

2 Competitive neutrality

Competitive neutrality (CN) policy aims to eliminate resource allocation distortions by ensuring government businesses do not enjoy competitive advantages over private companies as a result of their public ownership. Clause 3 of the Competition Principles Agreement (CPA) sets down the CN obligations, requiring governments to:

- impose on government business enterprises full Australian Government, state and territory taxes, debt guarantee fees and regulations equivalent to those faced by private sector businesses, and corporatise these enterprises ‘where appropriate’
- implement the same measures for other ‘significant’ government business activities or ensure the prices that those activities charge for goods and services account for tax or tax equivalents, debt guarantee fees and equivalent regulations, and reflect full cost attribution.

Each government is free to determine its own agenda for implementing CN principles and is required to implement the principles only to the extent that the benefits are expected to exceed the costs. Clause 7 of the CPA requires governments to apply CN principles to local government business activities.

The National Competition Council’s assessment of governments’ compliance with the CN obligations is based on each government’s measures to:

- apply CN principles to all government business enterprises and significant government business activities (including local government businesses) to the extent that the benefits outweigh the costs
- effectively investigate and act on complaints that significant government business activities are not applying appropriate CN arrangements.

In addition this year the Council draws on the latest findings of the Productivity Commission’s (PC) three-year research program into the performance of government trading enterprises.

Changes to competitive neutrality coverage

Governments have adopted various criteria for establishing the significance of a government business, such as its absolute size or its perceived impact on

the market. All governments have appropriate CN policies in place that apply to government business enterprises and to other significant (and local government) business activities.

Governments' CN policy statements specify coverage criteria. In its NCP assessments, the Council summarises changes to the application and coverage of CN principles reported by governments in their NCP annual reports. Changes to the approach and coverage of CN policy since the 2004 NCP assessment are noted below:

- *New South Wales*: State Water, formerly a business unit within the Department of Energy, Utilities and Sustainability, and Sydney Ferries were corporatised on 1 July 2004.
- *Victoria*: The Department for Victorian Communities, in conjunction with the Victorian Competition and Efficiency Commission (VCEC), the Department of Premier and Cabinet and the Municipal Association of Victoria investigated local councils' NCP compliance. Seventy-seven councils were found to be fully compliant and five needed to meet with the VCEC to clarify their CN policies. Victoria's 2004 NCP annual report noted that nine councils were assessed as requiring CN compliance training. This training has since been undertaken.
- *Western Australia*: In relation to smaller government businesses considered to be significant, Western Australia's practice is to review whether subjecting the business activity (that is, 'coverage') to CN is in the public interest. Unlike the situation in most other jurisdictions, a CN complaint against a government business cannot progress if the business is not covered.
 - Land Information Statutory Authority: In October 2003 Cabinet approved the establishment of a Land Information Statutory Authority. The department identified that the authority would operate in contestable markets, and a review concluded that the authority should be subject to CN principles.
 - radiation oncology: In Western Australia, one private and one public provider actively compete in the market for radiotherapy services. Since 2002, the private provider has claimed that the public provider's practice of bulk billing private patients places the private provider at a competitive disadvantage. A CN review may take place in 2006 (see the section on complaints below).
 - Eastern Goldfields Transport Board: Western Australia does not propose to undertake a CN review of the Eastern Goldfields Transport Board, despite a complaint against its charter bus operations.
- *South Australia*: In November 2004, the South Australian Government introduced policy guidelines for a new ownership framework for public non-financial corporations. The framework covers three areas: community service obligations, dividend payments and capital structure. The

government approved implementation of the new ownership framework for the South Australian Water Corporation (SA Water) and the South Australian Forestry Corporation (ForestrySA). The new framework supersedes the government's 1996 community service obligation (CSO) policy framework. Currently, specific CSO payments are only made to SA Water and ForestrySA. The Department of Treasury and Finance seeks advice from all agencies annually to confirm ongoing CN compliance for each significant business activity and to identify any new significant business activities.

- *Tasmania*: From 1 July 2004, the *Valuation of Land Act 2001* (Tas.) and the *Local Government Act 1993* (Tas.) were amended to remove impediments that prevented the imposition of rates on all government business enterprises. An exemption from rating was provided for the land on which Hydro Tasmania's generation assets are located. Instead, a memorandum of understanding is being negotiated with Hydro Tasmania, under which the business will pay a rates equivalent to the State Government. The memorandum is an interim arrangement, pending legislative amendments to require Hydro Tasmania to pay a rates equivalent.

