



Competitive neutrality in NSW

Final Report

May 2023

Acknowledgment of Country

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

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

Tribunal Members

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The Independent Pricing and Regulatory Tribunal

IPART's independence is underpinned by an Act of Parliament. Further information on IPART can be obtained from [IPART's website](#).

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Chapter 1 >>

Executive Summary

Overview of the report and recommendations

01

In NSW, state and local governments run a wide variety of businesses. They operate across a diverse set of industries, including manufacturing, laundry services, construction, waste disposal, gyms and fitness, childcare and aged care. Governments run these businesses for a wide variety of reasons. In some cases, these government businesses compete with private providers. In other cases, the government acts as a provider of last resort because there aren't sufficient private providers.

Competitive neutrality policies aim to ensure that significant government businesses do not have a competitive advantage over other businesses simply because they are owned by the government. Competitive neutrality does not prevent governments from running businesses or require privatisation. Competitive neutrality policy does not prevent governments from subsidising business activities where it is in the public interest, but it does require subsidies to be considered and deliberate.

A good competitive neutrality policy gives customers greater choice and better value for money by ensuring that the most efficient, innovative and customer-focused businesses are the ones that thrive. It also gives businesses who compete with, or want to compete with, government businesses the confidence to invest and provides a mechanism to have any concerns with the behaviour of government businesses heard.

Figure 1.1 Getting competitive neutrality right will benefit the people of NSW



Competitive neutrality policy has applied to NSW's state and local government business activities since the late 1990s. It was last reviewed around 20 years ago.

In 2022, IPART was asked to independently review NSW's competitive neutrality policies and processes, to identify issues and concerns with them and to analyse opportunities to expand their scope. We were also asked to consider how the policies compare to best practice and to recommend improvements. The [terms of reference for the review](#) are available on our website.

1.1 There is a strong case for reforming NSW's competitive neutrality policies and processes

Stakeholders are dissatisfied with the current competitive neutrality policies and there is broad support for change.

Through the review we heard from businesses, both large and small, about the lack of clarity around which activities are subject to competitive neutrality and the lack of transparency around whether, and how, the government businesses they compete with have applied it to their activities. We also heard from government businesses about the challenges they face in identifying which activities they need to apply competitive neutrality principles to, and what they are required to do.

Our review has also identified areas where the current policies are out of date, ambiguous or not fit for purpose.

To date, there have been very few competitive neutrality complaints in NSW. However, barriers to making a complaint mean this is not a good indicator of how big an issue competitive neutrality is. We have spoken to businesses that have commenced the process of making a complaint but, after spending significant time and resources on it, ultimately gave up. Because it is so difficult to make a complaint, there may be additional concerns that have not yet come to light.

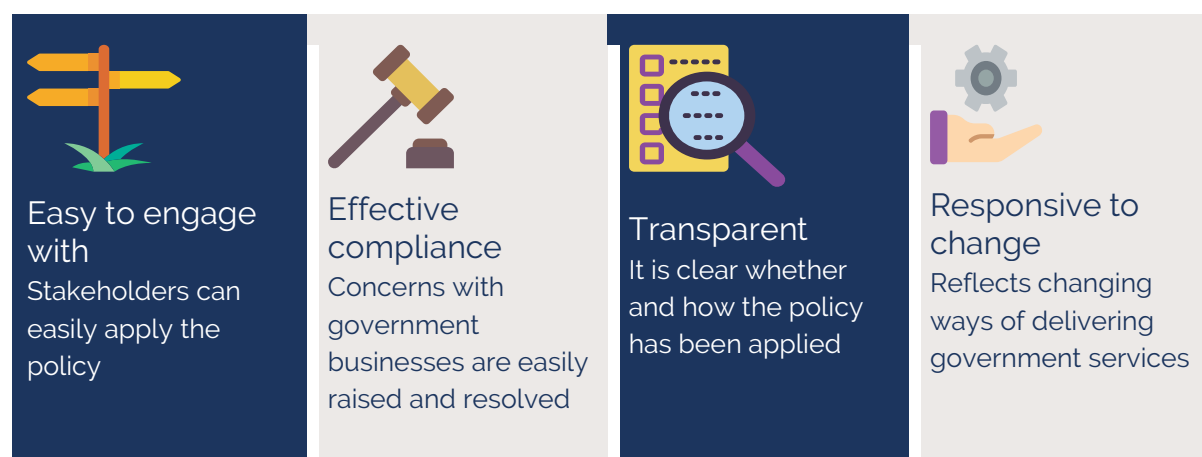
The costs of not making changes to address these issues are considerable. These costs are borne by a range of stakeholders, including non-government businesses across a broad range of industries, government entities, customers and taxpayers.

