B3 Implementing Competitive Neutrality Principles

B3.1 Competitive neutrality: what is it and why?

Competitive neutrality principles seek to encourage competition and better use of the community's resources by ensuring that government businesses operating in a market in which there are actual or potential competitors do not gain any net competitive advantage because of their public ownership. In essence, competitive neutrality principles are aimed at ensuring that significant government owned businesses operating in contestable or potentially contestable markets face the same market disciplines as their private sector competitors.

There can be significant economic efficiency and equity implications if government owned businesses compete 'unfairly'. For example, if a government business has special exemptions from the payment of taxes and charges, it may be able to undercut its private sector competitors. Such advantages can also form a barrier to the entry of potential competitors.

Where artificially lower prices charged by a government business cause consumers to choose that business's product, the production and investment decisions of both the business and actual and potential competitors will be influenced. If the government business is not otherwise the least cost producer, the allocation of resources toward production by this business will not be in the best interests of the community. Where this also reduces competition, the result may be a fall in the quality and range of goods and services. Longer term, scarce investment funds will shift out of higher-priced efficient production into lower-priced loss making activities, harming employment outcomes and overall economic activity.

Competitive neutrality policy is aimed at removing the advantages which allow for under pricing by government businesses. This helps to ensure that resources go to their best possible uses. It also brings increased competitive pressure on public businesses, helping to improve the operation of those businesses. Consumers will benefit from more competitive pricing and improved quality of government services. And where taxpayers' funds are no longer used to provide goods and services better provided by the private sector, and remaining government activities are more efficient, a greater proportion of total public funds is available for other priorities, for example, health, schools and welfare.

B3.2 CPA requirements for implementing competitive neutrality

Under the CPA, competitive neutrality principles must be applied, where appropriate, to all significant government businesses, including at local government level. Box B3.1 describes the nature of the businesses considered significant for competitive neutrality purposes in each jurisdiction.

In general terms, implementation of competitive neutrality involves:

- adoption of a corporatisation model for significant government business activities;

- payment of all relevant Commonwealth and State direct and indirect taxes or tax equivalents;

- payment of fees (or commercial interest rates), directed towards offsetting the reduced risk provided by explicit or implicit government guarantees on commercial or public loans;

- attainment of a commercial rates of profit (to ensure government businesses face a return on capital requirement equivalent to private businesses);

- compliance with those regulations to which private sector competitors are normally subject, for example, regulations relating to the environment and planning and approvals processes; and

- pricing of goods and services provided in contestable and potentially contestable markets to take account of all direct costs attributable to the activity, including the competitive neutrality-imposed costs.

All jurisdictions have competitive neutrality policy statements and guidelines to assist the implementation of competitive neutrality policy, and report annually on their progress. In addition, arising from obligations under the CPA, each has established a mechanism for investigating allegations that relevant government businesses are not appropriately applying competitive neutrality principles. Governments' annual reports must discuss allegations of non-compliance raised with complaints mechanisms within the scope of the jurisdiction's competitive neutrality policy.

Box B3.1 Significant Commonwealth, State and Territory Government Businesses

- The Commonwealth policy covers all bodies established principally as business entities (including Government Business Enterprises (GBEs), Business Units, share limited companies and competitive tendering and contracting activities) regardless of their size, profitability or class of business. Other government bodies which have commercial activities with turnover in excess of $10 million are also covered. Competitive neutrality principles may be applied to smaller entities upon the recommendation of the Commonwealth Competitive Neutrality Complaints Office.

- NSW has a Financial Policy Framework (FPF) which applies commercially based target rates of return, dividends and capital structures, regular performance monitoring, payment of State taxes and Commonwealth tax equivalents, payment of a risk related borrowing fee and explicitly funded 'Social Programs'. All significant GBEs that are monitored on a quarterly or half yearly basis are subject to the FPF. The corporatisation model is applied to local government entities with annual turnover above $2 million.

- All significant commercial Victorian Government Business Enterprises (now 22 following some privatisations since the first tranche assessment) are corporatised or commercialised and apply competitive neutrality principles. 'Other significant business activities' have applied appropriate competitive neutrality principles from 1 July 1997 or have been identified for competitive neutrality review.

- Queensland applies competitive neutrality principles to government business activities with annual current expenditure greater than $10 million and to businesses operated by its 17 largest councils. Size thresholds are used to identify three types of significant local government business activities.

- Western Australia defines significant government businesses by assessing the extent of actual or potential competition and the importance, to the Western Australian economy, of the market in which the government business operates. Western Australia considers that, in general, a business is unlikely to be significant unless it has annual turnover or assets greater than $10 million. Local government businesses with annual turnover of at least $200 000 are considered for competitive neutrality reform.

- South Australia applies competitive neutrality principles, where appropriate, to all significant business activities. Implementation of competitive neutrality principles was applied in the first instance to business activities with annual revenue greater than $2 million or assets greater than $20 million.

- All Tasmanian GBEs, except the Port Arthur Historic Site Management Authority, are subject to a full tax equivalent regime, dividend regime and guarantee fee. Tasmania has identified significant business activities within agencies and continues to regularly monitor activities in this area. Competitive neutrality arrangements are applied where appropriate.

- The ACT stated that it applies competitive neutrality principles where there is competition between a government business and another market participant. It has corporatised three business activities and is commercialising a range of other business activities, mostly within the Department of Urban Services.

- The Northern Territory applies competitive neutrality principles to all 11 of its Government Business Divisions and to the Territory Insurance Office (TIO). The TIO, the Power and Water Authority and the Darwin Port Authority are corporatised.

Source: Jurisdictions' 1996 policy statements and annual NCP reports.

What about Community Service Obligations?

A Community Service Obligation (CSO) arises when a government specifically requires a business to carry out an activity or process that:

- the organisation would not choose to do on a commercial basis, or that it would only do commercially at higher prices; and

- the government does not, or would not, require other organisations in the public or private sectors to undertake or fund.

CSOs are often established to meet government social policy objectives. Some examples of CSOs include:

- a direct payment by a State government, to certain disadvantaged consumers, to pay for some or all of their use of essential services, such as electricity and water;

- local councils providing waste disposal services to local nursing homes free of charge; and

- the requirement that Australia Post provide a standard letter delivery service throughout Australia for a uniform postage rate (currently 45 cents).