Processes for handling complaints

Effective CN policy implementation requires that governments have mechanisms in place to investigate complaints that their businesses breach CN policies. Accordingly, CPA clause 3 requires governments to have a CN complaints handling mechanism. All governments have instituted complaints processes, and their 2005 NCP annual reports document recent complaints and investigations.

Australian Government

The Australian Government Competitive Neutrality Complaints Office (AGCNCO) is an autonomous unit within the Productivity Commission. Any individual or organisation can lodge a complaint on the grounds that: an Australian Government business activity has not been exposed to CN arrangements; that it is not complying with the arrangements; or that the arrangements are ineffective. The AGCNCO can recommend remedial action or that the Treasurer initiate a formal public inquiry into the matter.

The AGCNCO carried out one formal investigation in the period 1 July 2004 to 31 March 2005. On 27 April 2004, Chandler Enterprises lodged a CN complaint with the AGCNCO against EDI Post, a business unit of Australia Post. Chandler Enterprises alleged that mail house services undertaken by EDI Post are priced below commercial rates and derive an advantage in the

market through access to details about the mail volumes of competitors' clients, contrary to CN principles.

The AGCNCO found that EDI Post sets prices in accord with CN principles and that there is no evidence that EDI Post has obtained competitor information from other areas of Australia Post that could provide it with a competitive advantage. Consequently, it found that no further action is required in relation to this complaint.

New South Wales

The New South Wales Government has two mechanisms for dealing with CN complaints against government businesses. The State Contracts Control Board (SCCB) investigates CN complaints relating to tender bids made by government businesses (except those bids relating to local government). The Independent Pricing and Regulatory Tribunal (IPART) investigates all other CN complaints. The IPART and the SCCB investigate complaints that are referred by the Premier.

Complaints against local government businesses are initially referred to the relevant council for consideration. The Department of Local Government can review the matter if the complainant is not satisfied with the outcome. In its 2005 NCP annual report, New South Wales noted that the department did not receive any complaints requiring investigation.

In March 2005, the Premier received a complaint relating to the commercial activities of the Sydney Ferries Corporation. The complaint was referred to Sydney Ferries for an initial response. In the event of an unsatisfactory outcome, the complainant may request that the Premier refer the matter to IPART.

Victoria

The VCEC investigates complaints made by any affected person or business about a government business that may not be applying CN. It also advises government agencies on how to implement CN—for example, by providing training. The VCEC seeks information on CN compliance from agencies within three months of a breach of policy being found and reports to the government on this compliance.

In its 2005 NCP annual report, Victoria detailed new CN complaints against:

- the City of Greater Geelong, in relation to a proposal to allocate funds to upgrade a livestock exchange. The VCEC investigated the complaint which was resolved with no action required.

- the Rural City of Wangaratta, in relation to the pricing of a successful tender bid prepared by the council for the provision of local government enforcement services. The VCEC has commenced an investigation.
- the Moyne Shire Council, in relation to the pricing of a successful tender bid by the council for the provision of road construction services. The VCEC has commenced an investigation.

Queensland

The Queensland Competition Authority (QCA) and the Queensland Treasury are responsible for the administration of CN in Queensland. The Queensland Treasury investigates CN complaints made against significant government business activities on matters that are outside the QCA's jurisdiction. Local governments are required to have processes to deal with CN complaints about their business activities. They may, however, nominate the QCA as a referee for complaints against their significant business activities. In addition, the outcomes from the local government complaints process may be referred to the QCA.

In its 2005 NCP annual report, the Queensland Government reported that the QCA has not formally investigated any CN complaints since April 2004. The Queensland Treasury received several inquiries during 2004-05, with two resulting in CN complaints being lodged:

- Cooper Creek Wilderness, a commercial eco-tour operator on freehold land within a world heritage area, complained that the Queensland Parks and Wildlife Service's partial cost recovery from commercial operators, but not from independent travellers, places its business at a competitive disadvantage. The Queensland Government contends that the matter will not be addressed through the CN complaints process, because Queensland Parks and Wildlife Service is not a business activity.
- Pavement Management Services alleged that the Department of Main Roads selected ARRB Transport Research Limited, a successful applicant in a tender to develop road condition evaluation training across Queensland, on the basis of its government ownership. Treasury concluded the tender process did not breach CN principles in this case, but recommended that the Department of Main Roads improve its communication strategies. The department subsequently confirmed that it had 'revamped' its CN policies, procedures and compliance manuals, and improved its awareness and compliance programs.