1.2 Our recommended changes will improve the policy

We have consulted with state and local government businesses, policy owners and non-government businesses. We have made 30 recommendations to address the issues they raised and improve NSW's competitive neutrality policies and processes.

These recommendations aim to ensure that NSW's competitive neutrality policy has the following four best-practice features:

Figure 1.2 Features of a well-functioning competitive neutrality policy



In addition to addressing the issues identified by stakeholders, bringing the policy up to date and delivering a best-practice approach, the recommendations will make it easier to gather data on where competitive neutrality and other competition issues exist. This will provide better evidence to inform future reviews of the policy and ensure that it remains fit for purpose.

1.3 Support is needed to successfully implement the changes

This report sets out recommended changes to NSW’s competitive neutrality policy. It provides better, clearer objectives, tests and obligations. It recommends improved processes, greater transparency and a simpler, more accessible complaints process. However, to ensure the revised policy is successfully implemented, we recommend that the government creates supplementary resources to support government businesses, help them to understand their competitive neutrality obligations under the revised policy and assist them to apply it to their activities. We recommend that this is done using a co-design process, particularly involving representatives from local government, who may have a greater number of activities to consider and limited resources with which to do this.



While we consider that the costs of complying with the revised policy will be lower than the costs of complying with the current policies, we recognise that there will be costs associated with the transition. We recommend that transition to the revised policy occurs when the resources have been developed to assist government businesses, particularly local governments, to adapt to the changes.

Once the policy changes are settled, we recommend that the government develops an implementation plan that maps out a clear transition strategy, including the timeframe for change, to help government businesses to adapt.

1.4 Overview of the recommended changes

Figure 1.3 sets out the key changes proposed and the reasons for the changes.

Figure 1.3 Summary of recommendations

	<p>Recommendation: A single policy that applies to both state and local government activities, with a clear statement of objective and a simpler, more logical structure.</p> <p>Why: A clear, well-structured policy makes it easier to identify who is subject to the policy and what the policy requires them to do.</p>
	<p>Recommendation: Retain the existing scope of the policy and deal with out-of-scope issues through other policies.</p> <p>Why: Competitive neutrality cannot easily be applied to non-business activities and there is currently not enough evidence to justify such a change.</p>



Government ownership test

Recommendation: Competitive neutrality should apply to activities undertaken by an entity that is fully owned or, if partly owned, controlled, by government.

Why: The current test has not kept pace with changes in government ownership structures.



Business activity test

Recommendation: Competitive neutrality should apply to activities that are commercial in nature; are undertaken by a public corporation; or are bidding to provide goods and/or services; and that are not exempt activities.

Why: A clearer test that is similar to business activity tests in other policies and legislation makes the test easier to apply and will deliver more consistent outcomes.



Significance test

Recommendation: Competitive neutrality should apply to significant government business activities. An activity is significant unless its annual turnover is under \$3.7 million (to be indexed)^a or it has a market share below 10%; and the Minister has not declared it significant.

Why: The current test is too complex and lacks certainty. An updated monetary threshold is a simple, low-cost approach. Options to undertake a simple market assessment or recommend Ministerial declaration provide flexibility without adding unnecessary cost and complexity.



Pricing/other obligations

Recommendation: All 'significant government business activities' are required to estimate a price that would be 'competitively neutral' in the market by establishing their costs and adjusting for advantages and disadvantages of government ownership.

Why: Clarifies what obligations the policy imposes, including on state-owned corporations and not-for-profit business activities.