Applying competitive neutrality principles does not prevent the provision of CSOs, but it does place certain requirements on governments in terms of their costing, funding and interaction with other competitive neutrality obligations. The intention is to encourage more effective and transparent provision of CSO services, with minimal impact on the efficient provision of other commercial services.

For an activity to be recognised as a CSO, the provider organisation should be directed explicitly to carry out the activity on a non-commercial basis, for example, by legislation, government decision or a publicly available direction from a Minister. CSOs should be funded from the purchasing portfolio's budget, with costs determined as part of a commercially negotiated agreement. CSO agreements should include similar competitive neutrality requirements as applied to other activities, that is, these activities should be able to pay taxes and earn a commercial rate of return (as if contracted out).

Where direct funding of CSOs entails unreasonably large transaction costs, portfolio Ministers may choose to purchase CSOs by notionally adding to the provider organisation's revenue result, for the purpose of calculating the achieved rate of return. CSOs should be costed as if directly funded. This notional adjustment should be transparently recorded. However, for consistency with competitive neutrality requirements, there should be no adjustment to the commercial rate of return target of the service provider to accommodate CSOs.

The financial frameworks adopted by governments and supporting legislation provide for the identification of CSOs, including why the activity should be considered a CSO rather than a business function, and the explicit funding of identified CSOs from the purchasing agency's budget. However, it is not clear that all governments routinely examine the effectiveness of different alternatives for delivering the CSO, or carry out on-going monitoring of the effectiveness of delivery once the CSO is in place, consistent with the resource allocation objective of the CPA. Moreover, the evidence from competitive neutrality complaints suggests that some governments need to ensure that, in practice, they provide clearly defined, budget funded CSOs in line with their stated policy approaches.

Common misconceptions – what the CPA does not require

Competitive neutrality applies to the significant business activities of governments, including those which government agencies operate as part of a broader suite of activities. It does not apply to non-business, non-profit activities of publicly owned entities. The Council encourages governments to consider business significance in terms of the effect of the business on its relevant market rather than only in terms of the size of the business.

Competitive neutrality does not require privatisation of government business activities, only corporatisation as appropriate. However, competitive neutrality does not prevent a government taking a policy decision to privatise a business activity. Neither does competitive neutrality require outsourcing of government activities. But when a government business participates in a competitive tendering and contracting process, it must comply with competitive neutrality policy. In-house business units should not have any unfair advantage over other public or private sector bidders.

Regulatory neutrality does not require the removal of legislation that applies only to the government business (and not to its private sector competitors) where the regulation is nevertheless considered to be appropriate.

Finally, competitive neutrality does not have to be applied as a matter of course. It should be applied only where the expected benefits from implementation outweigh the costs.

B3.3 Assessment of progress against neutrality objectives, by jurisdiction

Having examined the general policy approach of each jurisdiction in the first tranche assessment, the Council's second assessment looked for continuing progress with the application of competitive neutrality across significant business activities. The Council developed its assessment on the basis of information contained in governments' annual reports, including progress in applying competitive neutrality reforms to local government businesses, given the delays identified in the first assessment.

The Council also took note of alleged non-compliance with competitive neutrality policy, as provided by reports of complaints mechanisms, and governments' responses to those allegations. The view of the Council is that the recommendations of complaints bodies, and actions taken by governments to rectify identified breaches of policy, can be a useful indicator of the effectiveness of a jurisdiction's application of competitive neutrality policy. The Council expects recommendations of complaints mechanisms to be taken up by governments, unless the government can provide a convincing net public benefit case to support a different approach.

Commonwealth

Policy and scope of application

The Commonwealth Competitive Neutrality Policy statement (June 1996) (CNPS) deems all GBEs, Commonwealth share limited companies and Commonwealth Business Units to be significant business activities, and therefore subject to

competitive neutrality policy. Where other commercial activities of the Commonwealth meet the established definition of a 'business' and have turnover exceeding $10 million per annum, the merit of implementing competitive neutrality is determined on a case by case basis. This includes bids by in-house units for activities subject to the Commonwealth's competitive tendering and contracting guidelines.[11]

In general terms, Commonwealth competitive neutrality implementation requires:

- adoption of a corporatisation model for significant GBEs;
- payment of relevant Commonwealth and State, direct and indirect taxes, and tax equivalents;
- payment of debt neutrality charges or commercial interest rates;
- attainment of a commercial pre-tax rate of return on assets;
- compliance with regulations to which private sector competitors are normally subject; and
- pricing of goods and services provided in contestable markets to take account of all direct costs attributable to the activity and the competitive neutrality elements.

The actual implementation of these principles to particular businesses may vary depending on the market in which the business is operating. For example, where a business competes predominantly in a market where other participants have special arrangements for taxation, the business is required only to pay the same taxes as the majority of its competitors. Another example is that businesses, which are being corporatised or restructured along commercial lines, may have a lower pre-tax rate of return target for a transitional period of up to three years, to take account of identified public sector employment cost disadvantages.

Competitive neutrality complaints

The Commonwealth has established an autonomous unit within the Productivity Commission – the Commonwealth Competitive Neutrality Complaints Office (CCNCO) – for investigating allegations of non-compliance with competitive neutrality policy.

The CCNCO can investigate competitive neutrality complaints about any Commonwealth Government business. This is a desirable feature as it allows the CCNCO to recommend the application of competitive neutrality principles, where appropriate, to businesses below the Commonwealth's $10 million turnover threshold for significance.

---

[11] To be considered a business by the Commonwealth, the following criteria must be apply: there must be user charging for goods and services; there must be an actual or potential competitor in the private or public sector; and managers of the activity must have a degree of independence in relation to the production or supply of the good or service and its price.

Where the CCNCO considers that competitive neutrality arrangements are not being appropriately applied, it may make recommendations directly to the government business on the identified inadequacies and action to improve compliance. If a suitable resolution is not achieved, the CCNCO may recommend a public inquiry or that appropriate remedial action be taken by the Treasurer.

