

What is within the scope of competitive neutrality?

6 February 2023

This short information paper is written to explain and help you provide feedback on our draft recommendations concerning the scope of competitive neutrality.^a It outlines the three main tests for determining whether competitive neutrality principles apply to an activity and our draft recommendations to improve the tests. It can be read alone or with the material listed at the end of this paper.

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

Our terms of reference for the review asked us to consider the benefits and costs of expanding the scope of the NSW competitive neutrality policies beyond significant government business activities. We have considered whether competitive neutrality should apply to a broader set of government activities.

There are a range of situations where the government undertakes activities that could impact competition in a market, but that do not fall within the existing scope of competitive neutrality policies because they sit outside the current definition of significant government business activity. Examples include:

- provision of human services by government in competition with non-government operators (e.g. public hospitals, public primary and secondary schools)^b
- contracting out service provision to, and subsidising, a private operator in a particular industry (e.g. public transport)

^a Section 5 of this paper provides more information on what competitive neutrality is and why we are reviewing NSW's competitive neutrality policies.

^b These services may fall into the category of 'human services'. See section 3 of this paper for a discussion of human services and competitive neutrality.

- taking a minority ownership stake in a business (e.g. by selling a majority stake in a previously government owned business)
- government grants, concessional loans, tax advantages or equity stakes to private businesses to achieve policy outcomes, such as greater employment, innovation or industry development.

We propose to recommend retaining the existing scope of competitive neutrality. Competitive neutrality is likely to deliver the greatest benefits when applied to activities that have a commercial focus and that compete, or could compete, with the non-government sector. Where either of these conditions is not met, the benefits of competitive neutrality may not justify the costs, since many of the benefits come from a shift towards full cost pricing. Full cost pricing would undermine the policy objective of universal access or heavily subsidised services for a targeted group.

There was not strong stakeholder support to broaden the scope of the policies. The current barriers to making a complaint in NSW mean there is limited data that can be used to identify areas of concern. Where specific issues were raised through our consultation that sit outside the proposed scope, we consider that they can be appropriately dealt with through other processes.

Within the current scope of the policy, we propose a range of changes to deliver a clearer, more consistent policy with a more accessible complaints process and stronger reporting obligations. This should provide better information about additional areas of concern that can be used to inform the appropriate scope of competitive neutrality in future reviews.

2 The tests for identifying significant government business activities should be updated

The existing policies have a range of different criteria for determining whether an activity is a significant government business activity. These are different between state and local government activities and in many cases are not well defined or easy to apply.



Competitive neutrality applies to significant government business activities where it is in the public interest to apply them

We are proposing clearer and more consistent tests that government businesses can use to determine whether they are required to apply competitive neutrality to their activities. If any of these tests are not satisfied, then competitive neutrality policy does not apply to the activity:

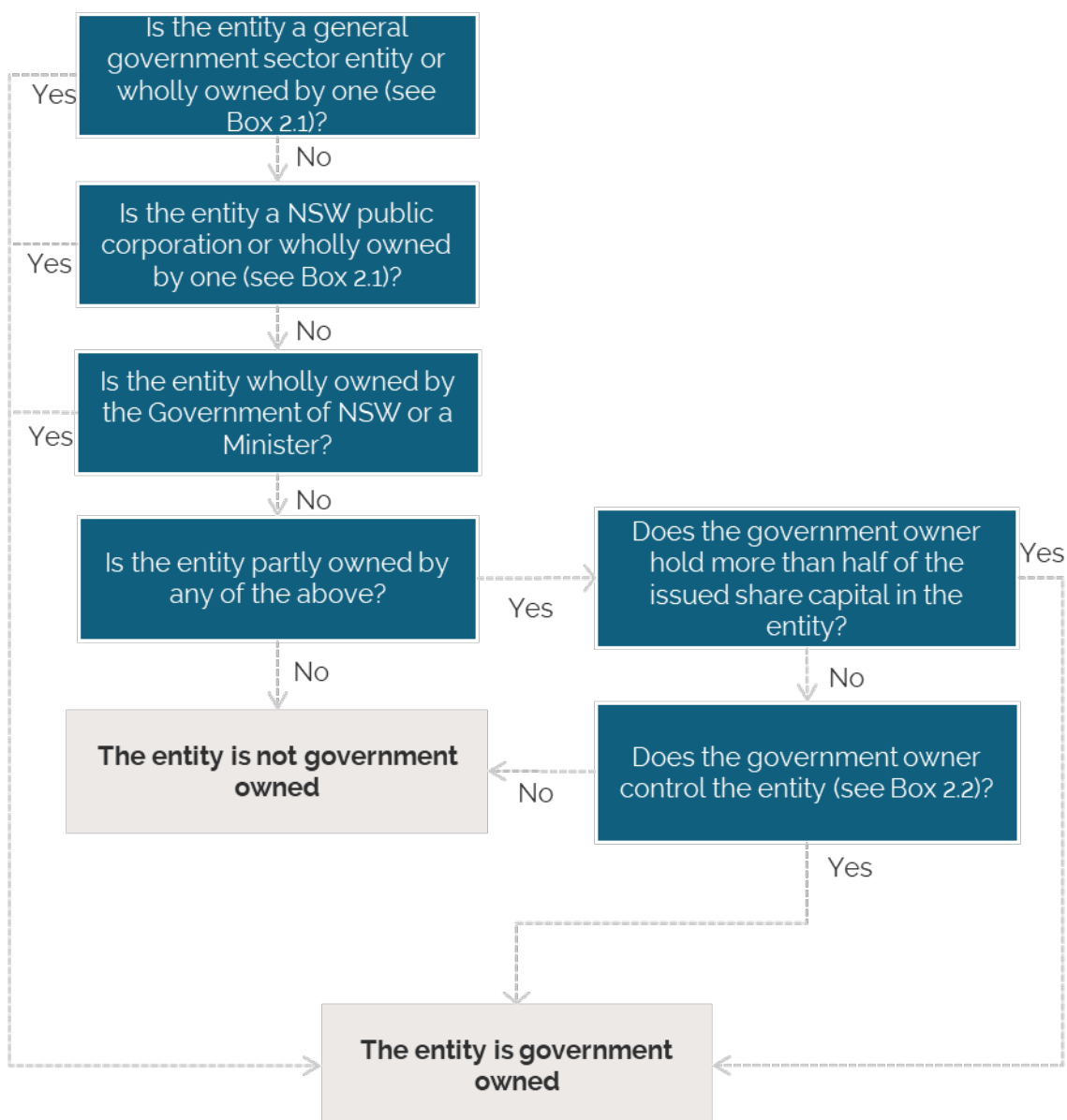
- The government ownership test
- The business activity test
- The significance test.

2.1 The government ownership test

Under our proposed government ownership test, an entity that carries out a business activity is government owned if it is fully or partly owned and controlled, by the NSW State or a local government. Examples of entities that would satisfy this test include government departments and agencies, public corporations (being public non-financial corporations, such as State Owned Corporations (SOCs) or public financial corporations) and local councils; as well as any entities they fully or partially own and control. See the full test proposed in Box 4.1 of the [Draft Report](#).

The proposed government ownership test is described in Figure 2.1. The test is applied to the legal entity that undertakes the activity.

Figure 2.1 Proposed government ownership test



Box 2.1 Example of government owned entities

General government sector entities include:

- NSW Government agencies or departments
- Public corporations
- Councils, county councils or joint organisations
- Persons exercising the functions of a council, county council or joint organisation
- Other general government sector entities.

A NSW public corporation is either a public financial corporation or public non-financial corporation.

Box 2.2 Indicators of control over a partially owned entity

Government owner's powers that indicate control include the ability to do one or more of the following:

- control the appointment or dismissal of a simple majority of the board, or a key committee or subcommittee, or veto appointments
- direct the entity to enter into transactions, or veto changes to transactions for the benefit of the government owned entity or the State
- cast, or control the casting of, more than one-half of the maximum number of votes that might be cast at a general meeting
- appoint or remove, or determine the remuneration of, key personnel (such as the chair, chief executive officer or finance director)
- direct the entity to acquire, manage or dispose of assets, or veto such decisions.

2.2 The business activity test

We propose a single, principles-based business activity test that is consistent between state and local government.

We propose that all activities undertaken by a public corporation, irrespective of the nature of those activities would be considered business activities. Similarly, bidding to supply goods and services (such as, a local council bidding to provide waste services in another local government area) would be included.

Activities carried out by government entities (other than public corporations) would be considered business activities if they involve regular, systematic supply of goods or services with a commercial or business-like character. It is not necessary that a price is charged for the goods and services provided or that the activity makes, or is intended to make, a profit. However, the activity needs to be more than an ad hoc arrangement (for example, a one-off sale of unwanted equipment).

