitive neutrality policy includes guidance rather than directing or advising a government entity to adopt a particular corporate structure because:

- Government entities undertaking business activities may not have control over their business structure (for example, Treasury determines which business activities are subject to its Commercial Policy Framework).
- Competitive neutrality is likely to be only one factor that is relevant to the decision to structure a business activity in a particular way.
- The advantages and disadvantages of government ownership can be addressed by other strategies if they are not addressed via corporatisation or commercialisation.
- Corporatisation/commercialisation may not be sufficient to remove net competitive advantage.
- A case-by-case assessment of the costs and benefits of different options would be required to determine what structure would deliver the highest net public benefit.

Draft Recommendation



12. Include a chapter in the revised policy on business structure that sets out high level guidance but does not require a government entity to adopt any particular structure for its business activities. We recommend including the guidance in Box 5.8

Box 5.8 Suggested guidance on business structure in the revised competitive neutrality policy

The options for structuring government business activities fall on a spectrum from full structural separation (where an entity undertakes only business activities) to no separation from general government (where an entity undertakes a mix of business and non-commercial activities using the same set of resources).

Corporatisation and commercialisation sit at one end of the spectrum. Businesses that have been corporatised or commercialised are governed by NSW Treasury's [Commercial Policy Framework](#). The framework imposes commercial performance and reporting obligations, as well as some level of independence in the operation and management of the business activity.

Corporatising or commercialising a business activity removes many of the advantages that the government entity would otherwise have because it imposes:

- equivalent obligations and regulations to non-government corporations
- the payment of taxes or tax equivalents
- the payment of dividends
- commercial objectives
- accounting separation from 'non-commercial' activities.

Structural separation is a continuum. Greater separation of commercial activities from non-commercial activities could be expected to provide additional benefits (i.e. greater accountability and incentives to improve performance) but also additional costs (see Table 5.5).

Corporatisation is the highest cost approach and unlikely to be in the public interest for smaller organisations. The costs of corporatisation include:

- establishing and operating a Board (e.g. payments to Board members)
- servicing the Board (e.g. the costs associated with preparing Board papers, holding Board meetings etc.)
- establishing a separate legal entity (this could include: legal and accounting costs, possibly including external advice).

Government entities should decide on an appropriate level of structural separation between their business and non-business activities, considering both the potential benefits of greater independence/separation and the costs. Key questions for consideration include:

- Is separation of commercial and non-commercial businesses activities feasible?

Box 5.8 Suggested guidance on business structure in the revised competitive neutrality policy

- Are there efficiency benefits (such as, economies of scope) between business and non-business activities?
- Could the non-business activities be funded through the CSO Framework?

Where structural separation of business activities from non-business activities is not feasible or would result in significant efficiency losses, the non-commercial activities could potentially be funded through a CSO. Funding non-commercial activities through the CSO framework would enable the business unit to effectively operate in a similar way to a fully commercial business.

The larger a government business activity, and the more impact it has on the market, the greater the degree of structural separation that should be considered.

Unless a government entity has demonstrated that it is not in the public interest to separately identify the costs of its significant business activities (including identifying and correcting for any net advantage from government ownership) some form of separation, at least for the purposes of reporting, is likely to be needed to demonstrate compliance with the competitive neutrality. Reporting that identifies the costs of the business activity will assist in implementing full cost pricing.

The NSW Government has a role in ensuring that the Commercial Policy Framework covers an appropriate range of government business activities. Government entities that undertake significant business activities should liaise with Treasury if they consider that there may be benefits from being under this framework. The advantages to a government business of being subject to the Commercial Policy Framework are a clear set of obligations, a simpler way of demonstrating compliance with competitive neutrality policy and the ability to access guidance and assistance from Treasury.

Source: IPART

Table 5.5 Costs and benefits of different structures

	Corporatisation & commercialisation	Structural separation	No separation
Benefits	<ul style="list-style-type: none"> • Creates a clear commercial focus • Accountability for performance • Incentives to improve efficiency • Incentives to respond to market & customer needs 	<ul style="list-style-type: none"> • Transparency around own costs • Transparency around implicit subsidies • Some accountability for performance 	<ul style="list-style-type: none"> • Low administrative cost • Greater flexibility to use staff for different functions as needed
Costs	<ul style="list-style-type: none"> • Highest cost approach (unlikely to be feasible unless activity is large) 	<ul style="list-style-type: none"> • Lower accountability for commercial performance 	<ul style="list-style-type: none"> • Limited incentive to improve efficiency or performance • Minimal transparency

Corporatisation & commercialisation	Structural separation	No separation
	<ul style="list-style-type: none">• Limited incentive to improve productive efficiency• Still likely to be some costs from separation	<ul style="list-style-type: none">• Low accountability in relation to commercial performance

Source: IPART

Chapter 6 >>

Assessing whether competitive neutrality is in the public interest

There are a range of reasons that a government entity may choose to price below the competitively neutral price. This chapter outlines the circumstances in which this may occur.



Once a government entity has worked out the competitively neutral price for their products and services, they may wish to charge below this price because they make a policy decision to subsidise the price. Government entities may also wish to retain non-cost advantages that have been identified. The revised competitive neutral policy should not prevent this where it is in the public interest.

The Competition Principles Agreement requires significant government business activities to apply competitive neutrality principles, but only to the extent that the benefits of applying competitive neutrality principles outweigh the costs (the 'public interest' test).¹⁰⁴ The Competition Principles Agreement also sets out specified matters which, where relevant, must be considered in assessing the public interest (such as CSOs and certain government policies). The main choices faced by jurisdictions around the application of the public interest test are when it should be applied and what should be considered as part of the test. There are also procedural questions of how often to apply the test and whether the test should be published or consulted on.

6.1 Overview of the draft recommendations

We recommend that the public interest test be undertaken by government entities with significant business activities where they consider that it would not be in the public interest to charge a competitively neutral price or to remove a non-cost advantage.

Currently, an entity does not have to go through the process of estimating a competitively neutral price or identify non-cost advantages if they can establish that the costs of applying competitive neutrality principles outweigh the benefits. Applying the public interest test *after* a competitively neutral price is estimated and non-cost advantages have been identified is preferred. This is because it exposes the cost of the subsidy and the impacts of applying it and allows the public interest test to be informed by a full set of costs and benefits.

There is limited guidance in the competitive neutrality policies on how a government entity should undertake a public interest test. We recommend that the revised competitive neutrality policy provides a clear, easy-to-apply framework for undertaking the public interest test.

A simple, qualitative approach for local government will reduce the regulatory burden on councils seeking to subsidise business activities. Currently councils can subsidise the price of goods or services for any reason once they identified the competitively neutral price for their goods and services. For state government, the public interest assessment should be quantitative where possible and reasonable, which is consistent with the obligation in the current competitive neutrality policies.

We also recommend that the revised competitive neutrality policy provides guidance on how frequently the test should be undertaken, what level of consultation should be incorporated when undertaking a public interest test and what information should be made public.

6.2 When to apply the public interest test

We are proposing that the revised competitive neutrality policy requires the public interest test to be done *after* the government entity has costed its services and accounted for the net advantages of government ownership. The test would only be done where the government entity suspects that charging the competitively neutral price, or removing a non-cost advantage, would not be in the public interest.

Undertaking the public interest test after estimating the competitively neutral price provides greater transparency on the cost of undertaking a business activity, the cost of the proposed subsidy and the merit of pricing below the competitively neutral price.

This is a shift from the current approach, where competitive neutrality principles need not be applied if an entity establishes that it would be in the public interest to not apply competitive neutrality.¹⁰⁵ It also overcomes the problem identified in the NSW competitive neutrality policy statement that the administrative costs may be overemphasised in the test as they are easier to quantify than the broader benefits of pricing in a competitively neutral way.¹⁰⁶

Both the NSW competitive neutrality policy statement and the local government policy statement currently state that competitive neutrality principles are to be applied even where user charges are to be set at less than full cost recovery.¹⁰⁷ However, an entity may not get to this later step if they find that it is in the public interest to not apply competitive neutrality. The local government policy statement also allows councils to subsidise for any reason, so long as the subsidies are fully disclosed as explicit transactions in councils' internal financial reporting.¹⁰⁸

6.3 How to apply the public interest test

We recommend that the revised competitive neutrality policy provides more information on how to undertake a public interest test. We are also proposing that the revised policy provide for a difference between the method to be applied by local and state government entities.

There is limited guidance in the current competitive neutrality policies on how a government entity should undertake a public interest test when it is considering not applying competitive neutrality principles. The NSW Productivity Commission submission noted that government businesses may not currently have internal capability to accurately quantify costs and benefits as part of the public interest test. The submission suggested that further guidance on the public interest test could be developed, such as recommended methodologies and when a qualitative cost benefit analysis may be appropriate.¹⁰⁹

A clear and easy-to-apply framework for the public interest test will assist government businesses to apply the test and is a key element in ensuring that the competitive neutrality policy delivers the benefits it is designed to achieve. Our proposed framework for undertaking the public interest test is as follows:

1. Define what is being proposed:
 - What is the proposed price or non-cost advantage?
 - How does it differ from a competitively neutral approach?

2. Assess the benefits of the proposed option:
 - Why is it being proposed? What objective is it trying to achieve?
 - What are the benefits of the subsidy and who will receive them?
3. Assess the costs of the proposed option:
 - What is the expected total cost of the proposed subsidy?
 - What impact would the non-price advantage and/or subsidy would have on competitors?
4. Decide whether the benefits outweigh the costs
5. Consider whether the objectives could be achieved by other means that are less costly

Government entities should have regard to the factors set out in Box 6.1 when responding to the questions set out above.

This framework contains elements of cost-benefit analysis as described in the NSW Government Guide to Cost Benefit Analysis.¹¹⁰ It also incorporates best practice aspects of the policies from other jurisdictions, particularly Victoria.^a

Box 6.1 Factors to be considered in applying the public interest test

The Competition Principles Agreement sets out a range of matters that must be considered (where relevant) as part of assessing the costs and benefits of a particular policy or course of action:

1. government legislation and policies relating to ecologically sustainable development
2. social welfare and equity considerations, including CSOs
3. government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity
4. economic and regional development, including employment and investment growth
5. the interests of consumers generally or of a class of consumers
6. competitiveness of Australian businesses
7. the efficient allocation of resources.¹¹¹

^a The Victorian framework requires the government business to (1) clearly identify the policy objectives that is to be achieved and that the policy objectives have official endorsement, (2) demonstrate that the achievement of the stated policy objectives would be compromised if a particular competitive neutrality measure under consideration was implemented and (3) determine the best available means of achieving the overall policy objectives, including an assessment of alternative approaches. Victorian Department of Treasury and Finance, *Competitive Neutrality Policy* (2012), pp 8-9.

Box 6.1 Factors to be considered in applying the public interest test

This is not an exhaustive list and other matters may be considered as appropriate.

Using these factors to identify the subsidy and its benefits

There are different types of subsidies:

- community service obligations (these are discussed in section 6.4)
- costs borne by government instead of the business activity, such as 'free' use of equipment, for example peppercorn rents. This gives the business activity the opportunity to charge below the competitively neutral price.
- costs borne by private sector businesses that are not incurred by the government entity e.g. taxes, rates of return or regulatory requirements.

The objective and benefits of the subsidy will vary on a case-by-case basis. The government entity should be clear on what it is trying to achieve by departing from the principles of competitive neutrality. As well as undertaking the steps described above, the government entity should identify which category (or categories) the benefits fall into.

Source: IPART

Box 6.1 Factors to be considered in applying the public interest test

Using these factors to assess the costs of the subsidy

Apart from the financial cost of the subsidy itself, the main cost of charging below the competitively neutral price and/or retaining a non-cost advantage is the impact that this has on competition in the market.

For example, would it affect the ability of competitors to innovate or develop new products or services, or impact on the growth of local business activities? This can be difficult to quantify, although a basic market study may assist in understanding market dynamics. The market study could cover:

- the existence or likely existence of competitors
- the prices charged by competitors
- the quality and quantity of competitors' services
- any expected market growth or changes, with or without the subsidy.