Public interest test

Recommendation: A proportionate approach to assessing whether charging below the competitively neutral price or retaining a non-cost advantage is in the public interest.

Why: A detailed, quantitative public interest assessment may not always be appropriate or within the capability of smaller government businesses.

^a The turnover threshold must not be exceeded if the price of the goods or services was set in line with the market price of non-government providers in the same or similar area.



Reporting

Recommendation: Clear and consistent obligation to report on competitive neutrality in the annual reports of government entities undertaking business activities.

Why: Effective governance and transparency arrangements are important for ensuring that the competitive neutrality policy is followed as intended.



Complaints

Recommendation: A simpler complaints process that is clear and easy to access, removing the requirement for the Minister to refer the complaint for investigation, and with a single complaints body.

Why: An independent and accessible complaints handling process is an important accountability measure for government policies.



Regular review

Recommendation: Review of the policy every five years by the policy owner to determine whether it is operating effectively and is adapting to changes in government service delivery.

Why: The current policy has not been reviewed for over 20 years and is outdated.



Transition and guidance

Recommendation: A transition process, accompanied by tools and resources, to assist government businesses to apply the new policy.

Why: Allowing government businesses to adapt to the changes over time will lower compliance costs and help boost compliance with the policy.



Other issues

Recommendation: Competition issues be considered systematically by the NSW Government when making decisions that impact competition.

Why: Systematic consideration of competition issues ensures that the most productive businesses thrive and helps raise standards of living.

1.5 List of recommendations

Recommendations

- | | | |
|----|---|----|
| 1. | Bring the competitive neutrality policies into a single document that covers both local and state government business activities. | 31 |
| 2. | Apply a consistent set of obligations to all entities regardless of their sector or business structure. | 31 |
| 3. | Include a clear statement of objective and scope up-front in the policy. We recommend the objective is framed around achieving an efficient allocation of | |

	resources through the economy and clearly articulates the benefits of applying the policy. The suggested wording is provided in Box 3.1.	33
4.	Retain the current scope of competitive neutrality policy, which focuses on applying competitive neutrality principles to significant government business activities where it is in the public interest.	37
5.	The 'government ownership test' be revised to improve clarity and make it easier to apply. The proposed test will capture activities undertaken by an entity that is fully government owned or, if partly government owned, controlled by government. The proposed government ownership test is set out in Box 4.2.	47
6.	The 'business activity test' be revised to improve clarity and make it easier to apply. The proposed test focuses on whether the activity is: undertaken by a public corporation; is bidding for goods and services; or it involves the supply of goods and/or services with system and regularity and has a commercial character; and does not fall into any of the excluded categories. The proposed business activity test is set out in Box 4.4.	58
7.	The 'significance test' be revised to better target activities where competitive neutrality is likely to be cost effective. The proposed significance test is set out in Box 4.8. An activity would not pass the significance test where:	74
	a. the activity has an annual turnover below \$3.7 million (indexed over time), or	74
	b. the entity undertaking the activity has assessed it as having a low market impact, evidenced by a market share of less than 10%.	74
	The Minister (either the Treasurer or the Minister responsible for administering Part 4C of the IPART Act) should have the ability to declare an activity significant that would not otherwise pass the significance test.	74
8.	The competitive neutrality policy continues to provide information on how to estimate both avoidable costs and fully distributed costs as valid approaches for estimating a government entity's own cost of business, and clearer guidance on how to select the most efficient approach. The recommended guidance on selecting the most efficient approach is set out in Box 5.1.	82
9.	The approach to adjusting for net cost advantages in the current competitive neutrality policies be retained. However, we recommend that the revised policy provide clearer guidance to assist government entities to estimate an appropriate rate of return.	91
10.	Include guidance in the revised policy on dealing with non-cost advantages and disadvantages. We recommend that the guidance states that where possible, the advantage or disadvantage be removed altogether or converted into an adjustment that can be accounted for in the government entity's costs.	96
11.	Non-cost advantages and disadvantages experienced by government business activities that are not experienced by competitors be treated as a competitive neutrality issue, unless the advantage/disadvantage is already addressed through another policy or obligation. Such advantages or disadvantages could arise from government ownership or market power.	96
12.	The revised policy includes high level guidance on business structure but does not require a government entity to adopt any particular structure for its business activities. We recommend including the guidance in Box 5.9	99
13.	The public interest test be undertaken in accordance with the following proposed framework:	111
	a. define what is being proposed and how it differs from the competitively neutral action	111
	b. identify the benefits and costs considering the factors set out in Box 6.1.	111