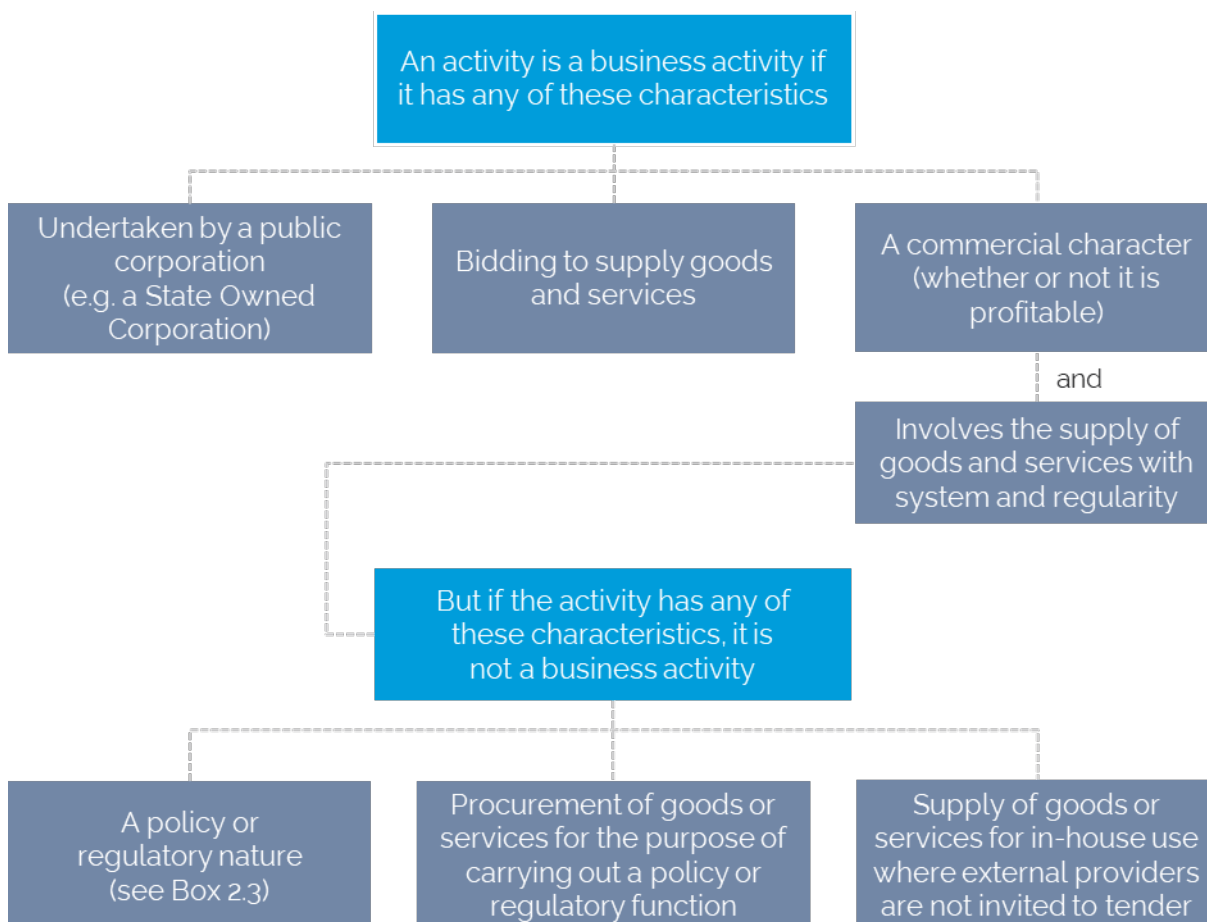
For entities other than public corporations, the following activities would not be considered business activities:

- Policy or regulatory activities – including policy development or carrying out a statutory duty, such as licencing, imposing taxes or levies, or delivering on a legislative obligation to provide free services, where the legislation leaves no discretion to refuse service provision.
- Procurement of goods or services for the purpose of carrying out a policy or regulatory function – for example, engaging a consultant or adviser
- Supply of good or services for in-house use where external providers are not invited to tender – such as, a local council undertaking its own road repairs or facilities maintenance.

See the full test proposed in Box 4.2 of the [Draft Report](#).

The following flow-chart (Figure 2.2) provides an overview of the elements of the proposed business activity test.

Figure 2.2 Proposed business activity test



Box 2.3 Examples of policy or regulatory functions

Activities of a policy or regulatory nature include:

- Functions to perform a statutory duty, such as:
 - granting or refusing to grant licences
 - provision of free services where there is no discretion to refuse service
- Policy development.