It is presumed that the application of competitive neutrality will promote the efficient allocation of resources. This may however be difficult to quantify without specialist economic expertise.^b

Weighing up the costs and benefits

This will generally involve a qualitative assessment, due to the difficulties of quantifying costs and benefits of subsidies with precision.

Considering whether the benefits could be achieved in a less costly way

For example, could the same or similar benefits be achieved by a targeted rather than broad subsidy? In some cases, the application of competitive neutrality may still achieve a policy objective if, for example, the competitively neutral price is low enough to meet demand for a good or service.

Source: IPART

^b For example, quantifying the deadweight loss associated with a subsidy requires an estimation of demand and supply curves in the product market, which is likely to be beyond the capability of most government organisations.

6.3.1 Differentiating between local and state government

Generally, we consider that it is best practice for the revised competitive neutrality policy to consistently apply competitive neutrality to state and local government. However, we consider that when it comes to the public interest test, there is a case for some differences in the way the test is required to be carried out. There are 2 main reasons for this. Local government is likely to have a higher number of smaller business activities, and may also have fewer resources to undertake such an assessment. In addition, the current competitive neutrality policies do not impose any obligation on local government to consider the public interest factors when making a decision to subsidise a business activity. While we expect that local councils form a view on the public interest when making these decisions, the framework we have proposed may differ from their current approach.

For local government, it is proposed that a qualitative assessment of the costs and benefits of a subsidy is sufficient so long as the public interest test framework is applied. That is, that all the relevant factors have been identified and weighed up in the decision-making process.

A qualitative approach to the public interest test should minimise the regulatory burden and cost associated with completing the public interest test for local government. We expect that local governments are already familiar with the objectives, benefits and financial costs of subsidies that are currently in place. The proposed test will require them to explicitly weigh these factors against the impacts of the subsidy on competition in the market.

For state government, quantification of costs and benefits of the subsidy should be encouraged where it is possible and proportionate to the significance of the activity. This is consistent with the NSW Government Guide to Cost Benefit Analysis.¹¹²

The basis for a subsidy could be quantified by obtaining information on customers (through surveys or other means), their willingness to pay for goods or services, and the size of benefits from below-cost activities. Consumer analysis could be segmented by different groups e.g. business groups, groups experiencing disadvantage, by age etc., to better understand impacts of applying a subsidy.

Draft Recommendations

13. The public interest test be undertaken in accordance with the following proposed framework:
 - a. define what is being proposed and how it differs from the competitively neutral action
 - b. identify the benefits and costs considering the factors set out in Box 6.1.
 - c. assess whether the benefits outweigh the costs
 - d. consider whether there is a less costly way to achieve the benefits.
14. Establish different guidance for undertaking the public interest between state and local government:

- a. For local government business activities, a qualitative assessment for the public interest test is acceptable, although the financial cost of the subsidy must be quantified at minimum.
- b. For state government, the public interest assessment must be quantitative where possible and reasonable (i.e. effort and cost involved in quantification of costs and benefits is proportionate to the size of the business activity).

6.3.2 Updating the public interest test

We recommend that the revised competitive neutrality policy provides some guidance as to how often the public interest test should be re-done to take account of changing circumstances. The current competitive neutrality policies do not provide any guidance on this but appear to assume that the findings will remain relevant in the future. This does not, however, reflect reality. There may be significant changes in a market over time, driven by a shift in consumer tastes or new competition.

We consider that government business activities should re-apply the public interest test when there are major changes in the market and at minimum, once every 5 years. This would ensure that the subsidy remains appropriate and that evidence on the impacts of the subsidy can be gathered over time.

Draft Recommendation

15. Government business activities re-apply the public interest test when there are major changes in the market and at minimum, once every 5 years.

6.4 Circumstances where government businesses may decide competitive neutrality is not in the public interest

There are some circumstances where government businesses may decide that applying competitive neutrality is unlikely to be in the public interest. We consider that there is value in setting out some of these in the revised competitive neutrality policy to assist government entities to apply the public interest test.

Government businesses must still apply the test, having regard to their particular circumstances and the costs and benefits they have identified.

Advantages that most other competitors also have

A government business may decide that it is in the public interest to not adjust its prices to include certain advantages, if:

- most competitors in the market can access the advantages (for example, most competitors are not-for-profits so do not pay a rate of return on their capital), and

- the government entity has assessed that there is a gap in the market that a government business activity should fill for a reasonable period of time.

The advantages also available to competitors may include not having to pay dividends and taxes or having access to grants or gifted resources such as donated equipment (as relevant).

The rationale is that there will be limited impacts on competition from not paying a dividend or taxes where most of the government business's competitors do not account for a rate of return or taxes in their prices. Likewise, impacts on competition from not accounting for grants will be limited if most competitors are eligible for the grant.

The government business may decide that the benefits from the subsidy (through cheaper services for consumers) are likely to exceed the limited costs.

Short-term below-cost pricing that will grow the market and promote innovation

Below-cost pricing can be undertaken by government businesses as a marketing strategy to grow the market and promote innovation. This is referred to in the current competitive neutrality policies as 'loss leading'. Unlike the private sector, which can also employ below-cost pricing to grow the market, it should be confined to limited circumstances.

Government businesses may decide that below-cost pricing (loss-leading) could have a net public benefit when:

- it is used in a growing market to promote innovation
- it would be uncompetitive for the government business to charge full costs (because of significant up-front costs) and
- it does not persist beyond the short-term (i.e. 1-2 years, depending on industry standards).

In these circumstances, below-cost pricing may not have lasting competitive impacts.

It is important to distinguish between circumstances where a market is growing, compared to the government business itself. Government businesses should not use below-cost pricing to grow their business in an established market. If done persistently by a government business activity, below-cost pricing can lead to loss-making and subsidisation by the taxpayer.

Government businesses should also take care not to contravene the prohibitions against misuse of market power (including through predatory pricing) in the *Competition and Consumer Act 2010* (Cth).

Community service obligations (CSOs)


The NSW *Guidelines for Community Service Obligations TPP 19-02* (CSO Guidelines) apply to public non-financial corporations and public financial corporations. Examples of CSOs include a requirement to provide a universal service at a fixed price, or to provide certain discounts to particular customers, such as pensioners.¹¹³

The CSO Guidelines outline 3 principles for commissioning a CSO from a government business activity¹¹⁴:

1. A CSO should have a clearly defined objective and establish that the activity is not contestable – i.e. it should set out the case for (1) why a private sector, NGO or general government entity is not better placed to achieve the objective, and (2) how the CSO is best placed to achieve the policy objective.
2. A CSO should be funded by the government department responsible for the objective – through the department's budget with sufficient funds allocated to the business to cover the costs.
3. A CSO should be formalised through a service level agreement – outlining the activity funding, key performance indicators, agreement period etc. They should also be reported in the Statement of Corporate Intent which is the annual agreement between Public Non-Financial Corporations / Public Financial Corporations and the NSW Government.

Where the application of a subsidy to a state government business activity^c meets the criteria and principles for a CSO set out in the CSO Guidelines, the government business may decide that the CSO is in the public interest. This is because it will have already undergone a public interest assessment before budget funding is allocated and alternative means of achieving the public policy objective will have been considered.

Draft Recommendation

-  16. The revised competitive neutrality policy outline circumstances where government businesses may decide that applying competitive neutrality would not be in the public interest. This includes:
- a. CSOs that meet the criteria and principles set out in the CSO Guidelines
 - b. below cost pricing where the government business activity has significant up-front costs, the market is growing, and costs are to be recovered within a reasonable period (1-2 years)
 - c. not setting prices to cover dividends, taxes or other costs avoided by not-for-profits or charities (as relevant) where most competitors are not-for-profits or charities, and there is a role for government in the market.

6.5 Publishing and consulting on public interest assessments

Given the subjective nature of the public interest assessment and the concerns we heard from competing businesses through our consultation process, we consider that there is a strong case for some level of transparency around these assessments.


^c Local government do not need to comply with the CSO Guidelines.

In NSW currently there is no general requirement to publish public interest assessments, unlike Victoria.¹¹⁵ In addition to promoting transparency for competitors and the public at large, publishing and consulting on public interest assessments may assist other government entities who may be considering subsidising a particular business activity. However, in considering what to require in the revised competitive neutrality policy, we have been mindful that there may be commercially sensitive information considered in the analysis and that publication of this information may disadvantage the business.


We are proposing that there should be a presumption within the revised competitive neutrality policy that public interest assessments will be published, with confidential information redacted. To aid government businesses in applying the public interest test, we propose to develop a template identifying information for inclusion and information that might be considered commercial in confidence.

Consultation could also be part of a public interest assessment. For example, Victoria requires consultation with the public on application of the test.¹¹⁶ While consultation is useful and may assist in identifying unanticipated impacts from introducing a subsidy, we do not propose to recommend consultation be mandatory as we consider that it would impose a considerable burden on government entities, particularly where they need to undertake a number of assessments. It is therefore recommended that consultation on the public interest assessment is encouraged but not mandated.

Draft Recommendations

-  17. Public interest assessments be published, subject to the removal of any commercial-in-confidence material. As part of this, a template identifying information for inclusion and information that might be considered commercial in confidence would be developed by IPART.
- 18. The revised competitive neutrality policies encourage but not mandate consultation on the public interest test.

Seek Comment

-  6. Do you agree with our proposed approach to the public interest test?
 - a. How does this approach differ from current practice?
 - b. What tools, templates and guidance would assist?
 - c. What information should be published about a public interest test?

Chapter 7 >>

Complaints

A good complaints process should be simple and accessible. This chapter outlines our recommended improvements to the complaints process to enhance accountability.

07

An independent, accessible and simple complaints handling process is an important accountability measure for government policies like competitive neutrality. A well designed complaints handling process allows third parties to identify instances of poorly applied policy and have their concerns considered independently of the government business.

We have identified a number of opportunities to improve the complaints handling process. These include simplifying the process to improve accessibility and changes to reduce the number of complaints handling processes and bodies which differ depending on the nature or ownership of the government business activity. This chapter outlines the issues with the current complaints handling process in NSW, explains what we heard in stakeholder submissions and presents our draft recommended changes to improve the process.

7.1 Overview of the draft recommendations

Our review of the complaints handling process indicates that the current process is too cumbersome to access and does not provide an appropriate mechanism for addressing concerns about the application of competitive neutrality.

We propose that the complaints process be simplified and improved by:

- providing a single, consistent process for all complaints against NSW Government business activities (state, tender bid-related, and local government) with the following features:
 - reducing the number of complaints investigation bodies to a single body (IPART).
 - allowing complaints to be made directly to IPART (without Ministerial referral).
 - encouraging, but not requiring, the complainant to first raise the issue with the government business.
 - allowing complainants' identities to be kept confidential where this is consistent with procedural fairness and any legal obligations, but noting that disclosure may be required in order to fully investigate a complaint.
- allowing IPART discretion regarding the decision to investigate a complaint or not, based on an assessment of the costs and benefits of an investigation.
- allowing complaints to be made by any affected party, whether or not they compete or intend to compete, with the government business.

7.2 A single, consistent complaints handling process

We recommend changes to the complaints handling process so that there is one clear process for complainants to navigate and a single complaints body to accept and investigate complaints.

NSW receives very few competitive neutrality complaints. There were mixed views from stakeholders about whether this is because competitive neutrality policy is working well or whether it is a result of the current complaints handling process, which is complex and time consuming.