c. assess whether the benefits outweigh the costs	111
d. consider whether there is a less costly way to achieve the benefits.	111
14. Different requirements for undertaking the public interest test be imposed on state and local government:	111
a. For local government business activities, a qualitative assessment for the public interest test is acceptable, although the financial cost of the subsidy must be quantified at a minimum.	111
b. For state government, the public interest assessment must be quantitative where possible and reasonable (i.e. effort and cost involved in quantification of costs and benefits is proportionate to the size of the business activity).	111
15. Government businesses re-apply the public interest test for their activities when there are major changes in the market and at minimum, once every 5 years.	111
16. The revised competitive neutrality policy outlines circumstances where government businesses may decide that applying competitive neutrality would not be in the public interest. This includes:	114
a. CSOs that meet the criteria and principles set out in the CSO Guidelines	114
b. below cost pricing where the government business activity has significant up-front costs, the market is growing, and costs are to be recovered within a reasonable period (1-2 years)	114
c. not setting prices to cover dividends, taxes or other costs avoided by not-for-profits or charities (as relevant) where most competitors are not-for-profits or charities, and there is a role for government in the market.	114
17. Public interest assessments be published, subject to the removal of any commercial-in-confidence material. As part of this, a template identifying information for inclusion and information that might be considered commercial in confidence would be developed by IPART.	115
18. The revised competitive neutrality policy encourages but does not mandate consultation on the public interest test.	115
19. The complaints process be made more open and accessible with a single process and a single investigative body (IPART). Complainants would be able to make complaints directly to the investigative body removing the need for Ministerial referral. Restrictions on who can make a complaint and requirements to contact the government business first would be relaxed. Amendments to Part 4C of the IPART Act, section 173 of the <i>Public Works and Procurement Act 1912</i> and Part 3 of the <i>Public Works and Procurement Regulation 2019</i> should be made to give effect to this recommendation.	124
20. IPART has a similar complaint handling process to that in Victoria's competitive neutrality regime, to be implemented through amendments to Part 4C of the IPART Act. Under this process IPART would not be able to initiate an investigation in the absence of a complaint and would not have enforcement powers. IPART would have discretion as to whether it will investigate a complaint.	128
21. The IPART Act be amended to reflect a broader range of options for outcomes from a complaint, including no investigative action or non-investigative action, similar to the outcomes available in Victoria.	129
22. IPART's role in assessing complaints about the public interest test be confined to assessing whether framework requirements have been applied and a reasonable conclusion reached.	129
23. Government agencies undertaking business activities be required to report basic information about competitive neutrality in their annual reports, subject to any	

	commercial confidentiality restrictions (see Figure 8.1). Templates should be developed that clearly set out the minimum reporting requirements for agencies.	138
24.	Agencies provide information on how to make a competitive neutrality complaint on their website, in addition to links to annual reporting on competitive neutrality and their active public interest assessments.	138
25.	NSW Treasury continue to provide advice to support state government entities to understand and apply competitive neutrality policies and principles. This advice would also be extended to local government entities, if the local and state government policies are combined (Recommendation 1).	140
26.	A suite of resources and tools, such as templates and checklists, be developed by the complaints handling body through a co-design process to support stakeholders to understand and apply competitive neutrality policies and principles.	140
27.	NSW Treasury review the competitive neutrality policy every 5 years, consistent with other Treasury review processes. As part of this review, they should report on the following data, at a minimum:	142
	a. the total number of government businesses in NSW, the number that apply CN, the number that pass the government activity and significance tests, and the number that apply the public interest test, and	142
	b. their sector, industry and size (e.g. by revenue, turnover or assets)	142
28.	The revised competitive neutrality policy not extend to councils as a purchaser of services. We recommend that the Office of Local Government considers whether the current regulations and guidance regarding procurement for local councils needs to be revised to include content that is currently sitting within the competitive neutrality policy but that would be removed under our recommended approach.	147
29.	The NSW Government review its processes to ensure that it systematically considers impacts on competition when making policy decisions that are likely to impact competition and which may not be picked up by regulatory impact assessments. This includes:	150
	a. subsidising services in a market	150
	b. acquiring minority government ownership of a business when competitive neutrality policy does not apply because the government does not fully own or, if it partly owns the business, does not control the business	150
	c. providing grants to businesses	150
	d. providing or removing access to data.	150
30.	Provide a transition period to give government businesses time to adjust to the changes. We recommend that this transition period commence once NSW Treasury and IPART have developed and published the advice, resources and training necessary to support and guide government businesses to implement the proposed changes.	156