2.3 The significance test

The significance test recognises that there is a cost of applying competitive neutrality principles to government business activities and aims to ensure that this cost is only incurred where there is likely to be sufficient benefit from applying competitive neutrality.

We propose that any government business activity is considered significant unless one of the following exemptions applies:

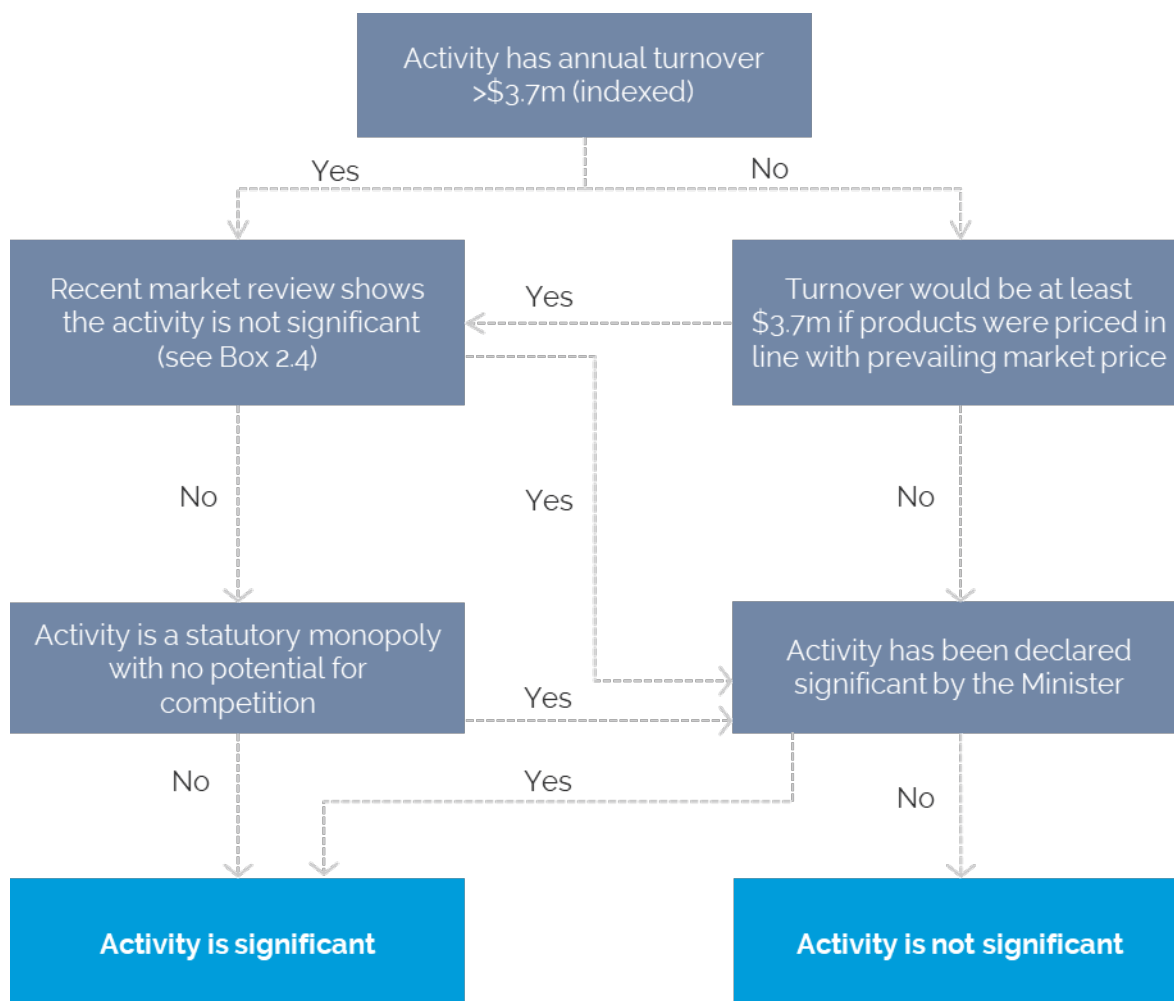
- **Business activities with an annual turnover of less than \$3.7 million are not significant.** This is higher than the current monetary threshold in the local government policies reflecting the change in inflation since the current threshold was put in place. For the exemption to apply, the turnover would need to be below the threshold if the goods and services produced were priced in line with the market price of non-government providers in the same or similar area. This will ensure that government businesses are not exempt from applying competitive neutrality to an activity just because they are pricing the service at a discount to the market.
- **The government business has reviewed the market and found the activity does not have a significant impact on the market.** Further detail on undertaking a market review is provided in Box 2.4.
- **The activity is a statutory monopoly where competition from other providers is prohibited.** Business activities carried out as a statutory monopoly, where legislation prohibits competition from other providers should not be subject to competitive neutrality policy because there will likely be little to no benefit from applying competitive neutrality principles. An example of a statutory monopoly is certain postal services that can only be provided by Australia Post.¹

We are also proposing that even if one of the above exemptions applies, the Minister may determine that a particular activity or group of activities is significant for the purpose of applying competitive neutrality policy.