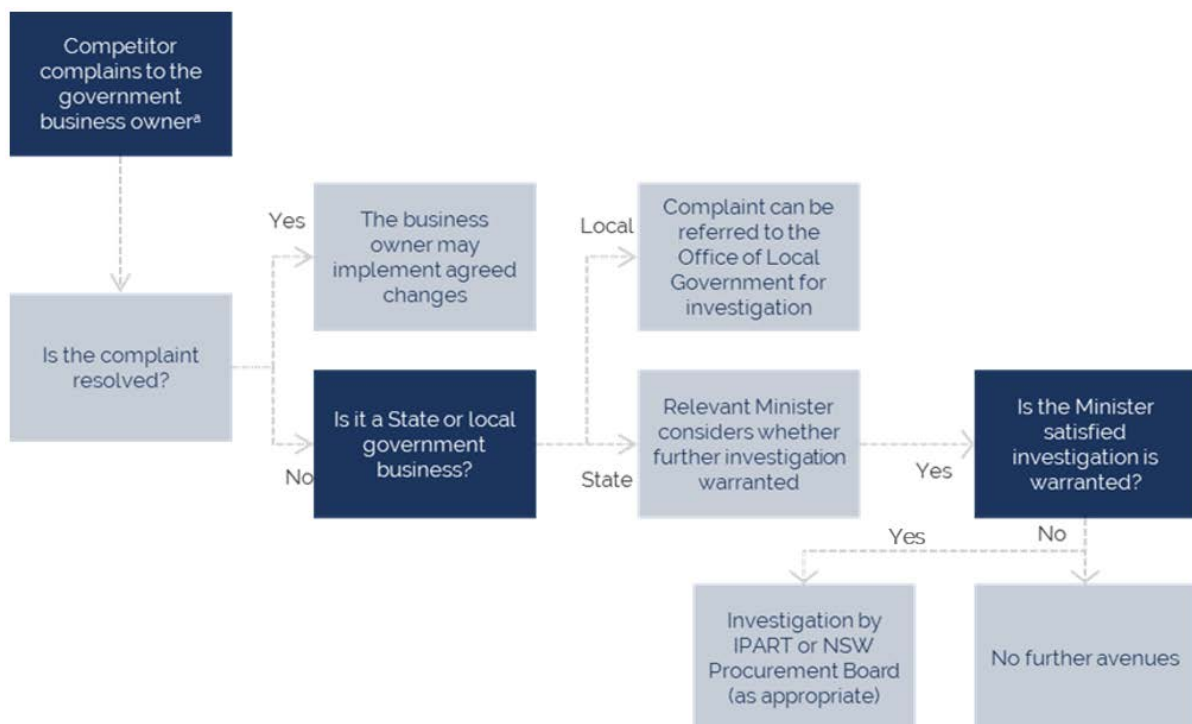
In its submission to the Issues Paper, Local Government NSW (LGNSW) stated that the current process for making a competitive neutrality complaint against a local government business is fit for purpose and appropriate.¹¹⁷ It noted that councils have not advised it of any difficulties relating to competitive neutrality and that there have been negligible complaints against council business since the introduction of the policy.¹¹⁸

However, concerns with the complexity of the complaints process were raised in several submissions to the Issues Paper and during the consultation workshops we held. Specifically, stakeholders voiced that they felt the current process is overly complex due to its multi-stage process and high information gathering requirements. These stakeholders told us that they supported changes to the complaints process to make it easier to lodge a complaint.¹¹⁹ Moreover, in its submission to our Issues Paper, the NSW Productivity Commission recommended that the requirement for the Minister to refer complaints to the complaints body be removed to improve the accessibility of the complaints process.¹²⁰

Some stakeholders also suggested that the requirement to contact the government owned business in the first instance stopped them from making a complaint, as they were concerned about the repercussions of this, particularly where government entities undertaking business activities are also responsible for regulating their activities.¹²¹

We heard of potential complainants who had wanted to make a complaint but struggled to have it recognised after trying for up to 18 months.¹²² We also heard of complainants who were met with disinterest when attempting to lodge their complaint.¹²³ This is especially problematic for small businesses who may not have the resources to persist with navigating the complaints process.

Figure 7.1 The complaints process in NSW's current policies



a. The business owner could be a government agency or local council, the competitor may include a potential competitor.

Source: New South Wales Treasury, Policy Statement on the Application of Competitive Neutrality (TPP02-01), January 2002, pp 17-18, IPART.

If the complaints process is not well designed, legitimate concerns about the application of competitive neutrality policy could go unresolved. This reduces the incentive for government entities to properly implement the policy and lowers accountability. It means that non-government businesses may be outcompeted even where they are more efficient and do business better than the government business. A well-designed complaints process can support the effective operation of the revised competitive neutrality policy and reinforce trust in government.

We have considered comments from stakeholders, the processes and numbers of complaints in other Australian jurisdictions and elements of best practice from other complaints handling processes, such as ombudsmen processes. We consider the following features of the current complaints process are not best practice and may deter would-be complainants from lodging a complaint:

- Complainants must first raise their complaint with the relevant government business¹²⁴. While in some cases this is appropriate, it may discourage complaints where complainants fear retribution from the government business.
- There are multiple review bodies (Office of Local Government, NSW Procurement Board and IPART) and review processes, depending on the nature of the complaint. This adds unnecessary complexity and creates uncertainty for complainants about where to lodge a complaint and how it will be dealt with.
- Complaints regarding state government businesses must be referred by the relevant Minister (depending on the nature of the complaint), subject to the relevant Minister being satisfied of several requirements. The Minister is not required by statute to provide reasons to the complainant for not referring a complaint to the review body.

To achieve the benefits of accountability that a complaints system should bring, we are proposing to recommend a range of changes aimed at simplifying the complaints handling system and making it more accessible.

We anticipate that reducing barriers within the complaints handling process could result in an increase in competitive neutrality complaints in NSW. We expect that even under a well-functioning policy, there are likely to be stakeholders that are unhappy about how the policy has been applied and will lodge a complaint to have this investigated. However, based on the relatively low number of complaints received in other jurisdictions, we would not expect to receive an unmanageable increase in the level of complaints.

A well-functioning complaints system will provide more information about the practical challenges of implementing the revised competitive neutrality policy. This information can be used in future reviews to improve and refine the revised competitive neutrality policy. This information can also be used to provide guidance to similar businesses and business activities.

7.2.1 Improving access to the complaints process

The priorities for improving access to the complaints system are:

- A more open and accessible process where complaints can be made directly to the complaints body, a single process with a single complaints body.
 - We consider that IPART is well placed to continue to hear competitive neutrality complaints as the single complaints body, as we are independent from government and we have regulatory functions in relation both state and local government.
 - By allowing complaints to be made directly to IPART, the Minister will no longer need to receive complaints or make referrals for complaints to be investigated.
 - While Office of Local Government could continue to investigate local government complaints, it does not seem sensible to allocate it responsibility for hearing complaints against state government businesses, as these sit outside the scope of its operations.
 - Similarly, the scope of the NSW Procurement Board's current role in relation to competitive neutrality is also narrow (limited to complaints about pricing of tender bids by state government businesses).^a Given its other responsibilities largely relate to government procurement, we consider it would not be suitable for the broader complaints handling function.
- Recognition of the concerns competing businesses have in contacting government businesses directly in certain circumstances and appropriate treatment of confidential information on both sides of the complaint.
 - The process should encourage, but not require, the complainant to first raise the issue with the government business.
 - There should be some limited scope for complainants' identities to be kept confidential (upon request to IPART), subject to any overriding legal obligation to disclose the confidential information (e.g. to accord the subject of the investigation procedural fairness or in response to an access application under the *Government Information (Public Access) Act 2009*).
 - The current provisions in Part 4C of the *Independent Pricing and Regulatory Tribunal Act 1992* (IPART Act) about treatment of confidential information should be retained. These provisions include the authority for the Tribunal to give directions prohibiting or restricting the disclosure of confidential information provided for the purposes of an investigation.

^a One complaint has been referred for investigation in relation to the pricing of tender bids, however this was referred to IPART to avoid potential conflicts of interest as the State Contracts Control Board (NSW Procurement Board's predecessor) was involved in awarding some of the contracts in question. See IPART, *Investigation of Competitive Neutrality Complaints against the State Valuation Office*, 2004.

- A process with low barriers to making a complaint but discretion for the complaints body to proceed with investigation, after having regard to the public interest.
 - Removing the requirement for a complaint to be made by an actual or potential competitor, consistent with the process in the Commonwealth and Victoria, would allow complaints to be raised by non-competitors, such as ratepayers, consumers and private businesses who purchase services from government businesses.^b
 - Allowing complaints to be made at low costs with relatively little information allows for patterns and systemic issues to be identified. However, it may also encourage vexatious or frivolous complaints. We propose to recommend that IPART is able to determine whether to proceed with an investigation after considering the basis for the complaint and the likely public interest in pursuing it.

7.2.2 Complaints involving multiple jurisdictions should continue to be dealt with on a case-by-case basis

One submission raised the issue of who should review complaints when more than one jurisdiction has ownership of an entity that conducts government business activities. For example, multiple Australian Governments were shareholders in e-conveyancing operator Property Exchange Australia Limited (PEXA) before it was privatised in 2018.

We understand from discussions with the Australian Government Competitive Neutrality Complaints Office that the decision on the appropriate body to investigate is currently resolved on a case-by-case basis between the complaints handling bodies for the relevant jurisdictions. Any clarification of this process would require agreement of all jurisdictions and is not something the NSW Government can address on its own. We consider that this approach remains appropriate, as it is difficult to determine rules or processes ahead of time that would address all the different circumstances in a satisfactory way.

7.2.3 Some competitive neutrality complaints made to IPART could be public interest disclosures

Currently, competitive neutrality complaints referred by the Minister to IPART cannot be public interest disclosures. If our proposed recommendation to allow competitive neutrality complaints to be made directly to IPART is accepted, it is possible that competitive neutrality complaints made directly to IPART in future may be public interest disclosures. IPART will need to treat any public interest disclosures in accordance with applicable legislation.

^b For example, ratepayers in Mornington Peninsula (Victoria) brought a complaint against a council-operated recreation centre, arguing that the fees were not fully cost-reflective, and that ratepayers were unnecessarily subsidising the centre (Victorian Competition and Efficiency Commission, *Competitive Neutrality Complaint Investigation Final Report Pelican Park Recreation Centre*, June 2008). Conversely, aviation industry groups argued that competitively neutral pricing should not be applied to counterterrorist first response services that airports purchased from the Commonwealth Government, as it was not a business activity (Commonwealth Competitive Neutrality Complaints Office, *Competitive Neutrality Investigation into Provision of Counter Terrorist First Response Services by the Australian Protective Service*, December 1998).

Changes to public interest disclosure legislation, with the commencement of the *Public Interest Disclosures Act 2022* in October 2023, will also impact how IPART treats competitive neutrality complaints that are public interest disclosures. Under that Act, depending on the nature of the public interest disclosure, IPART may need to refer the disclosure to another agency or, in some cases, investigate it ourselves.

Draft Recommendation



19. The complaints process be made more open and accessible with a single process and a single investigative body (IPART). Complainants would be able to make complaints directly to the investigative body removing the need for Ministerial referral. Restrictions on who can make a complaint and requirements to contact the government business first would be relaxed.

7.3 IPART's role as complaints body

Under our proposed recommendations, IPART would assume responsibility for receiving and investigating all competitive neutrality complaints in NSW. We are also proposing that IPART be subject to the same processes as the Victorian competitive neutrality complaints body, as we consider that this is a best practice approach (Box 7.1).

Box 7.1 The Victorian approach to complaints

There are a number of procedural and administrative features of the Victorian complaints handling process that we consider are best practice and should be adopted in NSW:

- The complaints body cannot initiate an investigation.
- The complaints body accepts complaints from a directly affected person or business, as well as from industry or community groups.
- The complaints body abides by principles of procedural fairness and investigates accepted complaints fairly, independently and rigorously and comes to a finding on the basis of the best available information.
- The complaints body consults with, and seek comments from, all parties involved before finalising its investigation.
- The complaints body provides finalised investigation reports - excluding any commercial in confidence information - to the parties and publishes them on its website.

Box 7.1 The Victorian approach to complaints

- The complaints body has no enforcement powers and cannot recommend compensation or termination of contractual arrangements.

On receipt of a complaint, Better Regulation Victoria, follows the following process:

“After a complaint has been lodged, the BRV undertakes a preliminary assessment to decide whether to advise the Commissioner to accept the complaint. This assessment is based on relevant information from the complainant, the BRV’s own desktop research and, where appropriate, the relevant government agency.