One formal complaint was received by the CCNCO for the period ending December 1998. In September 1998, airline representatives complained that the Australian Protective Service (APS) should not apply competitive neutrality policy to charges for its counter terrorist services delivered at airports. The CCNCO recommended in December 1998 that competitive neutrality should continue to apply to these services. However, it also recommended that the APS not include additional interest and tax in its service costing as these were already covered by the required pre-tax rate of return, and that the Commonwealth Treasury seek to remove scope for misinterpretation of these matters in its advice to agencies. At the time of reporting, the Minister for Financial Services was following up the CCNCO recommendations with the Attorney-General and Minister for Transport and Regional Services.

Assessment

The Council assesses the Commonwealth as meeting its second tranche competitive neutrality obligations.

New South Wales

Policy and scope of application

New South Wales requires all GBEs to implement competitive neutrality principles unless they can show through a benefit-cost analysis that this would impose a net cost on the community. The State is delivering its competitive neutrality obligations through a program of corporatisation of several non-budget sector agencies.

At 1 March 1999, New South Wales had 19 GBEs already corporatised, with several others being considered for corporatisation under the State Owned Corporations Act. These businesses operate in various sectors including electricity, finance, gaming and recreation, housing, ports and waterways, transport, water and providing miscellaneous marketing and administration services.

Corporatisation involves the application of the State Owned Corporation model and requires application of the State's Financial Policy Framework. Apart from where a net cost can be shown, non-corporatised GBEs implement competitive neutrality principles through the Financial Policy Framework. Some 45 GBEs currently fall within the Framework. This implements competitive neutrality principles through:

- the application of commercially based target rates of return, dividends and capital structures;
- regular performance monitoring;
- payment of State taxes and Commonwealth tax equivalents;
- payment of risk related borrowing fees;

- explicitly funded social programs (CSOs); and
- private sector equivalent regulation.

For other significant businesses that compete (or potentially compete) with the private sector – some 142 commercial activities of general government sector agencies, GBEs yet to adopt the Financial Planning Framework and GBEs not subject to independent prices oversight – the Treasury has developed costing and pricing principles. Broadly speaking, the objective is that entities set prices for their goods and services such that they recover full costs. The Treasury has taken action to assist the application of its pricing principles, including through issuing guidelines and conducting workshops.

Application to local government

Larger local government businesses (annual turnover of $2 million or more) must report separately from the other general business of the council and apply full cost attribution, including all competitive neutrality components. For smaller businesses, local governments are able to determine the extent of separation of the business activity and must apply full cost pricing where practicable. In all cases, subsidies to the business activity must be made transparent and there must be a system for dealing with complaints about non-implementation of competitive neutrality.

Following the Council's first tranche (June 1997) concerns about all jurisdictions' rate of progress in applying competitive neutrality principles to local government businesses, the New South Wales Government surveyed the progress of local governments within its jurisdiction in January 1998 and again in September 1998. At the time of the second survey, about 85 per cent of councils had completed the task of identifying and categorising their business activities. This categorisation showed there were 129 businesses with annual turnover exceeding $2 million and 529 smaller businesses.

The September 1998 survey also indicated a high level of compliance with the required reform program. Almost 90 per cent of the larger (category 1) businesses have separate internal reporting (the corporatisation model). There is evidence of good progress in applying taxation equivalents and debt guarantee fees, but some reluctance to require a commercial rate of return because of perceived impacts on prices. Subsidies to businesses were being made explicit in 70 per cent of cases and private sector equivalent regulation was being applied in all cases. Some 63 per cent of smaller (category 2) businesses were applying full or partial cost attribution.

Competitive neutrality complaints

New South Wales provides for an actual or potential competitor of a GBE to make a complaint if that competitor perceives it is being adversely affected by a net competitive advantage available to that GBE as a result of its public ownership. The complainant must first seek to resolve the matter with the relevant government agency. Where the complainant is not satisfied with the response of the agency, he or she may then refer the matter for independent assessment by a complaints mechanism. New South Wales has two independent mechanisms: the IPART for generic competitive neutrality matters and the State Contracts Control Board for complaints relating to tendering.

Prior to the establishment of IPART as the mechanism for dealing with generic competitive neutrality matters, complaints were dealt with by the New South Wales Cabinet Office. During 1998, the Cabinet Office received two complaints about unfair competitive advantage due to public ownership. In each case, the initial investigation by the relevant agency found that there was no contravention of competitive neutrality principles. New South Wales reported that, to date, both complainants have not wished to refer the matters to the independent bodies.

The Cabinet Office also considered three other matters during the second tranche period. One of these matters, concerning the University of Newcastle Sports and Aquatic Centre, while not a contravention of competitive neutrality policy, did raise the question of whether universities are appropriately categorised as a government business for competitive neutrality purposes.[12] One other complaint, which concerned a commercial business operated by the Sydney Eye Hospital, was addressed by application of New South Wales pricing principles and appropriate allocation of costs to the business. New South Wales reported that full compliance with competitive neutrality pricing was achieved at the end of May 1999.

Competitive neutrality complaints about local government businesses are dealt with in the first instance by the local government business owner, with recourse to the Department of Local Government if the matter is not resolved. New South Wales reported that nearly all councils now have a formal competitive neutrality complaints handling mechanism. The New South Wales Government's latest survey of local government showed that only six of 197 councils received a competitive neutrality complaint in 1997-98 and that all of these were resolved. The Department of Local Government received six complaints directly, all of which it referred to the relevant local government for consideration and response.

Assessment

The Council assesses New South Wales as meeting its second tranche competitive neutrality obligations.

Victoria

Policy and scope of application

The Victorian Government applies the following competitive neutrality principles, where appropriate:

- corporatisation of Victorian GBEs and other significant business activities;
- commercial rate of return targets;
- State taxes and utility charges and Commonwealth income and wholesale sales tax equivalents;

[12] The application of competitive neutrality principles to the higher education sector is now being addressed by a subgroup of the COAG Committee on Regulatory Reform.

- risk related borrowing fees; and
- relevant regulations to which the private sector is normally subject.