Western Australia

Western Australia's complaints handling process involves complainants initially making contact with the agency alleged not to be complying with CN

to discuss and, if possible, resolve the matter. If resolution cannot be reached, complainants can lodge a complaint with the complaints secretariat located within the Department of Treasury and Finance. Where the secretariat assesses a complaint warrants further investigation, it carries out the investigation and reports its finding to the government's Expenditure Review Committee.

In its 2005 NCP annual report, Western Australia advised that two formal CN complaints were received:

- In November 2004, a tourism wholesaler complained about the WA Visitor's Centre and the WA Tourism Network activities of Tourism Western Australia. The complainant alleged that the booking prices charged to tourism operators by the Visitor's Centre fail to recover costs and that the full costs of operating the Tourism Network are not reported by Tourism Western Australia, such that that Tourism Network competes unfairly with commercial booking agents. The allegation against the Visitor's Centre was deemed invalid, because a 2001 CN review found that the cost of implementing CN for the Visitor's Centre outweighed the benefits. The allegation against the Tourism Network was deemed worthy of investigation because the 2001 CN review found that full cost recovery principles should apply. In May 2005, the government authorised an investigation (in progress) into the Tourism Network's compliance with CN.
- In February 2005, a private waste disposal operator complained that its septage waste disposal site was unable to compete with a similar disposal business operated as a joint venture between the Water Corporation and the City of Albany. The complainant alleged that the joint venture's charges were insufficient to cover costs. The Water Corporation is subject to CN, so its involvement in the joint venture should be on a competitively neutral basis. Accordingly, in May 2005 the Government authorised an investigation (in progress) into the corporation's compliance with CN. In relation to the City of Albany, its share of the joint venture's annual income would need to exceed \$500 000 for it to be regarded as a significant business activity. If this test is satisfied, the benefits and costs of applying CN to the city's involvement in the joint venture would need to be assessed. The City of Albany would be responsible for carrying out this review.

South Australia

South Australia appoints competition commissioners who can be assigned to investigate CN complaints. The Department of Premier and Cabinet provides a secretariat for the complaints mechanism. On receipt of a written complaint, the secretariat first refers the matter to the relevant state or local government agency for investigation, response and possible resolution. Where the complaint cannot be satisfactorily resolved, the secretariat considers assigning it to the competition commissioner.

The South Australian Government reported that no new CN complaints were received in 2004. A complaint lodged in 2003 against the Adelaide Festival Centre Trust was referred to the competition commissioner in July 2004. The commissioner's investigation is underway.

Tasmania

The Tasmanian Government Prices and Oversight Commission is responsible for the complaints process. It considers complaints after the complainant has discussed the alleged contravention of CN policy with the government body against which the complaint is made. The commission reports to the Treasurer and the relevant portfolio minister. Where a complaint concerns a government business activity that is not subject to the CN principles, the commission considers whether failure to apply the principles to that business activity has adversely affected the complainant.

The Tasmanian Government reported that the Government Prices and Oversight Commission did not receive any CN complaints in 2004.

The ACT

The Independent Competition and Regulatory Commission is the responsible authority in the ACT for investigating CN complaints. In its 2005 NCP annual report, the ACT Government noted that the commission did not investigate any CN complaints in the twelve month ending 31 December 2004.

The Northern Territory

The Northern Territory Treasury handles CN complaints. The decision to not establish a specialist complaints mechanism reflects the government's view that the cost of such an undertaking would outweigh the benefits, given the territory's relatively small population.

In its 2005 NCP annual report, the Northern Territory Government noted that the Northern Territory Treasury did not receive any CN complaints in the 12 months to 31 March 2005.

Financial performance outcomes

To fulfil the CN principle that government business enterprises should not enjoy any net competitive advantage simply as a result of their public sector

ownership, governments must demand from their businesses a level of financial performance that is similar to that of privately owned businesses with comparable risk profiles. Continuing past analytical work, the Productivity Commission monitored the financial performance, from 1999-2000 to 2003-04, of 83 government business enterprises (which the commission calls government trading enterprises—GTEs) that controlled \$174 billion of assets in 2003-04 and generated \$55 billion in revenue (PC 2005b).

The commission observed a pronounced improvement in the financial performance of GTEs from the early 1980s. Nevertheless, in 2003-04, over half of the GTEs monitored recorded rates of return below the risk-free rate.¹ An even greater number failed to earn a commercial rate of return (a return that includes a margin sufficient to compensate for risk).

Looking at industry sectors, the commission found that the financial performance of the electricity, ports, water and urban transport sectors improved in 2003-04, while the results for the forestry and rail sectors were lower than in 2002-03 (table 2.1).