Key issues that the BRV considers in making a decision include:

- whether the activity is a significant business and in scope of the Competitive Neutrality Policy
- the evidence supporting the complaint
- the annual turnover of the government activity
- the relevance of the government activity to the complainant.

The Commissioner does not accept complaints considered frivolous, vexatious or outside the scope of the Competitive Neutrality Policy.

After assessing the complaint, the Commissioner will notify the complainant of her decision to:

- not accept the complaint and explain why
- accept the complaint for investigation
- accept the complaint but take non-investigative action to resolve the issue.

When a complaint has been accepted the Commissioner will:

- investigate to establish whether there is a breach of Competitive Neutrality Policy
- prepare a draft investigation report for review by the Commissioner
- provide the draft investigation report to the complainant, government agency and responsible government department for comment on a confidential basis
- consider responses and, where appropriate, revise the report
- distribute the final report, including recommendations for the government agency to action
- take follow-up action to check the steps taken by the government agency to implement the recommendations.

Box 7.1 The Victorian approach to complaints

Many factors can influence the time required to properly assess a complaint including:

- the type of government activity subject to complaint
- the complexity of the complaint
- the availability of information to assess the complaint."

Source: Department of Treasury and Finance Victoria, *Competitive neutrality policy*, September 2012, [Victorian Government, Competitive Neutrality Policy and the complaints mechanism](#) and [Competitive Neutrality Complaints](#). The complaints body in Victoria was formerly the VCEC and is now the Commissioner for Better Regulation Victoria.

To ensure that we have sufficient information to assess the complaint, and to dissuade frivolous and vexatious complaints, we intend to publish an application form for lodging competitive neutrality complaints to IPART. We propose that this form would include information about the nature of the complaint that we require in order to consider it, such as:

- basic information about the nature of complainant's business, area of operation, and product or service costs and prices (if relevant to the complaint)
- the relationship between the complainant and the entity subject of the complaint e.g., competitor (or potential competitor) of a government business, ratepayer, legal representative, or other impacted third party
- the impact of the matters complained of on the complainant's business activity, or other (e.g. ratepayer who is concerned about a potential breach of competitive neutrality by a local government business)
- the complaints relevance to competitive neutrality policy (e.g. the application of competitive neutrality tests, pricing and costing approaches, rate of return, corporate structure, other non-cost advantages).

IPART will use this information to inform its decision to investigate a complaint.

This is consistent with the approach taken in Victoria, which requires complaints to be made in writing using its competitive neutrality complaints proforma. The Victorian proforma requires the following information:¹²⁵

- a description of the nature of the business affected, including any special features that the Commissioner needs to be aware of
- the identity of the government agency
- a summary of the complaint and description of the type of unfair advantage
- evidence that supports the complaint (for example, sales data and pricing information for similar products or services)
- where relevant, other supporting information - such as copies of correspondence, references to material, and images - can be included

- if the complaint includes commercially sensitive information which you do not wish to be disclosed, it should be marked clearly as "Commercial in Confidence".

We consider that it is important to make the complaints process easy and more accessible. We are aware that for some potential complainants, the need to complete the application form may itself be a barrier. We intend to ensure that it is easy for people who want to make a complaint to contact us by phone or email, and that assistance is available for people who need it. We are interested in feedback on how best to ensure the right balance between having enough information to be able to accept a complaint and requiring so much information that it creates a barrier to the complaints process.

Better Regulation Victoria treats the identity of complainants as confidential unless authorised by the complainant to provide their details to other parties. In some instances, it may not be possible to preserve anonymity due to the specific nature of the complaint.

To ensure that our finite investigative resources are used appropriately, we recommend IPART have discretion regarding the complaints we will investigate, including:

- the ability to decide not to investigate a complaint (in which case we would provide reasons for our decision to the complainant)
- the option of non-investigative action (for example, mediation)
- the ability to consider separate complaints of a similar nature jointly.

We intend that these features should be modelled on the Victorian complaint handling process and the NSW Ombudsman's complaint handling process.^c

Where IPART would decide to commence an investigation, we would use our best endeavours to complete the investigation and report publicly within 10 weeks after receiving the complaint. We propose that there should be an obligation to notify the portfolio Minister responsible for an entity that is the subject of a complaint when an investigation into a complaint commences.

Additionally, we propose that the requirement that a written response from the responsible Minister be made public within 8 weeks of IPART's report be retained. These recommendations are broadly consistent with existing IPART processes for handling competitive neutrality complaints under the IPART Act.¹²⁶

Draft Recommendation



20. IPART have a similar complaint handling process to that in Victoria's competitive neutrality regime, to be implemented through amendments to Part 4C of the IPART Act. Under this process IPART would not be able to initiate an investigation and would not have enforcement powers. IPART would have discretion as to whether it will investigate a complaint.

^c The NSW Ombudsman has a large amount of discretion under the *Ombudsman Act 1974* (s 13) regarding which complaints to investigate. It has released guidance explaining what factors it will consider, including resourcing and the public interest, when exercising this discretion (NSW Ombudsman, [How we assess complaints](#), accessed 28 September 2022).

Seek Comment



7. Do you agree with the proposed changes to the complaints process? What else do we need to consider?

7.4 Possible outcomes of a complaint

As discussed above, we are proposing that IPART's role in handling and investigating complaints is similar to that applied in Victoria. This means that the possible outcomes of a complaint investigation would include:

- no investigation or further action taken
- non-investigative action taken to resolve the issue
- IPART will undertake an investigation to establish whether there is a breach of competitive neutrality policy.

If IPART decides to investigate a matter, we recommend that IPART would have the powers to:

- make recommendations to government businesses to address the areas of concern
- take follow-up action to check the steps taken by the government entity to implement the recommendations.

IPART would continue to have no enforcement powers to compel a government business to implement its recommendations, nor would IPART be able to recommend compensation or termination of contractual arrangements.

Draft Recommendation



21. The IPART Act be updated to reflect a broader range of options for outcomes from a complaint, including no investigative action or non-investigative action, similar to the outcomes available in Victoria.

7.4.1 IPART's role in assessing the application of the public interest test

Government entities are only required to apply competitive neutrality to their significant business activities to the extent that it is in the public interest to do so. Undertaking a public interest assessment involves weighing up a range of factors to determine whether a subsidy or retention of an advantage delivers a net benefit. There is likely to be a range of reasonable conclusions that decision-makers could reach. It is unlikely to be an efficient use of IPART's resources and time to re-do a public interest test where a government entity has identified the most relevant factors, weighted them using the best available evidence and reached a reasonable conclusion.

Instead, we suggest that IPART's role be limited to assessing whether the government entity has undertaken the assessment in accordance with the requirements of the revised policy or been unreasonable in its assessment. Examples of non-compliance could include:

- not considering relevant factors when assessing costs and benefits
- not considering less costly alternatives to the subsidy
- a public interest assessment that is not proportionate to the significance of the proposed business activity, for state government business activities.

If the government entity has not met the framework requirements, we propose that IPART recommends that the entity re-do the public interest test, rather than undertaking the public interest test on the entity's behalf.

Draft Recommendation



22. IPART's role in assessing complaints about the public interest test be confined to assessing whether framework requirements have been applied and a reasonable conclusion reached.

Chapter 8 >>

Governance, training and transparency

Ensuring that the policies are implemented as intended and periodically improved



Effective governance and transparency arrangements are important for ensuring that the revised competitive neutrality policy is implemented and followed as intended. Together with the complaints process, effective governance and transparency arrangements should result in any ineffective areas of the revised policy being identified and improved on a regular basis.

There is no central body responsible for assessing compliance with competitive neutrality in NSW. Compliance with competitive neutrality is the responsibility of individual government businesses, or the government entities that control them, and is tested through the complaints process. In this context, the provision of public information by government entities can improve compliance with policies.

Without an appropriate level of transparency about the decisions of government businesses, there is little distinction between whether a government business is legitimately exempt from competitive policy or whether it has not applied competitive neutrality principles at all. This can leave competing businesses confused about whether they should pursue a complaint and the prospects of its success. It is also important that sufficient advice and guidance is available to support government entities to implement the revised competitive neutrality policy correctly in the first place.

8.1 Overview of the draft recommendations

We are recommending a process that would provide for regular review of the revised competitive neutrality policy. The current competitive neutrality policies are outdated and uncertain for users to apply, having not been reviewed or updated for 20 years. Regular review of the revised policy by NSW Treasury (as the proposed owner of the revised policy) or the NSW Productivity Commission would ensure that the revised policy remains up-to-date and accessible for government and non-government stakeholders alike.

We also propose annual reporting of basic competitive neutrality information by government entities, to provide greater transparency and awareness about the application of competitive neutrality policy in NSW. Our review of existing reporting has identified that public reporting about competitive neutrality by government businesses is difficult to locate or has been discontinued. Our consultations also identified a low level of knowledge of the competitive neutrality policies among both public and private sector businesses.

There is also an appetite for greater provision of resources, training and advice on competitive neutrality issues from government and non-government stakeholders alike. We recommend that IPART develop a suite of resources and tools for government entities to use, such as templates and checklists. These low-cost resources will complement the provision of advice by NSW Treasury to government entities. We are seeking views on which resources would be most useful to government entities.

We considered a voluntary accreditation process, where one or more government businesses approach an independent body, such as IPART, to seek approval for its competitive neutrality approach. At this stage we don't recommend an accreditation process.

The combination of a simplified complaints process (proposed in Chapter 7) and improved compliance reporting should improve compliance with competitive neutrality and help identify problem areas.

Accreditation could be considered in future if complaints under the proposed complaints system indicate systemic issues and/or implementation of the revised competitive neutrality policy indicates that it would be of value to local government to have accreditation.

8.2 Regular review of the NSW competitive neutrality policy by NSW Treasury or the NSW Productivity Commission

The revised policy should be periodically reviewed to test its continuing relevance and effectiveness. The current competitive neutrality policies have not been reviewed since at least 2002 and they contain outdated references.

Where the current competitive neutrality policies refer to outdated legislation, definitions, documents or third parties, they become more difficult to apply and more uncertain for users and overseers alike. They also risk being forgotten or causing confusion about the obligations.

Ongoing review provides an opportunity to survey changes in the review period and adjust the policies to reflect changes in the economy, government activities and technological changes. It also provides an opportunity to refocus attention on the policy that is being reviewed. The scope of a review could vary from making small updates and corrections, to broader reviews of the policy and its application.

In its submission to our Issues Paper, the NSW Productivity Commission (part of NSW Treasury) suggested that NSW Treasury, as the policy issuer, review the NSW revised competitive neutrality policy and process documents every 5 years and that this requirement be built into the policy itself.¹²⁷ This would align with review requirements that apply to other NSW Treasury policy documents and could include an additional process for minor ad hoc changes with minimal formality to allow for any necessary corrections to be made outside of the 5-yearly review.

We recommend the same competitive neutrality policy apply to both state and local government (see recommendation 1), to achieve greater consistency and clarity. Whichever entity undertakes the review should work with the Office of Local Government when addressing matters that are relevant to local government.

Other submissions suggested that the revised competitive neutrality policy should be subject to a periodic review, which should happen at least every 10 years.¹²⁸ These submissions did not identify who such reviews should be done by (for example, NSW Treasury as the policy holder or IPART as an independent body).

Draft Recommendation



23. Treasury or the NSW Productivity Commission review the competitive neutrality policy every 5 years, consistent with other Treasury review processes.

8.3 Greater provision of advice, resources and training

Our competitive neutrality workshops revealed that the levels of awareness of the competitive neutrality policies is low across state and local government and further guidance is needed to support these stakeholders to implement competitive neutrality principles. Several submissions from government and non-government stakeholders also called for more guidance.¹²⁹ The Local Government NSW submission noted that resources including simple guidelines, checklists and templates would increase awareness and reduce the administrative burden of complying with competitive neutrality.¹³⁰

Currently, Treasury and the Office of Local Government provide advice to state and local government entities respectively on the application of the competitive neutrality policies. As the owner of the revised competitive neutrality policy, Treasury would have the role of providing advice to both state and local government entities. This could encompass chairing practice groups for local and state government businesses to share knowledge about competitive neutrality practices.