See the full test proposed in Box 4.3 of the [Draft Report](#).

The flowchart (Figure 2.3) below summarises the proposed significance test.

Figure 2.3 Proposed significance test



Box 2.4 Market review guidance

A market review is inherently subjective. It is, however, a useful way of assessing the significance of a product or service. It involves several steps:

1. Identify the relevant market

This involves considering:

- a. the product or service category in which competition does, or could, exist
- b. the geographic area in which competition does, or could, exist

2. Estimate market share

This involves considering:

- a. the number of actual or potential competitors in the relevant market

Box 2.4 Market review guidance

- b. the volume of sales or customer numbers generated by the business activity compared to its competitors

3. Assess significance

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

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

3 Applying competitive neutrality to human services

In 2015, a review of national competition policy (the Harper Review³) found that there is scope to extend competitive neutrality principles to markets where governments and other providers are supplying services, including human services.

There is no well accepted definition of human services, but we consider that they would generally consist of 3 main groups – welfare services, education services and health services. They may include (but are not limited to) healthcare, childcare, counselling, housing services, disability care, aged care, employment assistance, correctional services, and education. In some cases, human services provided by government entities are subject to competition from non-government providers (for example, private hospitals and private schools). Non-government providers may be for-profit or not-for-profit and may or may not receive government funding in some form.

The current competitive neutrality policies, and the revised policy proposed in our draft report, do not explicitly exclude human services. A human services activity will be in scope for competitive neutrality if it meets the definition of a significant government business activity. It is the nature of the activity that determines whether it is within-scope and not the contestability of the market.

Some types of human services are likely to fall within the definition of significant government business activities. Childcare services, vacation care, aged care and counselling services are examples of activities that are undertaken by state or local government entities and are likely to fall within the proposed definition of significant government business activities.

Other human services provided by government entities are unlikely to be captured. For example, public hospitals and public schools in NSW have a statutory duty to provide certain healthcare or education services for free to eligible residents and have limited discretion to refuse service provision. These types of government activities would not be subject to competitive neutrality policy unless the scope was explicitly broadened to capture them.

4 Further information

See our [review page](#) for further information and resources about competitive neutrality, including:

- terms of reference for the review
- Issues Paper
- Draft Report
- other information papers.

5 We want to hear from you

We want to hear about your experiences with the NSW competitive neutrality policies and processes, and your views on our draft recommendations. Hearing the views of a wide group of stakeholders is very important to us.

We have provided a short list of questions for you to respond to below. You can respond to these questions and/or the broader list of questions in the Draft Report, which provides further information on the issues raised here. We are interested in any feedback you can provide. You don't need to answer every question or stick to the questions asked.



When applying the tests to current government activities:

- Is it clear what activities are and aren't captured by the proposed tests? If not, what refinements would be needed?
- What further guidance might be needed to help apply these proposed tests?
- What are the pros and cons of allowing for the Minister to declare an activity significant?

Have your say

Your input is critical to our review process.

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

[Submit feedback »](#)

[Contact the review team »](#)

[Attend the public hearing »](#)

We are accepting written submissions on our Draft Report until 24 February 2023 and are holding a public hearing on 13 February 2023. You can express your interest in attending our public hearing on our website. If you have any questions regarding the review, are interested in meeting with us or would like to speak to the review team, please contact [Ineke Ogilvy](#).

6 Background

We are reviewing NSW's competitive neutrality policies and processes. Our review is identifying issues and concerns with current competitive neutrality policies and analysing opportunities to improve them. We have considered how the policies compare to best practice and recommend potential improvements in our Draft Report.

Competitive neutrality policies and processes aim to ensure that government businesses do not have a competitive advantage over other businesses because of their government ownership

Government businesses might compete across a range of industries, including in manufacturing, laundry services, construction (including roads), waste disposal, gyms and fitness, tourism services, printing, childcare and aged care.

¹ *Australian Postal Corporation Act 1989* (Cth) pt 3, div 2.

² Harper et al, *Competition Policy Review – Final Report*, March 2015, pp 253-267.