Table 2.1: GTE return on assets by industry sector

<i>Sector (per cent)</i>	<i>2003-04</i>	<i>2002-03</i>
Electricity	7.8	7.0
Water	4.8	4.6
Urban transport	0.7	0.1
Railways	-10.5	1.4
Ports	7.2	4.8
Forestry	1.8	7.0

Source: PC 2005b.

The Council has re-analysed the return on assets data collected by the commission by jurisdiction. Care must be exercised in interpreting the results owing to important differences in the industry composition of jurisdictional portfolios. Nevertheless, the GTE portfolios of four of nine jurisdictions provided returns above the risk-free rate (the Australian Government, Queensland, Western Australia and the Northern Territory) which was one less jurisdiction than in the previous year. Only one GTE portfolio (owned by the Australian Government) earned a return that could be confidently regarded as commercially satisfactory (table 2.2). The GTE portfolios of three jurisdictions—New South Wales, South Australia and Tasmania—earned aggregate returns significantly below the risk-free rate in both 2002-03 and 2003-04.

¹ Estimated by the Productivity Commission as 5.7 per cent in 2003-04, based on the average rate of return on 10-year Australian Government bonds.

Table 2.2: GTE return on assets, by jurisdiction, weighted by size

<i>Jurisdiction (per cent)</i>	<i>2003-04</i>	<i>2002-03</i>
Australian Government	19.6	15.4
New South Wales	1.8	2.7
Victoria	5.1	6.0
Queensland	5.8	6.0
Western Australia	7.4	7.1
South Australia	5.0	5.2
Tasmania	4.7	4.4
Northern Territory	6.2	2.9
ACT	4.2	6.2

Source: National Competition Council analysis of data from PC 2005b.

Forestry businesses

The Council has taken a specific interest in the performance of government forestry businesses, owing to longstanding community concerns that timber harvested by these businesses may be underpriced. According to the Productivity Commission, monitored government forestry businesses earned a 1.8 per cent aggregate return on their assets in 2003-04, down from 6.7 per cent in 2002-03 (table 5.1). As the commission noted, the profitability of forestry businesses can vary dramatically from year to year, recognising movements in the market value of standing forests, which flow predominantly from changes in demand for timber products. For performance monitoring purposes, annual rates of return need to be assessed in the context of longer term trends and other relevant information. The results reported by the commission (table 2.3) illustrate this volatility—particularly for DPI Forestry, which suffered a much smaller forest revaluation gain in 2003-04 than in earlier years. Only one business—ForestrySA—showed a return above the risk-free rate in 2003-04, down from three businesses in 2002-03.

Two businesses—State Forests of NSW and Forestry Tasmania—produced returns consistently below the risk-free rate over the period 2001-02 to 2003-04. The Council's 2004 NCP assessment report provides explanations by the respective governments. In the case of State Forests of NSW, the low returns reflected:

- heavy investment in expanding its plantation estate over the past 10–20 years, which has significantly expanded its asset base and the annual costs of protecting and enhancing growth stock
- the available cut exceeding processing capacity, weakening State Forests' bargaining power.

The government expects State Forests' profitability to improve over the next 10 to 15 years as plantations mature and are harvested and processing

capacity expands, lifting prices (Government of New South Wales 2004a). State Forests is funded for the provision of community service obligations such as recreational facilities and community fire protection.

Similarly, the Tasmanian Government argues that Forestry Tasmania's low returns reflect recent substantial investment in expanding its plantation estate, and that these returns will improve as these plantations mature. The enterprise is expected to meet or exceed its weighted average cost of capital on all new investments, but not on assets managed for non-commercial purposes, such as parkland (Forestry Tasmania 2003). Estimating the cost of managing non-commercial assets can be complicated as some relevant costs are jointly incurred with managing commercial assets. Nevertheless the Tasmanian Government's failure to fully fund community service obligations delivered by Forestry Tasmania obscures the underlying performance of the enterprise. This issue is likely to have contributed to persistent doubt in the community about the economic viability of the enterprise's investments and pricing.

Table 2.3: Forestry GTE return on assets

<i>GTE (per cent)</i>	<i>2003-04</i>	<i>2002-03</i>	<i>2001-02</i>
State Forests of NSW	2.2	0.5	2.4
DPI Forestry (Queensland)	-3.3	23.8	10.6
Forests Products Commission (Western Australia)	3.9	7.6	6.4
ForestrySA	6.1	6.8	4.6
Forestry Tasmania	3.2	-0.6	1.0

Source: PC 2005b.

Assessment

Governments' application of CN to major government business enterprises and other significant business activities is well advanced. In all jurisdictions, major government business enterprises have been corporatised, other significant businesses have been exposed to CN principles and complaints units established.