We have recommended changes throughout this report to make the revised competitive neutrality policy clearer and easier to apply for government businesses. We propose that IPART should also develop resources to support government stakeholders to understand and implement competitive neutrality principles and non-government stakeholders to understand the policy and its obligations. We would develop these resources under our complaint handling role.

These resources would offer a cost-effective means of supplementing a revised, simplified policy and the provision of advice by Treasury to local and state government agencies. Some examples of resources we propose to develop are:

- checklist of criteria to assess the significance of a government business activity
- decision tree of factors which could trigger the need to reassess significance of government business activities.
- further guidance to conduct a cost-benefit analysis for the public interest test
- decision tree to assess which pricing approach is appropriate for a government business activity
- guidance to account for both advantages and disadvantages of Government ownership
- templates for annual reporting of competitive neutrality compliance
- case studies to illustrate how the tests would apply to activities of particular interest to state and local government entities.


In our local government workshop, stakeholders also expressed views that training about the revised competitive neutrality policy would support them to implement and comply with competitive neutrality principles. It was suggested that the following training resources be offered to state and local government business stakeholders:

- targeted workshops about competitive neutrality compliance and implementation
- online training modules about the competitive neutrality policy
- short training courses about the competitive neutrality policy.


These are higher cost proposals, so further evidence of demand and benefit would be needed before they could be developed.

We are committed to supporting government entities to adapt to, and comply with, our proposed changes to competitive neutrality policy. We are seeking feedback about the types of assistance IPART and Treasury could offer government entities to support them to implement the revised competitive neutrality principles. Additionally, we are considering the option of co-designing guidance resources with representatives of state and local government businesses, and potential complainants. IPART would facilitate the co-design process and would invite interested stakeholders to participate. This will ensure that the resources are relevant, fit for purpose and are compatible with existing procedures and systems (e.g. compatibility between proposed costing obligations and existing accounting methods).

Draft Recommendations

- 24.  Treasury continue to provide advice to support state government entities to understand and apply competitive neutrality policies and principles. This advice would also be extended to local government entities, if the local and state government policies are combined (Draft Recommendation 1).
- 25. A suite of resources and tools, such as templates and checklists, be developed by the complaints handling body through a co-design process to support stakeholders to understand and apply competitive neutrality policies and principles.
- 26. Further evidence is required before investing in higher cost resources for stakeholder education, such as workshops, online modules and in-person training

Seek Comment

- 8.  What types of training and advice could IPART and/or Treasury offer to best support government entities to implement and comply with competitive neutrality principles?

8.4 Reporting obligations to increase transparency

Reporting and public information is a low intervention mechanism that improves transparency of government activities. In a framework where no external body is actively responsible for monitoring compliance, the provision of public information can also improve compliance with policies.

Reporting obligations can achieve this by enforcing a discipline on government businesses to regularly check and confirm that its business activities comply with the revised competitive neutrality policy. It would also provide more up-to-date information about a business activity, that could be relied on in an investigation of a complaint. It would allow competitors to assess whether a complaint had a reasonable prospect of success and would save it and the government business time in making and responding to complaints.

Our review of existing reporting identified that reporting about competitive neutrality is difficult to locate or has been discontinued. For example, some reporting for state government business enterprises used to occur through the Council of Australian Governments' (COAG) annual Competitive Neutrality matrix, but this matrix ceased to be published in the transition to National Cabinet during the COVID-19 pandemic. NSW state government businesses are not required to report on compliance with the competitive neutrality policies in their annual reports.

NSW councils are required to report on progress in implementing competitive neutrality in their annual reports and the Office of Local Government is required to report on overall progress in its annual report.¹³¹ Councils are required to include in their annual reports:

- a list of all business activities identified as category 1 businesses
- a statement that each of the pricing requirements (tax equivalent regime payments, rates of return and debt guarantee fees) have or have not been applied to each business. This does not require councils to state the amount of those calculations
- a list of all business activities identified as category 2 businesses
- a statement of expenses incurred, revenue raised, assets acquired, and assets held for significant businesses
- a comparison of actual performance during the year with the projected performance of category 1 businesses, including an explanation of any difference.¹³²

However, reporting on these matters is not done consistently. Additionally, the above reporting requirements no longer align with requirements for councils' annual reports as currently set out in the *Local Government Act 1993* (Local Government Act), Integrated Reporting and Reporting Guidelines, and Local Government Code of Accounting Practice and Financial Reporting.

Councils also issue schedules of rates, fees and charges as part of their operating plans required under the Local Government Act and prepare Special Purpose Financial Statements for declared council business activities. While these are not components of the competitive neutrality policies, these schedules and statements may explain the pricing policy taken to determine the fees and charges applied to the council's services. However, it is often not clear from these documents how competitive neutrality has been applied.

Without an appropriate level of transparency about the decisions of government businesses, there is little distinction between whether a government business is legitimately exempt from the competitive neutrality policies or whether it has not applied the policies at all.

We have heard in our workshops that this leaves competing businesses confused about whether they should pursue a complaint and the prospects of its success. It also makes it more difficult to compile information about a complaint that is needed to satisfy the Minister to refer the complaint to IPART.

8.4.1 Annual reporting by agencies would improve transparency

The Harper Review recommended that all Australian governments should require government businesses to include a statement on compliance with competitive neutrality principles in their annual reports.¹³³ This is already the case in the Commonwealth, Queensland, Tasmania, and Victoria.¹³⁴

In submissions to our Issues Paper and in stakeholder workshops, various non-government stakeholders suggested that government businesses should have to provide enough information in their annual reports to give their competitors confidence that they are being competitively neutral.¹³⁵

However, some government stakeholders expressed concern about being required to publish commercially sensitive information in their annual reports.¹³⁶ Since their competitors would not need to do the same, they argued that this would place government businesses at an unfair disadvantage.

We consider that, as proposed by NSW Treasury in its submission,¹³⁷ the revised competitive neutrality policy should improve reporting and access to public information by requiring government entities to provide the information set out in Box 8.1 in their annual reports. This would be subject to any commercial confidentiality restrictions.

Box 8.1 Information to be published in government businesses' annual reports

- Statements of compliance reporting for all government owned business activities (including those that indicate they do not meet the significance or public interest tests)
- a summary of the costs and benefits of applying competitive neutrality where a public interest test has been applied to exempt a significant government business activity
- steps taken to comply with competitive neutrality policy (including the last date the application tests were assessed)
- basis of pricing decisions (fully distributed costs, avoidable costs, market pricing or other)
- number of complaints received about competitive neutrality, their outcome and any changes made by the business in response.

Source: IPART

Government entities are not expected to disclose confidential or commercially sensitive information in their annual reports.

A renewed focus on reporting basic information about competitive neutrality decisions and a statement of compliance aims to strike the right balance of providing transparency, without disadvantaging government businesses by requiring them to release commercially sensitive information. A complaint body would retain the ability to consider confidential information during an investigation.

In its submissions to our Issues Paper, Local Government NSW pointed out that councils already comply with multiple reporting and regulatory obligations and suggested that no additional obligations be introduced.¹³⁸

Rather than introducing new obligations, competitive neutrality annual reporting requirements could be refreshed and integrated into existing annual reporting processes. They could be updated to be consistent with the annual reporting requirements for state government businesses and integrated into existing reporting processes for local government. For state government entities, this could be achieved by amending the NSW annual report regulations.^a For local government, the Integrated Planning and Reporting Framework of the Office of Local Government could be updated.^b

To reduce the reporting burden for councils providing competitive neutrality information, the Caravan & Camping Industry Association of NSW has suggested templates and other guidance materials be created for councils. These documents would clearly set out the minimum reporting requirements.¹³⁹ As discussed in section 8.3, we agree with this proposal.

Draft Recommendation



27. Government agencies undertaking business activities be required to report basic information about competitive neutrality in their annual reports, subject to any commercial confidentiality restrictions (see Box 8.1). Templates should be developed that clearly set out the minimum reporting requirements for agencies.

8.4.2 Annual reporting by IPART

IPART is required to include a statistical summary of complaints received by it, investigations conducted by it, and complaints disposed of by it, for the relevant year in its annual report.¹⁴⁰ This annual report is presented to Parliament.¹⁴¹

As part of this reporting, we may comment on the implementation of any changes to competitive neutrality policies arising out of this review.

^a *Annual Reports (Departments) Regulation 2015* and *Annual Reports (Statutory Bodies) Regulation 2015* (AR(SB) Regulation). The AR(SB) Regulation also applies to the annual reports of statutory owned corporations.

^b The annual reporting obligations could also be prescribed in the *Local Government (General) Regulation 2021* if a legislative basis is preferred.

8.4.3 There may be value in establishing a voluntary accreditation process in future

Voluntary accreditation involves one or more government businesses approaching an independent body, such as IPART, to seek approval for its competitive neutrality approach. A voluntary accreditation process could incentivise government agencies to improve compliance with competitive neutrality. One potential model involves business activities that had been accredited by IPART (or another independent body) as competitive neutrality compliant to be exempt from a complaint in relation to the accredited aspects.

One of the strongest incentives for a government business to seek accreditation would be to gain an exemption from complaints. However, the incentive to seek accreditation may not be very large due to the historically low number of competitive neutrality complaints in NSW.

The other incentive for government businesses is the assistance they would receive to develop their competitive neutrality approach to applying competitive neutrality policy from the body undertaking the accreditation (that is, it is less resource intensive for the government business). This incentive may also be limited as:

- Any accreditation process would likely need to be public and transparent. The accreditation body would need to test the proposed accreditation including by providing an opportunity for competitors and customers to make submissions, particularly if the accreditation results in reduced scope for complaints. This may lengthen the accreditation process.
- We are recommending changes throughout the Draft Report to make the revised competitive neutrality policy clearer and easier to apply for government businesses.
- There would be a cost to government businesses to obtain accreditation (even if that is limited to preparing applications and engaging with the accreditation body). Particularly in the local government sector, the costs associated with obtaining accreditation may deter government businesses from applying.

IPART may receive higher numbers of complaints following the simplification of the complaints process and enhancements to reporting requirements. In this case, the NSW Government could review whether accreditation would be worth pursuing in future. Without this data, there is a risk that time is spent designing an accreditation process that is not used by government businesses.

There is also the possibility of an accreditation process that allows several government businesses to apply jointly for accreditation (for example, several local government businesses operating camping grounds). Such a process would require careful consideration to ensure it is compliant with competition laws. We consider that the next review of competitive neutrality policy, in 5 years' time, would be an appropriate point at which to consider whether additional mechanisms such as an accreditation process would be of value.

Seek Comment



9. Do you agree with our proposal for annual reporting on competitive neutrality? How can we best balance the need for transparency with the administrative costs and need to treat commercial information in confidence?

Chapter 9 >>

Other issues

Related issues that are outside the scope of competitive neutrality policy



This chapter discusses issues that have been raised throughout our consultation processes that may impact on competition but we consider to be outside of the scope of competitive neutrality policy. Here we outline these issues and explain why we consider they are out of scope with reference to the proposed objectives of the revised policy.

As discussed in Chapter 3, we recommend that the revised competitive neutrality policy should have a clear statement of objective and scope. These focused objectives can be used to clarify which competition-related issues fall out of the scope of the revised competitive neutrality policy.

Competitive neutrality is one of many policies or instruments that promote competition and fairness. Some issues that have been raised would be better addressed by other means. Where possible, we have highlighted other policies that would apply to issues that are outside of the scope of competitive neutrality.

9.1 Overview of the draft recommendations

We propose that the revised competitive neutrality policy not govern the way that local government entities carry out procurement, when purchasing goods and services. The current local government pricing guideline includes a section on how councils putting services out to tender should construct their processes and assess bids. However, other aspects of procurement sit outside the competitive neutrality policies, and there are state and local government bodies set up to oversee these processes. We consider that issues relating to local government procurement terms and conditions should be overseen by the Office of Local Government. We recommend that the Office of Local Government review the rules around local government procurement to ensure that they adequately incentivise and support local government entities to promote competition when they purchase services.