The Victorian Government applies a corporate business model approach and/or Tax Equivalent System (TES) model to its GBEs, covering for example, water corporations, the Transport Accident Commission, the Victorian Workcover Authority, and the Urban Land Authority. Other GBEs are to be reviewed for potential inclusion within the TES framework. Many business activities adopt a commercialised structure and full cost attribution in pricing, including competitive neutrality components.

Application to local government

Victoria reported that all local councils are applying competitively neutral pricing principles to in-house agreements entered into since July 1997. Where contracts which have been entered into prior to July 1997 are re-tendered, local governments will be required to apply competitively neutral pricing principles. Councils with significant businesses are either applying competitively neutral pricing principles or are reviewing the operation of those businesses, including to apply competitive neutrality policy.

Competitive neutrality complaints

Complaints about the business activities of the State Government and local councils are investigated by the Competitive Neutrality Complaints Unit (CNCU), within the Department of Treasury and Finance, for analysis and decision. Competitive neutrality principles now apply to all Victorian Government business activities, providing a significant role for the CNCU. Complaints about tendering procedures of local governments are handled by the Office of Local Government

Given the broad scope of application of competitive neutrality policy, the CNCU now also monitors how agencies have implemented its recommendations. Where the CNCU has found a breach of policy, it seeks information from agencies on how compliance with competitive neutrality policy has been achieved, six months after it has made its recommendation.

The CNCU also plays an active role in promoting the application of competitive neutrality policy through presentations to relevant groups and advice to government and local government agencies. The Municipal Association of Victoria and the CNCU are planning the joint development of case studies on the implementation of competitive neutrality by local governments.

The CNCU dealt with 15 cases of alleged non-compliance with competitive neutrality policy from 1 July 1997, finding a breach of competitive neutrality policy in seven cases. The Victorian Government took action to facilitate implementation of competitive neutrality consistent with the CNCU recommendation in each case.

One case likely to be relevant in other jurisdictions centred on the Department of Human Services. The complainant alleged that the Department breached competitive neutrality policy because government-owned childcare centres were eligible for

higher subsidies from the Department than private providers and that some programs operated by the Department were not available to private providers. In this case, the CNCU found that, in the absence of underlying policy reasons for targeting funding arrangements under the Youth and Family Services program specifically to non-profit service providers, the Department of Human Services had breached competitive neutrality policy by not allowing existing private sector providers to apply for funding. The Department subsequently indicated that it will amend its funding policies to ensure that any legally constituted service providers can apply for funding. The CNCU also raised issues relevant to Commonwealth programs with the Commonwealth Competitive Neutrality Complaints Office.

There have been four competitive neutrality complaints concerning local governments considered by the CNCU since 1 July 1997. One complaint was upheld, with the CNCU finding that the City of Port Phillip had breached competitive neutrality policy by:

- providing financial assistance to council managed childcare centres which is not available to competing private centres; and

- not applying full cost pricing principles in setting the price of its child care services.

The CNCU is working with the City of Port Phillip to achieve compliance with competitive neutrality policy.

Another case involved the management of a gymnasium facility by the Shire of Campaspe. The CNCU found that, while competitive neutrality principles were not applied in relation to the existing management contract, there is technically no breach since the contract pre-dated the application of competitive neutrality rules to local government. The Office of Local Government and the CNCU are working with the Shire to develop options for achieving compliance with competitive neutrality policy under the current contract.

Assessment

The Council assesses Victoria as meeting its second tranche competitive neutrality obligations.

The Council gave consideration to the number of competitive neutrality complaints recorded by Victoria in assessing the State's progress and the actions taken by the Government to implement CNCU recommendations. While there have been a larger number of complaints in Victoria than in other jurisdictions, there are several explanations for this. Unlike some other jurisdictions, the complaints mechanism in Victoria applies to all government business activities. From its introduction in July 1997, the operation of the CNCU has been widely publicised. More broadly, the Government has been pursuing governance reform for a considerable period across a wide range of business activities, and it requires contestability in service provision at both State and local levels (for example, compulsory competitive tendering in local government). The Council therefore does not consider the number of complaints to indicate poor implementation of competitive neutrality policy in Victoria.

Queensland

Policy and scope of application

Queensland's policy approach defines the application of competitive neutrality obligations to include:

- corporatised GBEs;
- commercial rates of return dividend and capital structures;
- regular performance monitoring of business activities;
- payment of state taxes and Commonwealth tax equivalents;
- payment of risk related borrowing fees;
- explicitly funded social programs (CSOs); and
- application of equivalent private sector regulation to government businesses.

Queensland's NCP annual report outlines the State's recent progress in applying competitive neutrality principles to nine candidate significant Queensland Government businesses. For several of these businesses, there has been some delay in applying reforms, despite reviews early in the life of NCP recommending commercialisation or corporatisation. This is particularly the case for the urban water authorities, where matters such as the ownership and control of assets by the State and local governments and the arrangements preferred by major consumers, have influenced approaches to commercialisation.

Queensland reported that its ability to incorporate the South East Queensland Water Board under the Corporations Law (its preferred approach), is being adversely affected by disincentives and uncertainty in the taxation environment. Queensland stated that this arises in relation to:

- section 51 AD and Division 16D of the Income Tax Assessment Act, which it claims provide a significant disincentive for State Governments converting asset-intensive entities into Commonwealth tax paying entities;
- the Deferred Company Tax proposal flagged by the Review of Business Taxation (Discussion Paper 1999), which Queensland stated could have an impact in relation to SEQWB potentially as large as Division 16D; and
- the potential income tax implications for corporatised businesses of the proposed National Taxation Equivalent Regime.

The Council has previously acknowledged local government concerns about disincentives created by the possible implications for taxation of corporatised local government businesses. The Council notes that, on this matter, the Commonwealth has given local government a commitment that it will not be financially disadvantaged, at an aggregate level, from the corporatisation of its business activities.

The Council has also stated previously its view about the desirability of resolving business taxation arrangements as soon as possible. The proposal relating to Deferred Company Tax referred to by Queensland is at present only a possible option (one of three) identified in a Discussion Paper prepared by the Review of Business Taxation. Since releasing its Discussion Paper, the Review has taken further submissions and is due to report on 31 July 1999.