Chapter 2 »

Introduction

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

02

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

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

Government entities engaged in business activities (referred to in this report as government businesses) can have a range of advantages that are not available to other businesses. These include not having to earn a profit or pay taxes, access to cheaper funds and hidden subsidies. Competitive neutrality policies and processes are aimed at preventing government businesses from using these advantages to out-compete other businesses. They require governments to account for the full cost of providing goods and services and make the value of any taxpayer subsidies explicit. Without them, government businesses may price their goods and services too low, which locks other businesses out even where they are more efficient and ultimately leads to higher costs and poorer services. This does not however prevent government from explicitly deciding to subsidise its business activities when it is in the public interest to do so (see Chapter 6). Nor does it stop governments from running businesses or require privatisation of government businesses.

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

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

2.1 What we reviewed and why

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

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

In NSW, the current competitive neutrality policies:

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

2.1.1 The competitive neutrality policies in NSW are overdue for review

Competitive neutrality policies have applied to NSW's state and local government business activities since the late 1990s. In 1995, the Australian Commonwealth, State and Territory Governments signed the National Competition Policy agreements, which are a set of 3 intergovernmental agreements which establish Australia's National Competition Policy. The 3 agreements are the Competition Principles Agreement (amended in 2007), the Conduct Code Agreement and the Agreement to Implement the National Competition Policy and Related Reforms.

Clause 3 of the Competition Principles Agreement sets out broad competitive neutrality principles and gives each government discretion on how to implement them (as long as their actions are consistent with it).

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

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

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

^a Including potential competitors.

2.1.2 Aspects of the current policies are not working well

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

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

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

2.2 Overview of the review process

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

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

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

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

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

- 3 from local governments or representative bodies
- one from a SOC
- 3 from government agencies in NSW
- 10 from private businesses or representative bodies, representing industries such as water, medical imaging, waste collection, tertiary education, and camping and caravan parks.

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

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

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

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

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

This consultation and our research informed our [Draft Report](#) which was published on 16 December 2022. The Draft Report put forward 30 draft recommendations aimed at improving the policy. We published 7 short information papers to complement our Draft Report.

We received a total of 12 submissions in response to our Draft Report. These submissions included:

- 5 from local governments or representative bodies
- one from a SOC
- 4 from private businesses or representative bodies
- 2 from individuals.

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

On 13 February 2023, IPART held a public hearing for our review of NSW's competitive neutrality policies and processes. The public hearing was attended by 53 individuals (excluding IPART staff). Stakeholders discussed and asked questions about IPART's draft recommendations on:

- the structure and scope of the policies
- obligations and the public interest test
- the complaints process
- governance and transparency.

The transcript, presentation slides and video recording can be found on IPART's [website](#).

The feedback received and research conducted has informed the preparation of this Final Report and our recommendations. A summary of what we heard at the Issues Paper and Draft Report stages is set out below.

2.3 What we heard - Issues Paper and workshops

Stakeholders' views differed on the effectiveness of the current policies and the need for reforms to the competitive neutrality policies in NSW. However, most submissions to the Issues Paper and workshop attendees acknowledged the need to review the NSW competitive neutrality policies. Some submissions and workshop attendees only sought minor updates to the documents to reflect changes since the original drafting. Others advocated for more substantial changes to the policies and guidance documentation. Many stakeholders, particularly state and local government entities, requested further training and guidance documents to support them with compliance. Some non-government businesses also called for a more simplified and direct complaints handling mechanism, so that it is more accessible and easier to navigate for everyone.