We also propose that the NSW Government consider putting processes in place to ensure that competition impacts are considered when policy decisions that may impact on competition are made. Submissions raised numerous examples of policy decisions that may have adversely impacted competition in a market.

A systematic process for ensuring that these impacts are picked up as part of the policy development process should help minimise these issues. We acknowledge that the regulatory impact assessment process (set out in NSW Treasury's *Guide to Better Regulation*)¹⁴² requires government agencies to consider competition impacts when developing legislation and regulations. Some policy decisions that impact on competition are not picked up by the regulatory impact assessment process because, for example, they are set out in policy documents or relate to funding. It is these decisions that require more systematic consideration for competition impacts.

9.2 Local government procurement terms and conditions

Waste Contractors and Recyclers Associations (WCRA) submitted that there is a gap in the competitive neutrality policies around terms and conditions in local government tenders.

"For example, a local council issues an invitation to tender for waste and recycling collection services. If it is the council's preference to retain the collection service in house, then council will load the terms and conditions with fines and penalties and unfair assignment of risk. This then creates a competitive disadvantage to the private business sector thereby not allowing for competitive neutrality. Competitive neutrality cannot just be about pricing. It must be about ensuring a level playing field for all parties from start to finish."¹⁴³

When a council decides to tender for services and to allow competition between an in-house provider and private businesses, the council is carrying out 2 roles:

- Council as purchaser of services – scoping the services, setting up the tender, reviewing bids
- Council as a provider of services – identifying its costs, responding to the tender.

The local government pricing guideline includes guidance to councils on both aspects:

- When councils are purchasing services, the guideline encourages the council to consider financial risks and contractors' liability associated with appointment of an external service provider and factor this into the price of external bids.
- When councils are tendering to provide services, it requires councils to include the full costs of providing the service in their bid (i.e. all direct and indirect costs, tax equivalents, debt guarantee fees and rate of return). The council is then required to evaluate each bid on a common basis.¹⁴⁴

There is no equivalent section in the existing NSW pricing guideline that applies to state government purchasers of services where they are considering bids from government and non-government owned service providers.

We consider that a best practice competitive neutrality policy should not apply to councils as purchasers of services (but would still apply to councils bidding for services). There are 2 main reasons for this:

1. The general obligations that the current policies impose on councils (costing their products and services, identifying and adjusting for advantages and disadvantages and deciding how to set price) should be completed regardless of whether they are tendering for an in-house or external contract, and should be separate from the actions the council should always take in order to ensure it conducts fair tender processes.
2. There are existing legislative and policy obligations that cover council tendering.^a The Office of Local Government can investigate complaints about procurement processes, as with any council function under the Local Government Act.^b If council procurement were to sit within the scope of the revised competitive neutrality policy, the business activity test would need to be extended to include the activity of purchasing services, and the revised policy would need to include unique obligations that apply to entities carrying out that activity.

^a There are provisions in the Local Government Act (ss 55 and 55A) dealing with tendering by councils. The Local Government (General) Regulation 2021 also sets out a detailed procedure for tenders (see Part 7) and [Tendering Guidelines for Local Government](#) also apply.

^b There has been at least one investigation since 2011, see NSW Government, [11-37 Council Procurement and Contract Management Practices – Contracts for Consultancy and Professional Services](#)

As a result, we recommend:

- Content from the current competitive neutrality policies that relate to council as a purchaser of services should be removed. Our recommended business activity test does capture councils providing services.
- The Office of Local Government should consider whether the current regulations and guidance regarding procurement for local councils needs to be revised to include content that is currently sitting within the competitive neutrality policies but that would be removed under our proposal.

A complaint relating to a council's behaviour when bidding to provide goods and services would be captured by the business activity test and so considered a competitive neutrality complaint. In contrast, any complaint relating to a council's behaviour when conducting a tender process should be dealt with in the same way as other tender process related issues.

Draft Recommendation

28. The revised competitive neutrality policy not extend to council as a purchaser of services. We recommend that the Office of Local Government considers whether the current regulations and guidance regarding procurement for local councils needs to be revised to include content that is currently sitting within the competitive neutrality policy but that would be removed under our recommended approach.

9.3 Impact of policy decisions on competition

We consider there could be instances where competition in particular markets is negatively impacted by a range of government policy decisions. The types of policy decisions we consider are most likely to impact competition include:

- subsidising services in a market
- acquiring minority government ownership of a business when competitive neutrality policy does not apply because the government does not control the business
- providing grants to businesses
- providing or removing access to data.

The sections below discuss these competition issues in more detail. While these competition issues do not fall under the scope of the revised competitive neutrality policy, we recommend that the NSW Government should review its processes to ensure that it systematically considers impacts on competition when it is making these policy decisions.

9.3.1 Selectively subsidising services in a market

Government decisions to subsidise particular service providers can have an impact on competition in relevant markets. The Small Business Commission in its submission to our Issues Paper reported concerns raised by stakeholders about recent policy decisions creating an unequal playing field between for-profit and not-for-profit providers in the early childhood education and care industry. It submitted that:

“Stakeholders have expressed concern that the NSW Government’s provision of free preschool for children, through the NSW Start Strong Free Preschool program, has adversely affected enrolments for small business ECE services in recent years. The program requires services to be a not-for-profit community-based preschool or mobile preschool service to participate.”¹⁴⁵

The Small Business Commission noted that the NSW government has made changes to address some of these impacts in this particular case, including by introducing the Start Strong Long Day Care program. The potential competitive advantages are exclusive to all not-for-profits rather than only government businesses, and therefore this is out of scope of competitive neutrality policy. However, our view is that the government should ensure that it systematically considers impacts on competition in advance of deciding to subsidise services in any industry.

9.3.2 Minority ownership of a business

Our Terms of Reference required us to investigate how competitive neutrality principles should apply when government has a minority ownership stake in a business. Businesses with minority government ownership may benefit from access to cheaper finance or perceptions of lower risk but are not captured by the current competitive neutrality policy because the Government does not ‘control’ the entity. This would still be the case under the revised policy updated with our draft recommendations.

In 2000 the COAG decided that in these circumstances, a ‘best endeavours’ approach requires, at a minimum, that governments provide a transparent statement of competitive neutrality obligations to the business in which they have a minority stake. COAG suggested governments could also:

- have staff available to answer the business’s questions,
- prepare information for and meet with the business regularly
- request regular reports from the business
- undertake joint reviews with the business of its competitive neutrality policies.¹⁴⁶

However, the competitive neutrality policies in NSW have not been updated to reflect this decision. The NSW Government’s current approach is to encourage the relevant government business to comply with competitive neutrality principles.¹⁴⁷

In response to our Issues Paper, NSW Treasury recommended competitive neutrality and other policy implications should be considered as part of investment decisions, submitting that:

"Given the possible competitive neutrality advantages from even a minority government equity share, the NSW Government should commit to applying competitive neutrality principles, to the extent relevant, to all equity investments. This would require the NSW Government to undertake a considered and transparent assessment of competitive neutrality prior to becoming a part owner of a business or divesting a controlling share of a government business. This is the point at which the NSW Government can implement competitive neutrality principles, for example through contractual arrangements. Other policy considerations should also apply, including whether it is an appropriate role for government and broader competition policy implications."¹⁴⁸

As specified by the government ownership test, we recommend the revised competitive neutrality policy should only apply to government owned or controlled entities. Therefore, business activities where the government has a minority stake without control would not be subject to competitive neutrality policy. However, we agree with NSW Treasury's submission and consider that the NSW Government should consider impacts on competition and competitive neutrality principles before it becomes a part owner of a business or when it divests a controlling share of a government business.

The decision to invest or divest is a policy decision, not a business activity to which competitive neutrality applies. However, when it makes these policy decisions, the NSW Government should consider whether competitive neutrality principles would apply to future operations of the business and structure the business accordingly. This will inform decisions around control and what mechanisms need to be put in place to ensure competitive neutrality principles can be applied to business activities. We also recommend the government considers the broader competition implications and whether the investment is appropriate for government. For example, government investment in an individual business may be seen as giving unfair preference to that business over other similar businesses in the sector. The competition implications also need to be weighed against other policy objectives.


9.3.3 Providing grants to businesses

Government economic activities such as providing grants may impact competition but would not be captured under the revised competitive neutrality policy. We are not proposing to broaden the scope of competitive neutrality policy to capture businesses that receive government grants. However, we recommend that the NSW Government considers impacts on competition when administering grants to ensure that they do not distort competition in the market. Department of Premier and Cabinet (DPC) could include these considerations in its Grants Administration Guide.¹⁴⁹


9.3.4 Unequal access to data and the role of open data

Government actions and decisions, can impact on competition, whether intentionally or not. For example, governments providing certain businesses with access to data, or publishing data and later removing access to it, can impact businesses who rely on that data. While there may be good policy reasons to provide limited access or remove access to data, we think there is benefit in encouraging government entities to consider impacts on competition when making these decisions. We also encourage government entities to consider open data initiatives where possible. We consider some of these issues could be addressed by open data, and open data could play a role in enabling competition and reinforcing trust in government.

Draft Recommendation

-  29. The NSW Government review its processes to ensure that it systematically considers impacts on competition when making policy decisions that are likely to impact competition and which may not be picked up by regulatory impact assessments. This includes:
- subsidising services in a market
 - acquiring minority government ownership of a business when competitive neutrality policy does not apply because the government does not control the business
 - providing grants to businesses
 - providing or removing access to data.

Seek Comment

-  10. Are there any additional issues that should be addressed by competitive neutrality policies?

9.4 Other issues relating to fair processes

Competitive neutrality is one of many policies and processes that promote competition and fairness for private businesses competing against government entities. Other existing competition policy levers could be used in addition to, or instead of, any proposed changes to competitive neutrality policies. DPC submitted that IPART should review any proposed reforms to the competitive neutrality policies in the context of other competition policy levers, such as:

- the application of the NSW procurement policy
- a review of any differences in regulations for government and private businesses operating in the same sector
- enforcement of existing national competition policy and regulations through the Australian Competition and Consumer Commission (ACCC).¹⁵⁰

In addition to the policy levers raised by DPC, the Competition Principles Agreement contains a guiding rule that legislation should not restrict competition unless the benefits of the restriction outweigh the costs, and its objectives can only be achieved this way.¹⁵¹ Under the Competition Principles Agreement, state governments are required to review legislation with potential competitive impacts systematically every 10 years¹⁵², including examining the net public benefits of keeping or removing competitive restrictions. The NSW Government also promotes fair and open competition through its procurement objectives.¹⁵³

The sections below discuss issues raised by stakeholders that we consider are outside the scope of competitive neutrality policy and should be addressed through other policy levers.

Concerns about unfair advantages enjoyed by public universities

Independent Higher Education Australia (IHEA) submitted that public universities have many advantages that prevent private higher education providers from competing on a level playing field. The advantages they discussed include:

- the FEE-HELP loan fee of 20%, which applies to education and training for independent sector students, not being imposed on students attending public and private universities.
- disability funding only being available to Table A university providers
- the independent sector having more exposure to regulatory processes
- public universities not adequately calculating the true cost base of postgraduate courses.

IHEA's concerns relate to a wide range of issues around access to funding and different regulatory arrangements that apply to public and private higher education providers. While IHEA notes that the regulation of the Higher Education sector is mostly conducted at the federal level, it also argues that many of the independent sector businesses operate and are headquartered in NSW and face competition from NSW public universities. However, our view is that these issues are outside the scope of NSW's competitive neutrality policy as they relate to federal funding decisions and regulations. Further, NSW public universities are not within the control of the NSW Government.^c

IHEA's submission advocates for NSW competitive neutrality policy to be broadened to apply to public universities' educational activities. Currently, competitive neutrality principles only apply to the non-education activities of public universities. We do not consider the competitive neutrality policies should be expanded to include the educational activities of public universities, as the tests can be used to determine whether competitive neutrality principles apply.