In addition to these delays, there have also been questions raised with the Council about the coverage of Queensland's competitive neutrality reform program. For example, the Child Care National Association believes that government-owned child care businesses are not competing with private providers on a competitively neutral basis. The Association is not able to have its concerns investigated by the Queensland competitive neutrality complaints handling body, the Queensland Competition Authority (QCA), because child care is not declared as a significant business activity. The Council raised this matter with Queensland earlier this year, proposing that Queensland examine the case for including childcare as a significant business activity consistent with its undertaking in the first tranche assessment in 1997 to progressively consider smaller government business activities for competitive neutrality reform.

Application to local government

The State's 17 largest local councils have assessed the net public benefit of applying one of the three identified competitive neutrality reform models – namely, corporatisation, commercialisation or full cost pricing – to their business activities. These councils identified 25 significant business activities for application of competitive neutrality.

The task of assessing whether local governments are achieving a satisfactory level of reform is delegated to the QCA. The QCA conducts an annual independent and objective assessment of local government performance in implementing CPA-style reforms. The QCA delivered its first report in November 1998. The report indicates that all councils were delivering on their promises and implementing appropriate reforms. Of the 25 businesses, 15 were commercialised and full cost pricing was applied to the remainder.

The Queensland Government stated in its annual report that it is now making concerted efforts to apply this approach to significant businesses activities in other large and small councils.

Queensland earmarks approximately one-fifth of its competition payments for local governments which implement NCP reforms. The Government's commitment is to share up to $150 million over five years, commencing on 1 July 1997. The Queensland Government provides a Financial Incentive Package which funds training for local governments and the conduct of NCP reviews by local governments, and rewards local governments which implement the full array of NCP reforms appropriate to their circumstances. The Council strongly supports the approach being taken by Queensland.

Competitive neutrality complaints

In Queensland, complaints may be raised on the grounds that a significant business is not complying with relevant competitive neutrality principles, or that arrangements in place are not effective in removing or offsetting the advantages arising from public ownership. However, unlike in some other jurisdictions, complaints cannot be lodged about businesses which the Government has not identified as subject to competitive neutrality principles.

The Government has adopted a two-stage approach to handling complaints. Initially, a complainant must raise his or her concerns with the government business that is the source of the complaint. If the two parties are unable to reach agreement, then the matter can be referred to the Queensland Competition Authority (QCA) for investigation. The QCA must decide whether the Government's competitive neutrality policies apply and, if so, recommend to Cabinet on the complaint. Complaints about local government businesses are made to the local government owner of the business, and referred to the QCA if resolution is not achieved at the local government level.

The Coachtrans complaint

Queensland reported that the only competitive neutrality complaint referred to the QCA in the period relevant to the Council's assessment was by Sita Queensland (trading as Coachtrans), the operator of a bus service between Brisbane and the Gold Coast. Coachtrans alleged that the price charged by Queensland Rail (QR) for the passenger service on the Brisbane to Gold Coast route, and certain associated procedural and regulatory processes available to QR, breached the principle of competitive neutrality.

In July 1998, the QCA found that the fares charged by QR for its Brisbane to Gold Coast services breached competitive neutrality principles. According to the QCA, the level of fares charged by QR was insufficient to recover its operating costs, an appropriate return on its own capital, and the cost of maintaining the track and associated infrastructure. The QCA found, on the other hand, that Coachtrans is in receipt of no subsidies or other assistance from the Queensland Government, and is required to meet all its costs, including a return on its own capital. The QCA also stated that "available evidence suggests that bus operators (in general) recover the capital costs of road infrastructure to government". However, the QCA found no breach in respect of the procedural or regulatory processes available to QR's Brisbane to Gold Coast services (QCA 1998).

The QCA recommended that the Queensland Government develop a CSO framework for the Brisbane to Gold Coast public transport service which complies with the principle of competitive neutrality, achieves efficient resource allocation in the public transport market in South-East Queensland and promotes competition. The QCA also recommended that, until a CSO framework is in place, the Queensland Government should, within six months of the release of its report, ensure that passengers currently travelling by bus retain access to those or equivalent public transport services.

On the 6 August 1998, the Queensland Premier and Treasurer gave notice that they:

- rejected the QCA finding that there was a breach of competitive neutrality policy in relation to QR's fares on the Brisbane to Gold Coast route, reasoning that the information available was not sufficiently conclusive to support the QCA's decision; and

- accepted the QCA finding that QR has no procedural or regulatory advantages which breach competitive neutrality principles.

The Ministers advised that they had requested the Department of Transport to develop a CSO framework for the Brisbane-Gold Coast service that takes account of competitive neutrality principles.

Subsequently Coachtrans commenced two actions – a case under section 46 of the Trade Practices Act (Federal Court) and a judicial review action in relation to the decision by the Ministers to reject the QCA finding (Supreme Court of Queensland). The section 46 matter was listed for hearing in June 1999 and the judicial review set down for August 1999.

The Ministers' decision notice did not provide the reasoning supporting their decision to reject the QCA recommendation. Neither does the Queensland NCP annual report address the matter, stating that no comment is made pending the decision of the Supreme Court.

The Council's views

The Council considers that the efficacy of each government's complaint handling, including its response to the recommendations of its complaints mechanism, is an important indicator of whether competitive neutrality principles are being appropriately applied. To be assessed as complying with NCP obligations, the Council expects governments to implement the recommendations of competitive neutrality complaints mechanisms unless the government can provide a justification for acting differently. As a general rule, however, the Council expects relevant government businesses to have presented their case during the investigation of the complaint. In view of this, the Council considers that a government would need to provide a rigorous justification for departing from the recommended course of action if it is to be considered as complying with competitive neutrality obligations.

As with government decisions in other areas, a government's rejection of the recommendations of its competitive neutrality complaints mechanism can be tested, such as Sita Queensland has chosen to do, by seeking judicial review of the decision. While a judicial review will generally examine the soundness of the government decision making process, rather than the merits of the decision, it does involve similar considerations to the Council's assessment of a government's compliance.

Given that the judicial review action by Sita Queensland is still underway, the Council finds it inappropriate to conclude its assessment of the Queensland Government's compliance with competitive neutrality principles at this time.