Throughout the workshops, state and local government representatives reported a medium to high level of awareness of competitive neutrality within their agencies. However, some workshop attendees in these groups expressed that they had a limited understanding of applying competitive neutrality principles to relevant business activities, such as applying competitive neutrality tests for significance or public interest. Discussions within these workshops seemed to indicate that there is a low level of understanding of the purpose of competitive neutrality policy across state and local government agencies. Several submissions to our Issues Paper also stated that competitive neutrality principles are difficult to apply because the relevant policies are vague or unclear, difficult to read, and hard to source.

Throughout the workshops, we asked attendees how the NSW competitive neutrality policies could be improved. There was a clear demand for training and guidance resources from state and local government representatives. Both submissions and workshop attendees suggested that training and guidance documents should be provided to support them to comply with competitive neutrality policy. In particular, stakeholders called for further guidance and support to understand concepts and testing methods embedded within the NSW competitive neutrality policies.

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

Some stakeholders⁷ raised in submissions to the Issues Paper that the competitive neutrality complaints handling process is inaccessible, difficult to navigate, and that it is not worth the effort of lodging a complaint. During the workshops, some non-government business representatives called for a more simplified and direct complaints handling mechanism. These stakeholders also requested that our review consider the approaches taken towards implementing competitive neutrality policies in other jurisdictions. There was a particular emphasis that we should consider adopting elements of the South Australian and Tasmanian approaches.

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

- The NSW Productivity Commission (part of NSW Treasury) expressed the view that the current competitive neutrality policies are not fit for purpose and are not best practice.⁸
- DPC considered this review of competitive neutrality policy is beneficial to assist the NSW Government ensure its competition policy is fit for purpose for the changing needs of a competitive marketplace. However, DPC also submitted that any expansion of the scope of competitive neutrality policies should be based on a cost benefit analysis to ensure it delivers a net benefit.⁹

Submissions from representatives of local government and state government entities indicated that they generally seek minimal changes to the scope or obligations of the current competitive neutrality policies. In particular, workshop attendees from state and local government entities raised concerns about potentially being required to release further information in their annual reports. They maintained that there is already a considerable regulatory burden to publish financial information in their annual reports. An increase in reporting requirements would incur additional costs relating to gathering data and responding to public questions. Furthermore, these stakeholders asserted that a requirement to publish further financial information could place them in a position of competitive disadvantage. However, the submissions did express support for minor amendments to the existing competitive neutrality policies, including the clarification of key concepts, additional guidance to implement competitive neutrality policy, and a review of the \$2 million significance threshold for local government business activities.¹⁰