^c This will be clarified under the proposed definition of government ownership, which uses NSW and local government general government sector classifications under the GFS should address the issue. Under the GFS, universities fall within a general government sector category called 'control not otherwise defined'. Public universities are categorised at the national level because they are considered to be implementing policy (i.e. tertiary education) that is primarily of concern at a national level.

Concerns about land use and development

Urban Taskforce raised concerns about government entities having unfair advantages when accessing industrial land for redevelopment and residential land releases. It also raised concerns about Transport for NSW's approach to compulsory acquisitions. Urban Taskforce submitted that:

- different rules appear to apply to the private sector versus the public sector when it comes to industrial land
- Landcom appears to receive preferential treatment when it comes to residential land releases
- there is a perception, reflected in a recent Parliamentary Inquiry report, that Transport for NSW, along with the office of the Valuer General, is pursuing land acquisition in poor faith, often involving low initial offers and drawn-out processes.¹⁵⁴

Our view is that these issues are outside the scope of competitive neutrality policy and would be better dealt with through another policy. It appears that Urban Taskforce's concerns about compulsory acquisitions are being addressed through the Parliamentary Inquiry into acquisition of land for major transport projects, which made several recommendations including that the NSW Government commission an independent review into land acquisitions.¹⁵⁵

Concerns about Medicare rebates for public hospitals

The Australian Diagnostic Imaging Association (ADIA) raised concerns about public hospitals providing outpatient radiology services benefitting from access to both state government funding and Medicare rebates, while private providers have access to the Medicare rebate only. The ADIA submitted that "in order to ensure competitive neutrality, consideration could be given to reducing the financial support provided to government owned businesses or reduce the reward on the point of providing the good or service (in radiology's case, the Medicare rebate)."¹⁵⁶

Changing the Medicare rebate is a federal issue and is outside the scope of NSW competitive neutrality policies and our review. However, to the extent that these activities fall within scope of the competitive neutrality policy (ie. are considered significant government business activities), they will need to apply competitive neutrality costing and pricing guidance to those activities.

Seek Comment



11. Do you agree with our findings on out-of-scope issues?

Chapter 10 >>

Impact of the proposed changes

Our assessment of the likely impact of the changes we are proposing on government businesses

10

In this draft report we have proposed a suite of improvements to NSW's competitive neutrality policies. The key changes would bring the current set of policies under a single revised policy with clearer, more consistent definitions and obligations across government businesses. Other key changes are aimed at making the complaints process more accessible and government business' application of competitive neutrality policy more transparent.

These changes will necessarily impose some additional costs on government businesses and may require additional training for staff. All government businesses will need to educate themselves on the revised policy and go through a process of re-evaluating their activities to determine whether they are significant, checking their costing and adjustment processes to ensure they are consistent with the revised policy and putting systems in place to record and report on their application of competitive neutrality.

We have been mindful of the impact of these changes as part of our assessment. We have made draft recommendations that aim to reduce the costs and impacts on staff where we considered it was consistent with the overall aims of the review. For example, we have proposed a more qualitative public interest test for local government businesses in recognition of the fact that they will have to apply this test more often than they would have had to under the current competitive neutrality policies. We have also increased the monetary threshold for the significance test, in recognition of the fact that threshold has been unchanged since it was established in 1996.

This chapter discusses the recommendations that are likely to have the most significant impact on the different government businesses in the transition to the revised policy. We are seeking comment from government businesses on what transition strategies and timeframes are achievable and ensure that the necessary policy adjustments can be made without imposing significant cost and disruption on government businesses. We are particularly interested in the impact on local government.

10.1 Overview of the draft recommendations

We are strongly of the view that the transition costs to government businesses in making the changes required to comply with the revised policy are outweighed by the benefits to small and large businesses, to the economy more broadly and to the people of NSW. Nevertheless, we recognise that it will take time for government businesses to change their processes and review their activities. We are proposing that the government considers a transition strategy for the revised policy that will allow government businesses to adapt to the changes over time. We propose that this transition only occur when resources have been developed to assist government businesses, particularly local government, to adapt to the changes.

We consider that the transition costs associated with the draft recommendations are an unavoidable consequence of producing an improved revised policy that is clearer, more consistent and more effective. These changes are needed to ensure that government businesses compete on their merits and that the most efficient, dynamic, and innovative businesses are the ones that flourish. A clear and consistent competitive neutrality policy gives businesses the confidence to invest and provides a mechanism for competing businesses to have their concerns heard.

10.2 Impact of changes to the test for significant government business activities

The key impacts of the draft recommendations are:

- Changes to the content of the competitive neutrality policies to make it clearer and less ambiguous. The impact of clarifying the content of the policies will depend on how government businesses have resolved the ambiguities in the current policies. In the long run, a clearer, easier to apply revised policy will reduce costs.
- The government ownership test may capture more businesses than previously as we are proposing to define it based on ownership or control, although the extent of the difference is difficult to quantify because the current tests are not very well specified.
- The business activity test may capture more businesses than previously as the intention to make a profit or charge for goods and services is no longer required, although the extent of the difference is difficult to quantify because the current tests are not very well specified.
- The changes to the significance test mean that state government business activities with revenue under \$3.7 million that have been assessed to be significant and local government activities with revenue between \$2-3.7 million will no longer be covered by the competitive neutrality policy.
- Competitive neutrality principles will no longer need to be applied where there is no prospect of competition. However, there will be potential for the Minister to declare an activity significant or for a government business to have an adverse finding made against them by IPART in response to a complaint, in which case competitive neutrality policy would apply going forward.

10.3 Impact of changes to costing obligations

The key impact of the draft recommendations on costing services and identifying and applying adjustments to account for the advantages and disadvantages of government ownership are:

- The recommended approach to costing sets out more specific guidance, which means government business activities may have to alter their costing approach for calculating the competitively neutral price, depending on what their current approach is.
- Change in the rate of return calculation, which should make the process simpler and more certain for government businesses. However, it would require a business activity to have good information on its debts and equities.
- Adjustment for the advantages and disadvantages of government ownership remains the same, but the clarification provided may help government business activities to estimate their net competitive advantage.
- Clarification for non-cost advantages may assist with the complaints process and assist with identifying what to account for. Including this guidance is likely to be particularly beneficial for government businesses that are monopoly service providers.

- We are proposing that the obligations to cost services and identify and correct for the advantages and disadvantages of government ownership apply to all significant government business activities regardless of their business structure, sector or status. This means that SOCs and other government businesses that fall under the scope of Treasury's Commercial Policy Framework will need to apply competitive neutrality to their activities. For the most part, this will not impose any additional cost on these businesses compared with the current policies. Corporatised and commercialised entities are covered by the current competitive neutrality policies but do not need to apply the pricing and costing guidelines.
- We are proposing that corporatised and commercialised government entities are subject to the same obligations as other types of businesses. Where their structure has removed any advantages they would otherwise have had (for example, by requiring them to pay dividends or taxes), they will not need to take any action to address these under the revised competitive neutrality policy. The recommended changes include clarity on what constitutes a non-cost advantage for the purpose of competitive neutrality policy, which may be particularly useful for larger, corporatised entities where their market position gives them access to advantages that other businesses do not have.

10.4 Impact of changes to the public interest test

The changes to the timing and process for the public interest test are likely to be the most significant changes that we are proposing in terms of costs for existing government businesses. While the current competitive neutrality policies require government businesses to undertake quantitative assessments if they suspect that application of competitive neutrality is not in the public interest, we are not aware of any government businesses having applied the test.

Under our proposed changes, if state or local government entities do not plan to adopt competitively neutral pricing or remove a non-cost advantage, they will need to undertake a public interest assessment to demonstrate that their proposed course of action is in the public interest. We have provided greater guidance on how to undertake such a test. While this is a feature of the current state government policy it is not required under the local government policy. Under the current competitive neutrality policies local councils are free to subsidise their services for any reason, provided they have estimated the competitively neutral price. There is a broad range of circumstances where subsidies are allowed and in the public interest, however we recognise a need for the costs and reasoning to be more transparent.

We have tried to balance this by including guidance to support local governments in applying a qualitative test. We do not consider that applying this test will impose a significant additional cost on local governments since we expect that they are already familiar with the objectives, benefits and financial costs of subsidies that are currently in place. We consider that it is likely that local governments already undertake some degree of public interest assessment when they decide to subsidise the goods and services provided by their businesses.

10.5 Impact of changes to the complaints regime

We believe the proposed changes will make the complaints process more accessible, without encouraging spurious complaints. This may lead to an increase in complaints, but information from other jurisdictions suggests that the resources required to address complaints are unlikely to be significant. While there is some additional possibility that a government business will need to deal with a complaint, the additional obligations around transparency may also reduce the likelihood of a complaint being made.

10.6 Impact of changes to governance, training and transparency

Increased frequency of competitive neutrality policy review can enable increased monitoring of the effectiveness and user-friendliness of the policy. This in turn should allow continuous engagement with stakeholders and process improvements.

We have recommended that IPART and Treasury provide more advice, tools, resources and training about competitive neutrality. This should help improve awareness of stakeholders but also assist government businesses, especially local government businesses, to implement competitive neutrality at lower cost. We propose to offer resources such as simple guidelines, checklists and templates which should help reduce the administrative burden of complying with competitive neutrality. We are also recommending that Treasury's role in providing assistance to government businesses is expanded to incorporate local government businesses, which provides further opportunities for local government businesses to lower their compliance costs.

The proposed reporting requirements are largely consistent with existing reporting requirements. Some additional information would need to be published. While this may raise administrative costs for government businesses, particularly until the new processes are bedded down, they should help improve transparency of government activities, which helps to inform stakeholders such as the public and competing businesses, potentially reducing the time government businesses will need to deal with complaints.

Draft Recommendation

30. Consider providing a transition period to assist government businesses time to adjust to the changes. We recommend that the transition period provide an appropriate timeframe for government businesses to review their business activities against the revised tests and to update their internal policies and processes to reflect the requirements of the new policy. We recommend that this transition period commence once Treasury and IPART have provided the advice, resources and training necessary to support and guide government businesses to implement the proposed changes.

Appendices

Appendix A >>

Glossary

Commonly used terms within the Draft Report



Term	Definition
Application tests	These are the significance test and public interest test used to determine whether competitive neutrality policies apply to a government business activity.
Community Service Obligations (CSOs)	These are non-commercial activities that the NSW Government has asked a government business to undertake, which address a policy objective. These activities do not achieve a commercial return and would not be undertaken by comparable private sector businesses.
Competitive neutrality framework	This is the suite of legislation, policies and processes that establish competitive neutrality within NSW
Competitive neutrality policies	The 7 policies and processes which establish competitive neutrality within NSW and are subject to this review which are: <ul style="list-style-type: none"> • NSW Government Policy Statement on the Application of Competitive Neutrality (TPP O2-1), 2002. • Guidelines for pricing of user charges (TPP O1-O2), 2001 • Part 4C of the Independent Pricing and Regulatory Tribunal Act 1992 (IPART Act) • Section 173 of the Public Works and Procurement Act 1912 (Public Works and Procurement Act) and Part 3 of the Public Works and Procurement Regulation 2019 (Public Works and Procurement Regulation) • Pricing and Costing for Council Businesses – a Guide to Competitive Neutrality, 1997 • Policy Statement on the Application of National Competition Policy to Local Government, 1996 • Department of Local Government - Guidelines on the Management of Competitive Neutrality Complaints, 1997.
Competition Policy Agreements	The Competition Policy Agreements are a set of 3 intergovernmental agreements that form Australia's National Competition Policy. The 3 agreements are the Competition Principles Agreement, the Conduct Code Agreement and the Agreement to Implement the National Competition Policy and Related Reforms.
Corporatisation	This creates an arms-length relationship between government and the government business activity. For example, SOCs have been incorporated as separate organisations. Their boards and management operate within incentive structures that mirror, to the extent possible, those faced by the private sector. Local government businesses activities do not necessarily have to be formally or legally incorporated as separate organisations. Corporatisation requires them to be separately identified within the operations of council and have accounting and other operations structured in a way that provides a distinct reporting framework.
Full cost attribution	This includes a range of costing methods that competitive neutrality policies require government businesses to use to set prices that at least cover the costs of carrying out the business activity.
GFS	The Australian Bureau of Statistics Government Finance Statistics
General government businesses	These are funded directly or indirectly (via consolidated fund) by taxes or fees or fines, through being dependent on other agencies which are directly or indirectly funded by taxes or fees or fines, or through having regulatory functions which enable them to raise taxes, fees or fines.
General government sector agency	Has the meaning given in the GFS
Government business	Means a government owned or controlled entity engaged in business activities
Government entity	Means an entity owned or controlled by government
IPART Act	Independent Pricing and Regulatory Tribunal Act 1992
Local government businesses	The NSW competitive neutrality framework specifies that the provision and operation of water supply, sewerage, gas production and reticulation and abattoirs are activities of local government businesses. Other activities are determined as local government businesses by the circumstances. Generally, a business activity will involve the supply of goods and services for a fee or charge. However, not all activities involving the supply of goods and services would necessarily be classified as business activities.