Assessment

The Council considers that the matter of the judicial review of the decision by the Ministers to reject the QCA finding of the competitive neutrality breach complaint is relevant to its second tranche assessment of Queensland's competitive neutrality compliance. Because of this, the Council proposes to conduct a supplementary assessment of Queensland's competitive neutrality performance. The supplementary assessment would consider the Queensland Government's approach on the QR matter after the outcome of the Sita Queensland Supreme Court action is known and, to the extent necessary, the Government has had time to consider the outcome. As part of this assessment, the Council would take account of the progress achieved by Queensland towards developing a public transport framework for South-East Queensland consistent with the QCA recommendation.

As well as this, the Council sees some value in Queensland examining whether there is benefit in extending the application of its competitive neutrality policy beyond the significant business activities so far nominated. Any such action would need to involve extending the mandate of the QCA to investigate competitive neutrality complaints, for example, to enable the QCA to recommend to the Government on whether it is appropriate to apply competitive neutrality principles to businesses where they currently do not apply. Consideration of this matter by Queensland would be consistent with the Government's assurance to the Council during the first tranche assessment in 1997 that its intention is to progressively consider smaller business activities for application of competitive neutrality principles.

Western Australia

Policy and scope of application

Western Australia has taken a number of steps to apply competitive neutrality principles to its significant business activities. These include:

- corporatisation of Western Power, AlintaGas and the Water Corporation, which collectively earn 80 per cent of all revenues derived by government businesses in the State, and the application of the competitive neutrality principles in accordance with the CPA;

- commercialisation of the State's port authorities and application of competitive neutrality principles;

- commercialisation of the Western Australian Land Corporation (Landcorp), relocation of Landcorp's regulatory and policy functions, application of competitive neutrality principles including independent and transparently provided CSOs, and independent performance monitoring; and

- commercialisation of the Western Australian Treasury Corporation and application of competitive neutrality components including a required return on capital through a dividend payment to the Consolidated Fund.

Western Australia has a number of competitive neutrality reviews of medium and small sized government agencies currently underway.

Application to local government

Western Australia categorises its local governments as category 1 (with annual revenue exceeding $2 million) and category 2. There are 54 category 1 councils and around 90 category 2 councils. Significant local government businesses (annual turnover exceeding $200 000) are most likely to be operated by category 1 councils.

Western Australia has required all local governments to review their significant business to determine whether these businesses warrant competitive neutrality reform. The Government reported that, at 31 March 1999, 136 local governments had fully met their commitment to examine their business operations. While the majority of businesses fall under the threshold for significance, a total of 129 businesses have now been reviewed, with competitive neutrality principles now implemented in about half of these.

Competitive neutrality is applied most commonly through full cost pricing, although some businesses have also been established as commercialised business units. Similarly to Queensland, Western Australia devotes a proportion of its NCP competition payments to local governments which achieve their obligations under NCP.

Competitive neutrality complaints

Western Australia's Cabinet Government Management Standing Committee (GMC), comprising senior Ministers of the Western Australian Government, supported by a Complaints Secretariat within the Western Australian Treasury, handles allegations of non-compliance with competitive neutrality policy. Complaints may be made by individuals, businesses and industry groups in the private sector and government agencies of other jurisdictions (which are already subject to competitive neutrality) who:

- are, or may be, directly and adversely affected by the competitive advantage alleged to be enjoyed by the Western Australian Government agency carrying out the significant business activity; and

- compete or seek to compete in a particular market with a Western Australian Government agency, but are prevented from doing so by the competitive advantage alleged to be enjoyed by that agency.

Initially, complainants make contact with the relevant government business to attempt to resolve the allegation of non-compliance. If the complainant is unable to resolve their concern, they can lodge a written complaint with the Complaints Secretariat. The Complaints Secretariat then investigates the complaint to determine that it is a competitive neutrality matter, and where this is the case, makes recommendations for consideration by the GMC.

Where the GMC finds a breach of competitive neutrality, it determines the action necessary to rectify the problem on a case by case basis taking account of the seriousness and nature of non-compliance. Once the actions necessary to rectify a competitive neutrality problem are decided, implementation is monitored by the Treasury. There is no avenue for appeal against a finding by the GMC that there is no breach of competitive neutrality policy.

The Complaints Secretariat has received one complaint since the establishment of the formal GMC mechanism in October 1998, which it decided fell outside the scope of competitive neutrality policy.

Assessment

The Council assesses Western Australia as meeting its second tranche competitive neutrality obligations.

South Australia

Policy and scope of application

After some early delays, South Australia is progressively applying competitive neutrality principles to the Government's significant business activities, to the extent that the benefits outweigh the costs. As set out in its June 1996 policy statement, this includes corporatisation, tax equivalent payments, debt guarantee fees and private sector equivalent regulation. Where corporatisation is found not to be appropriate, prices must reflect full cost attribution. The State gazetted some 30 larger government businesses[13] for competitive neutrality and, following some delays, on 13 May 1999 gazetted a list of smaller businesses. South Australia's timetable should see competitive neutrality principles applied to smaller government businesses by June 2000 at the latest.

South Australia has reviewed its Competitive Neutrality Policy Statement and the relevant sections of the *Government Business Enterprises (Competition) Act 1996* (the GBE Act), with the objective of clarifying the scope of application of competitive neutrality policy and revising the implementation timetable. The revised policy statement and amendments to the Act are expected to be put in place during 1999.

Application to local government

Competitive neutrality continues to be extended to local government business activities. All councils determined by 30 June 1998 which competitive neutrality instruments were to be applied to their business activities. Councils identified both large and small businesses, although most are small scale activities. Implementation for the smaller local government businesses will be completed by June 2000.

Councils are reviewing by-laws and the South Australian Government is reviewing the Local Government Act including for conformity with competitive neutrality requirements.

Competitive neutrality complaints

Under GBE Act, the Competition Commissioner investigates complaints that government businesses are infringing competitive neutrality principles. According to

[13] That is, those government businesses with revenue greater than $2 million or assets valued at greater than $20 million.

the Government the Act allows complaints from a competitor or potential competitor of a government or local government agency that:

- an activity has not been identified as a "significant government business activity";
- the most appropriate competitive neutrality measure (corporatisation, commercialisation, or cost reflective pricing) has not been chosen for the activity;
- the chosen competitive neutrality measure has not been properly or fully implemented, or that there has been a breach of a provision that has purportedly been implemented; and/or
- a time-line set out in the South Australian Government Policy Statement has not been met.