Governments are free to determine their agendas for implementing CN, so a divergence in approaches is not surprising. New South Wales applies CN principles to all government businesses unless a specific case is made that the costs of applying CN would exceed the benefits. Conversely, Western Australia has high threshold coverage criteria, such that some sectors/businesses are exempt unless a 'coverage review' determines that CN should apply—the complaints mechanism cannot act until the activity is deemed to be covered. In the state, for example, one private and one public radiotherapy service provider actively compete with each other. In 2002, the

private provider alleged that the public hospital's practice of bulk billing of private patients places the private provider at a competitive disadvantage (box 2.1). A coverage review may occur in 2006 and depending on the review outcome, a CN complaints investigation may arise. In other jurisdictions, this matter would have been resolved.

Some governments appear reluctant to apply CN principles to the commercial activities of universities. In this regard, however, Western Australia has been proactive: its universities have been subject to CN (including a complaints process) since the government endorsed a review of universities' business operations in 2003.

Governments' complaints mechanisms are generally operating satisfactorily but there is scope for improvement. In some jurisdictions, the relevant portfolio minister decides whether complaints should be heard, which may create adverse perceptions about the independence of the process. In some states, a complaint against a government businesses must, in the first instance, be made to that government business. While this requirement may be effective in achieving a relatively quick resolution of the complaint, it is questionable whether it should be mandatory. The need to initially seek resolution with the relevant government business may deter complainants who fear retribution—for example, businesses that compete for government tenders.

Box 2.1: Competitive neutrality coverage reviews

Western Australia does not require businesses operated by public hospitals to apply CN principles. The Council has raised this matter with the government on many occasions since mid-2002, when a private radiation oncology company advised the Council of its concerns about competing with the radiation oncology department of Perth's Sir Charles Gardiner public hospital (SCGH). The Western Australian Health Minister deferred any decision on this matter until a national inquiry into radiation oncology (the Baume inquiry) was completed. The findings of the Baume inquiry were released in September 2002, and an Australian Health Ministers conference endorsed the final report of the Radiation Oncology Jurisdictional Implementation Group made in response to the Baume report.

In mid-2004, officers from the Health Department, the Department of Treasury and Finance (DTF) and SCGH met to determine whether a CN review should be conducted. The Health Department contended that the service did not satisfy the criteria for a significant government business activity and, therefore, did not fall within the ambit of the state's CN policy. However, the DTF noted that the installation of new linear accelerators by July 2005 would increase the value of SCGH's asset base to approximately \$10 million—the state's CN 'significance' threshold. The DTF and SCGH subsequently agreed that a CN review should be conducted in July 2005. In August 2004, the Health Minister committed to a CN review. However, the Health Department subsequently advised that the plan to install linear accelerators had been delayed to January 2006. Given that the CN review is contingent on this expansion, it too has been delayed.

The performance of government businesses has improved as CN has promoted a more dynamic culture through greater transparency and accountability. The adoption of CN principles, including the capacity for private businesses to compete with government businesses on an equal footing, has improved businesses' efficiency, encouraged better services and

more cost-reflective prices for goods and services, and resulted in a more efficient allocation and use of (private and public) resources.

Notwithstanding this progress, the Productivity Commission's performance monitoring of government trading enterprises reveals that most are not achieving fully commercial levels of financial performance. This shortfall could reflect a range of factors, including failure to ensure appropriate pricing, inefficient cost structures, uneconomic activities, over valued assets and/or unfunded community service obligations. Whatever the explanation, poor financial performance by GTEs indicates that the community could derive greater benefits if some resources were allocated to different uses. Governments generally met the explicitly stated obligations of CN several years ago, but realising the objective of CN still appears some way off, bringing into focus the CN obligations that are only implied.

In its latest research paper on GTEs, the Productivity Commission argued that governments, to achieve the objective of CN, must commit to improve the external governance arrangements for GTEs, by:

- clarifying the objectives of GTEs, ensuring a commercial focus is central, and fully funding any community service obligations
- making a clear distinction between external and internal governance, increasing the independence of GTE boards, and improving the transparency of the role of ministers
- strengthening accountability for performance, such as through making statements of corporate intent publicly available.

These matters are bundled within the CN obligation to adopt a corporatisation model, where appropriate and to the extent that the benefits exceed the costs.

The Council encourages governments to consider options for strengthening their corporatisation models, as well as accelerating investigation processes and any necessary remedial actions. After a decade's experience of different models across Australia, the Council urges governments to take the opportunity to search for and adopt only the very best practices for governance of business enterprises.