Term	Definition
Local government policy statement	The NSW Government Policy Statement on the Application of National Competition Policy to Local Government, 1996
Local government pricing guideline	Pricing and Costing for Council Businesses – a Guide to Competitive Neutrality, 1997
Non-government businesses	Business activities that are not local, state or Commonwealth government businesses.
NSW competitive neutrality policy statement	The NSW Policy Statement on the Application of Competitive Neutrality (TPPO2-1), 2002.
NSW pricing guideline	The NSW Treasury Guidelines for pricing of user charges, Policy & Guidelines Paper (TPP 01-02), 2001.
Public financial corporations	Has the meaning given in the GFS NSW has 2 public financial corporations- icare and TCorp. For these, the NSW Treasury plays a similar role in monitoring and managing performance as for the SOCs.
Public non-financial corporations	These include both SOCs and self-contained organisational units within the public sector. They are principally engaged in trading activities that could, in principle, be provided through the marketplace without compromising the government's social and economic objectives. They raise most of their income from user charges.
Public trading enterprises	Due to Australian Bureau of Statistics classification changes, they are now called public non-financial corporations.
Significant local government businesses	NSW competitive neutrality policies apply to these. Under current competitive neutrality policies, local government businesses are considered significant based on a monetary threshold using annual sales turnover: <ul style="list-style-type: none"> • businesses with sales turnover of more than \$2 million are significant (referred to as category 1 businesses) • businesses with a lower sales turnover (category 2 businesses) are considered significant on a case by case basis. Councils should apply full cost attribution to as many of these businesses as is practicable.
Significant state government businesses	NSW competitive neutrality policies apply to these. Under current competitive neutrality policies, state government businesses are considered significant on a case by case basis. Relevant considerations include the: <ul style="list-style-type: none"> • business' size • business' influence on the market • resources commanded • effect of poor performance
State Owned Corporations (SOCs)	These are public trading enterprises that have been corporatised. Corporatisation creates an arms-length relationship with Government to ensure that boards and management operate within incentive structures that mirror, to the extent possible, those faced by the private sector. There are 8 SOCS in NSW: <ul style="list-style-type: none"> • Essential Energy, • Forestry Corporation of NSW, • Hunter Water Corporation, • Landcom, • Port Authority of NSW, • Sydney Water Corporation, • Transport Asset Holding Entity of NSW • WaterNSW.
State government businesses	The NSW competitive neutrality policies use the term government business to describe parts of the public sector that are principally engaged in trading activities, including the provision of goods and services to other parts of the public sector. The main types of state government businesses include public trading enterprises, SOCs, general government businesses and public financial corporations.

Appendix B >>

Case study of full application of
competitive neutrality principles

B

The case study in this appendix has been presented to show how competitive neutrality principles would be applied under the revised competitive neutrality policy that incorporate our draft recommendations. We have selected a case study that shows how all of the elements of the proposed competitive neutrality policy would be applied. The conclusions drawn are based on the factors described in this case study, some of which have been deliberately simplified (for example, we have not factored in any additional government price support). We are not suggesting that the same outcomes would always apply to similar businesses or situations. Throughout the Draft Report we have also included case studies that illustrate particular elements of the proposed policy. We are interested in feedback on whether there are other case studies or circumstances we should consider before making our final decision.

B.1 Key information

A local council in an urban area of NSW is considering setting up a school holiday program that would operate at 10 locations spread across the local government area (LGA). These programs would run every weekday of the school holidays, with parents/caregivers being able to choose which days they want their child(ren) to participate in the program. In total, the council program would provide around 410 places per day. There are several other privately owned holiday programs operating in the area, but the council has identified a need for more options.

Statistics show that households in this council area have a lower median income than the national median. The council estimated that in total there are around 3720 places offered in holiday programs in the LGA per day of the school holidays.

The council is considering its fee structure for the holiday program. It currently is considering 2 main options:

1. a daily fee that does not include a subsidy provided by the council, which is the same for every child (approximately \$124 per child per day)
2. different fees depending on household income:
 - a. a fee that includes a subsidy provided by the council for children of low-income families (approximately \$104 per day, with further discounts for families with multiple children enrolled) and
 - b. an unsubsidised fee for children of families with an income above the threshold, (approximately \$124 per day).

The council is planning to run a marketing campaign through flyers and large posters displayed at other council facilities.

B.2 Government ownership test

The holiday program would pass the government ownership test. The holiday program is directly owned and run by an organisational unit of the council (see 1(d) of the government ownership test).

B.3 Business activity test

The holiday program would pass the business activity test.

The activity:

- a. involves the supply of goods and/or services, with system and regularity, and
- b. has a commercial character (whether or not it is profitable).

The activity involves the supply of services (childcare through a holiday program) that a private trader could undertake, and it is undertaken with system and regularity (every school holiday day).

The management of the holiday program has a degree of independence over the supply of the service and the price at which it is provided. While childcare services including holiday programs are subject to the *Education and Care Services National Law 2010 (NSW)*, there are no mandated prices for such services. The legislation applies to private holiday program providers as well.

The activity involves the marketing of services, as demonstrated by the marketing campaign that was run by the council when its new centre opened.

A similar example that would not pass the business activity test is a one-off free writing workshop for children that runs for 3 hours. While it is still a type of holiday childcare, it would not pass the business activity test because it does not have the commercial character that the other service has.

B.4 Significance test

A government business activity is significant unless one of the following applies:

1. The annual turnover from the business activity is less than \$3.7 million, which is to be indexed in the policy.^{jj}
2. The government entity undertaking the business activity has conducted a recent market-based review that shows that the activity does not have a significant impact on the market.
3. The activity is a legislated monopoly where there is no potential for competition from other providers.

The holiday program activity is significant as none of these exemptions apply.

^{jj} The threshold is based on turnover for the financial year ending immediately before the current financial year. In order to be exempt on the basis of low turnover, the business needs to ensure that its turnover would be under the threshold where its products/services are priced in line with non-government providers in the same or similar area

The combined annual turnover of the holiday programs under the planned pricing would be a maximum of \$3,050,400 (depending on which charging option the council selected), which would be below the turnover threshold of the significance test. However, the pricing of the programs proposed is lower than other non-government owned competitors in the market, so an alternative measure of revenue based on a market price needs to be tested against the threshold. The market price was established by checking the websites of 10 other randomly chosen non-council holiday programs in the council area for their fees. The fees of these holiday programs varied between \$149 and \$164, with an average fee of \$155. If the average market price of \$155 was used to calculate turnover instead, the turnover would be \$3,813,000, which exceeds the turnover threshold for the significance test.

The council has conducted a recent market review that concluded the activity has a significant impact on the market. The template used for the market review is shown in Table B.1.

Table B.1 Overview of market-based assessment for council childcare

Question	Answer (Yes/No)	Significance determination
1. Does the business activity have market share greater than 10% in the relevant market?	Yes	If yes, continue to Question 2. If no, the business activity is not significant.
2. Is the market share of the business activity (based on turnover or customer numbers) larger than or comparable to its private competitors?	Yes	If yes, the business activity is significant. If no, continue to Question 3.
3. Is there evidence that the business activity has a significant influence or competitive impact in the relevant market?	N/A	If yes, the business activity is significant. If no, the business activity is not significant.

The combined market share of the council holiday programs is greater than 10%. The council programs hold approximately 11% of the market share (410 out of 3720 daily spaces). The next largest operator has 310 places per day, meaning the market share of the business activity is larger than its private competitors. It is not necessary to consider question 3 in Table B.1, as the answer to question 2 is yes.

B.5 Establishing the competitively neutral price

In the case where the operation of the council holiday program has been found to be a significant government business activity, the council will have to establish the competitively neutral price.

The first step to establishing the competitively neutral price is calculating the actual cost of the activity. A cost approach must be decided on using the cost approach guidelines. In this example, the council should use avoidable costs as the cost approach. This is because:

- the holiday program service is operated by the council, meaning the activity is part of a general government sector entity and not a stand-alone business

- the holiday program shares resources with the council that are justified by the council's non-commercial use alone. These resources are largely administrative, such as using council-provided payroll software. The software license covers all council activity at a flat fee, so the cost of the license does not depend on whether the holiday program activity occurs. The buildings used by the holiday program are not considered shared resources since they are owned by the council and hired by the holiday program during the school holidays.

Table B.2 below quantifies the competitive advantage of the holiday program. The council did not identify any notable competitive disadvantages.

Table B.2 Cost adjustment for competitive advantage

Advantage	Adjustment
Reduced rent - the buildings that the holiday program would be operated from are owned by the council and would be hired at low prices. The total of the market hire for the buildings is \$190,000 per year, whereas the actual predicted hire fees total to \$105,000.	\$85,000
Total adjustments	\$85,000

Factoring in the avoidable cost with the adjustment translates to a competitively neutral price of \$124 per child per day, which is the same as the proposed flat fee.

B.6 Public interest test

A public interest assessment will be required to charge below the competitively neutral price, and as the council is currently investigating its fee options it can apply the public interest test to help it determine which approach to take. The council is considering applying a subsidy to the fees for the holiday program, for which a public interest test could be carried out as follows:

- Objective and benefits of the subsidy:**
 - Objective: access to more affordable school holiday program options in the area.
 - Benefits: higher women's economic participation for low-income families from improved access to childcare on price grounds. Improved social outcomes for children that attend holiday programs.
- Costs of the subsidy:**
 - The subsidy would cost approximately \$100,000 per year (including \$3,000 for the administration for verifying eligibility and setting up payment systems). This cost will have to be paid for by redirecting funding from another program.
 - The council will need to find resources (e.g. staff) to be able to administer the subsidy.
 - Provision of subsidies to users of the council-run holiday program discriminates against other providers, which may impact competition for holiday programs in the area. For example, if council offers lower subsidised fees, potential competitors may be discouraged from entering the market and/or existing providers may exit. In the long run this may result in consumers having fewer choices and/or remaining competitors having less incentive to provide high quality services.

3. Do the benefits outweigh the costs?

The subsidy has social benefits as it could help make holiday programs more accessible to low-income families. This is in line with the overall objective. However, if the subsidised fee is significantly lower than the prices offered by competitors this could reduce competition for holiday programs and, in the long term, impact the quality and choice of services for consumers.

Council weighs up the factors and decides that the social benefits from the subsidy will outweigh the costs.

4. Are there less costly ways of achieving the objective?

Not applying the subsidy at all (i.e. having the same fees for everyone) would create less direct costs for the council and would have the least competitive impact but may mean families miss out on being able to access care for their children in the school holidays due to not being able to afford it. Making holiday programs less accessible is a significant cost and does not meet the objective.

5. **Conclusion:** in this case, the subsidy would be in the public interest.

Seek Comment



12. Are there other case studies we should consider? What other elements would be helpful to demonstrate how to apply the revised policy?

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