South Australia handles complaints in two stages. First, the complaint is referred to the State agency or local government business owner for initial response. If the complaint is not resolved, then the matter can be referred to the Competition Commissioner, who undertakes an investigation and recommends to Cabinet as appropriate.

The Commissioner had three incomplete complaints investigations at the beginning of 1998. During the year, the Commissioner received a further five complaints and finalised three. One of these, relating to the Cleland Wildlife Park, was upheld after a 13 month investigation. In this case, the Commissioner recommended that the Department for Environment, Heritage and Aboriginal Affairs conduct an analysis of the application of competitive neutrality principles to the Park. The South Australian Government accepted this recommendation, and the Department undertook to conduct the recommended analysis within twelve months.

Another of the investigations completed during 1998 concerned the distribution by the Department of Human Services of a funded energy rebate to pensioners via ETSA Power, a government-owned electricity retailer. A private gas distributor, Envestra, complained that distributing the rebate via ETSA Power was anti-competitive. In this case, the secretariat to the Competition Commissioner terminated this complaint following Crown Law advice that the complaint was *ultra vires* the GBE Act, i.e. outside the scope of the Act. The principal reasons given for this were that:

- the rebate was the initiated by the Department of Human Services which is not engaged in a significant business activity;
- the decision to pay a rebate and distribute it in the manner chosen are matters of government policy – complaints against government policy cannot be brought under the GBE Act; and
- in distributing the rebate ETSA Power was fulfilling a community service obligation – these are not subject to competitive neutrality (South Australian Government 1999).

Assessment

South Australia has made recent advances in delivering its competitive neutrality policy obligations, although there is still some way to go in relation to smaller State Government businesses and local government. That said, the Council acknowledges that there are unlikely to be a large number of local government businesses in South Australia which are significant for competitive neutrality purposes.

The Council has considered two matters arising from South Australia's handling of competitive neutrality complaints. In the case of the Cleland Wildlife Park, the Competition Commissioner upheld the complaint and the Government accepted the recommendation. Although the investigation took some thirteen months, the Council was assured that this did not impose an unnecessary economic burden on the complainant and was necessary to allow the investigation to take a fully consultative approach acceptable to all parties to the complaint.

In the case of the complaint concerning ETSA Power and the energy rebate, the Council was concerned that the stated reasons for terminating this complaint (see above) appeared inconsistent with the Government's own statement of policy. In particular they left considerable uncertainty as to scope of applied competitive neutrality policy in South Australia and, especially, the degree to which CSO activities are subject to competitive neutrality principles.

The Council would be concerned if, as could be implied by the stated reasons, merely by labelling measures "government policy" or "community service obligations", they were made exempt from competitive neutrality complaints. These concepts are potentially so broad as to severely undermine the value of competitive neutrality policy. The Council has addressed these matters with the South Australian Government, which has clarified its basis for the termination and confirmed the continued application of the requirements of its CSO Policy Framework of December 1996 that "undertaking of CSO activities does not conflict with Competitive Neutrality principles". The Council is therefore satisfied that in this case the Government's competitive neutrality obligations have been appropriately fulfilled.

Tasmania

Policy and scope of application

Tasmania's *Government Business Enterprises Act 1995* places GBEs on a more competitive footing. As umbrella legislation overarching the portfolio Act establishing each GBE (for example, the Hydro-Electric Corporation Act 1995), the GBE Act has provided the framework for improvement in the efficiency, effectiveness and accountability of the State's GBEs and is consistent with the principles underpinning corporatisation. Since July 1997, all GBEs except the Port Arthur Historic Site Management Authority have been subject to full competitive neutrality arrangements by way of:

- tax equivalent regimes;
- debt guarantee fees;
- dividend requirements; and

· all regulations normally applying to the private sector.

Tasmania is currently considering its approach to the Port Arthur Historic Site Management Authority. The Government has released a public discussion paper on the future of Port Arthur. The Government's NCP annual report stated that it will take the outcome of this process into account in its future plans for the Management Authority.

Tasmania identified all significant business activities operated by budget sector agencies in June 1997. Competitive neutrality arrangements are being applied in these business activities, with progress reported to the Tasmanian Treasury every six months. Many government services are now outsourced to private sector providers. Where government services continue to be provided by government business activities, in most cases, fees are set on a full cost attribution basis.

Tasmania has a CSO policy designed to ensure that delivery of the Government's social and other objectives does not impact on the commercial performance of its GBEs. Consistent with the approach set out in section B3.2 above, Tasmania requires that CSOs be clearly identified through a directive from the Government, justified and separately accounted for. The Government has negotiated contracts for the provision of agreed CSOs with the Hydro-Electric Corporation, Metro Tasmania, the Public Trustee and Aurora Energy.

Application to local government

The Council's supplementary first tranche assessment noted that Tasmania's application of competitive neutrality principles to local government businesses had been delayed pending finalisation of a program of local government amalgamations then underway. At the time, the Tasmanian Government gave an undertaking to negotiate with local governments to reinvigorate the application of NCP within the local government sector.

Tasmania has now renegotiated a new timetable for competitive neutrality application. The timetable provided for full cost attribution for all significant business activities by no later than 1 January 1999 and a process of public benefit assessments to determine whether local government trading enterprises should be corporatised. That process should see businesses corporatised, where assessments show this to be appropriate, by July 2000 at the latest.

Competitive neutrality complaints

Tasmania established an independent competitive neutrality complaints handling mechanism within the Government Prices Oversight Commission (GPOC) through the *Government Prices Oversight Amendment Act 1997* and *Government Prices Oversight Regulations 1998.* Prior to the formal commencement of the GPOC mechanism, an interim mechanism operated within the Department of Treasury and Finance.

Under the GPOC mechanism, an individual may lodge a complaint against a State Government and local government business activities, having first attempted to resolve the complaint with the relevant entity. A desirable feature of the GPOC

process is that a competitive neutrality complaint may be lodged about any government business activity. Tasmania has now widely publicised its complaints handling process.