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

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

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

2.4 What we heard - Draft Report and public hearing

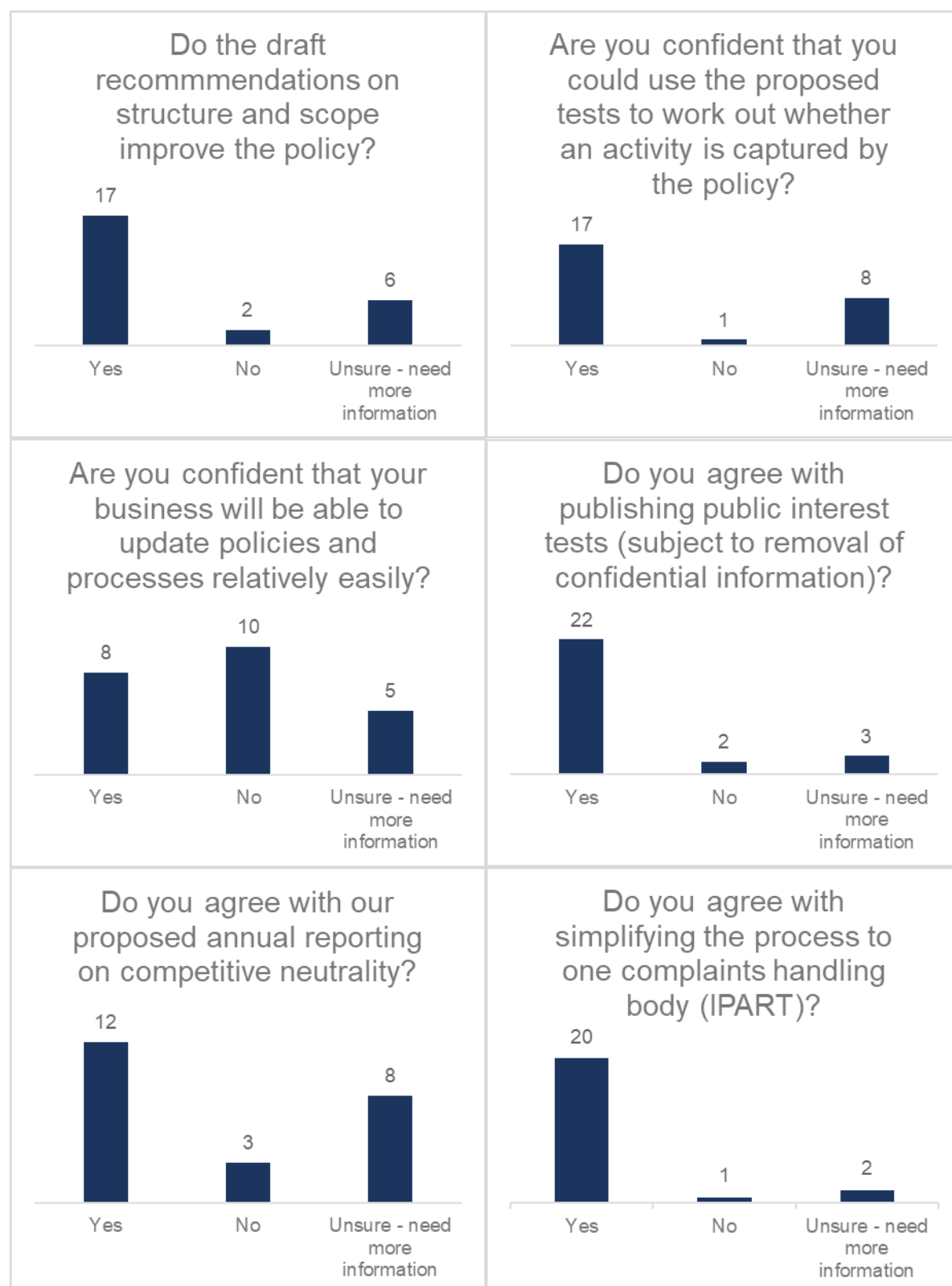
We received feedback on our 30 draft recommendations in the form of written submissions on the Draft Report and via the public hearing, which was attended by representatives from a range of different industries. The key feedback we received was:

- General, though not unanimous, support for updating the competitive neutrality policy, bringing it into a single policy and the proposed changes to the complaints process.
- Support for having a revenue threshold for significance but mixed views on its value.
- Concern from some councils and government businesses about the administrative burden of the proposed annual reporting and estimating a competitively neutral price but support for these measures by non-government businesses.
- Mixed views on the draft proposal to allow complainants to complain directly to IPART without first attempting to resolve the issue directly with the government business.
- Calls for specifics around the proposed transition period – government entities favoured a longer transition period and private businesses supported a short transition period.
- Assistance to implement the revised policy with strong support for templates, training and on-call assistance.

We used live polls during the public hearing to capture stakeholder feedback. The results of some of the polls are shown in Figure 2.1.

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

Figure 2.1 Public hearing feedback



Some government businesses supported the draft recommendations in full.¹¹ Others were keen to ensure that the scope of the policy would not be inadvertently expanded and that the administrative costs of complying with the policy would not be too onerous.¹² Non-government businesses strongly supported change. Their feedback indicated that there is widespread support for clearer tests and obligations, increased reporting and transparency, and for a more accessible and independent complaints process.¹³

There was support for measures to be applied in a proportionate way. For example, there was widespread support for the proposal to permit local government businesses to undertake the public interest test on a qualitative basis.¹⁴

One of the key issues raised in response to the Draft Report was what assistance will be available to stakeholders to assist them to apply the revised competitive neutrality policy.¹⁵ They requested further guidance on various aspects of the competitive neutrality framework, such as the application of the significance test and public interest test, identification of 'business activities' and 'significant' business activities, identification of 'commercial businesses', identification of activities excluded from competitive neutrality, and the application of competitive neutrality in government tendering processes. We recognise that this is a key concern, particularly for local governments.