There have been no formal competitive neutrality complaints in Tasmania as at March 1999. While the State's interim complaints mechanism received three informal complaints in late 1997 and passed these to GPOC for action, in each case the complainant chose not to proceed.

Assessment

The Council assesses Tasmania as meeting its second tranche competitive neutrality obligations. The Council will continue to monitor progress with the implementation of competitive neutrality arrangements at local government level.

Australian Capital Territory

Policy and scope of application

The ACT has implemented competitive neutrality arrangements within its significant business activities, including:

- taxation equivalents and Territory taxes and charges are payable by government owned corporations and many larger authorities, and are progressively being applied on a wider basis, including to small business activities embedded within public agencies; and

- debt guarantee fees are imposed on government businesses, using a credit rating system to distinguish between the risk classes of different public enterprises;

- competitive tendering processes are increasingly used by the Government for publicly provided services to test the cost effectiveness of existing service arrangements and to establish benchmark costings for services.

Competitive neutrality complaints

The ACT Government has established a mechanism for investigating and recommending on competitive neutrality complaints – the Competitive Neutrality Complaints Unit (CNCU) − within the Chief Minister's Department. The CNCU is able to investigate complaints only about businesses that have been formally exposed to competitive neutrality principles.

The CNCU received one complaint during the second tranche assessment period, relating to the provision of long day childcare. This matter is currently under consideration by the ACT complaints body and is not relevant to this assessment of progress.

In assessing second tranche progress, the Council also took account of developments relating to an earlier complaint raised with the CNCU following the ACT Government's announcement that it would fund an aquatic centre with an indoor 50 metre pool and associated facilities in the Belconnen area. The owners of two privately owned swimming facilities in Belconnen were concerned that, while the new

business would be competing with them for the same customers, the new pool would have the benefit of a public subsidy.

The CNCU's investigation in 1997 found that the proposed facility would be in direct competition with the existing pool complexes. It recommended that the ACT Government conduct a public benefit test to assess whether the benefits to the community of the proposed development would outweigh the costs. Following this recommendation, the ACT Government commissioned the Allen Consulting Group (Allen Group) to examine the proposal's net community benefit.

The Allen Group concluded that only the Government could determine the net benefit, if any, because the benefits were largely intangible and some of the costs (and therefore the size of any public subsidy) were dependent on subsidy and pool design choices. It did, however, recommend that to minimise the costs:

- any subsidy be applied on a per-swimmer basis and only for services not commercially available elsewhere in Belconnen;

- that the Government could incorporate "*social objectives such as low entry fees for different categories of user (unemployed people, pensioners, students, etc) …in a subsidy program*"; and

- that both the building and the business of operating the pool be competitively tendered (Allen Consulting Group 1999).

Subsequently the ACT Government has decided there is a net public benefit in proceeding with the aquatic facility in Belconnen. It has placed certain limits on the maximum permissible capital subsidy for the proposed building and instituted a tendering process which is underway at the time of reporting.

Assessment

The Council assesses the ACT as meeting its second tranche competitive neutrality obligations.

The Belconnen Pool complaint illustrates how the provision of services consistent with community objectives can sometimes introduce tensions with policies aimed at achieving benefits through competition. These tensions can be reduced if governments ensure community services are clearly defined, well justified, and delivered effectively.

The Council considers that the ACT Government has pursued this complaint appropriately. The Allen Group recommendations appear to provide a sound approach to maximising the community benefits while minimising the costs, including the potential for harm to competing private pool owners. This goal may be further promoted by adoption of the Allen Group's suggestion that the subsidy be targeted to particular classes of users who may not otherwise be able to afford to pay market prices for entry. For competitive neutrality compliance, prices charged for pool entry, together with any subsidy, should cover the cost of providing the service.

Given that the competitive neutrality complaints process can be a useful tool for monitoring the potential for extending reform, the Council suggests that the ACT's

mechanism allow for investigation of complaints that a business has not been exposed to competitive neutrality principles. This would enable the CNCU to consider whether it is appropriate to apply competitive neutrality reforms to businesses where they currently do not apply.

Northern Territory

Policy and scope of application

The Northern Territory has instituted appropriate competitive neutrality policies that achieve allocative efficiency, effective resource use and transparency.[14] This involves:

- all 11 Government Business Divisions (GBDs) paying tax equivalents and debt costs;
- facilitating the efficient use of resources by having GBDs pay the cost of all resources used in service provision and ensuring prices of goods and services fully reflect costs;
- identifying and costing CSOs;
- reviewing capital structure and dividend policies of GBDs against private sector benchmarks; and
- performance monitoring of all GBDs, involving reporting annually on relevant economic, financial and non-financial performance indicators, as well as analysing and interpreting these indicators.

The Territory Insurance Office, a government owned statutory corporation supplying insurance and financial services, is corporatised and subject to competitive neutrality policy. In addition, the Government is establishing Territory Discoveries, a tourism wholesaling operation established by the Northern Territory Tourist Commission, as a GDB subject to competitive neutrality policy. The Government accepts that Territory Discoveries is a significant business operating in competition with private sector providers.

Competitive neutrality complaints

The Northern Territory Treasury handles all complaints regarding breaches of competitive neutrality policy. Complaints can be made that significant business activities are not applying relevant principles or that the principles being applied are not effective.

The Treasury has received one complaint. On 22 March 1999, it received a complaint from the Australian Council of Tour Wholesalers relating to Territory Discoveries. At

[14] The Council accepts that local government businesses in the Northern Territory are unlikely to be significant for purposes of competitive neutrality policy.

the time of the Northern Territory's annual report, the Treasury was investigating this complaint.

Assessment

The Council assesses the Northern Territory as meeting its second tranche competitive neutrality obligations.

Given that the competitive neutrality complaints process can be a useful tool for monitoring the potential for extending reform, the Council suggests that the Northern Territory's mechanism allow for investigation of complaints that a business has not been exposed to competitive neutrality principles. This would enable the Treasury to consider whether it is appropriate to apply competitive neutrality reforms to businesses where they currently do not apply.