Representatives from local government entities also emphasised the importance of providing tools, information, and training to support government businesses in navigating and complying with the added regulatory requirements.¹⁶ They highlighted the need for practical resources to help them cope with the increased obligations.

Stakeholders, including both government entities and competing businesses, highlighted key considerations such as:

- promoting transparency and ensuring that government businesses are not burdened with excessive regulatory requirements
- consistency in regulatory requirements and the specific needs or challenges unique to different industries
- consistency or predictability of policy frameworks and the need for such frameworks to be fit-for-purpose
- public interest and fair competition
- anonymity in the complaints handling process and cost-effectiveness.

2.5 How this Final Report is structured

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

Chapter 3 discusses the structure, objectives, and scope of NSW competitive neutrality policy.

Chapter 4 discusses which activities should be subject to competitive neutrality.

Chapter 5 discusses competitive neutrality obligations.

Chapter 6 discusses the public interest test.

Chapter 7 discusses the complaints handling process.

Chapter 8 discusses governance, training, and transparency.

Chapter 9 discusses related issues that are outside the scope of NSW competitive neutrality policy.

Chapter 10 discusses our analysis of the impact of the changes we are proposing on government businesses.

Appendices A-B set out:

- A. Glossary of terms used throughout this report.
- B. Case studies of the full application of competitive neutrality principles.

Chapter 3 »

Structure, proposed objectives and scope

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

03

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

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

The Competition Principles Agreement requires that competitive neutrality be applied to "significant government business activities".¹⁷ We were asked in our terms of reference to consider the costs and benefits of broadening the scope of competitive neutrality to a wider range of activities where government and other service providers operate in the same market, such as human services. If the scope of competitive neutrality policies is too narrow, opportunities that would deliver real benefits for consumers for lower prices, better service quality and greater choice may be missed. On the other hand, if the scope of competitive neutrality policies is too broad, it creates costly administrative processes for little gain and could slow down government processes.

3.1 Overview of the recommendations

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

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

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

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

3.2 A single policy document with a consistent set of obligations

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

The NSW Productivity Commission raised issues about the structure and content of the current policies in its submission to the Issues Paper. It suggested that a refresh of the policy could involve reducing the number of separate policy documents and ensuring that relevant competitive neutrality principles are clear, consistent, and easy to understand.¹⁸

We also heard in workshops that non-government businesses had low levels of awareness of competitive neutrality, while local government businesses had low or medium awareness.¹⁹ Some non-government businesses reported that they had cause to make a complaint but did not know it was an option.²⁰

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

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

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

Several submissions to the Draft Report supported the merging of state and local government policies into a single policy document, including several local councils.²¹ However, this support was not unanimous.²²

Below is an outline of what we propose the policy should cover.

1. Background to competitive neutrality policy
2. The objectives of the policy
3. Application and scope of the policy
 - a. tests for government business activity, significance, and public interest

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

- b. interaction with the Commercial Policy Framework
- 4. Competitive neutrality measures:
 - a. guidance on business structure
 - b. estimating the competitively neutral price
 - c. addressing non-cost advantages and disadvantages
 - d. guidance on pricing below the competitive neutral price or not addressing non-cost advantages
- 5. Compliance and reporting obligations
- 6. The complaints mechanism

State and local government business activities

The Competition Principles Agreement requires the principles in the Agreement to be applied to local governments.²³ It allows for a separate statement of principles for local government.²⁴ Other jurisdictions have adopted a range of approaches – in Victoria and South Australia, a single policy applies to local and state government businesses.²⁵ In Queensland, Western Australia and Tasmania, local government is dealt with separately to state government businesses.²⁶

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

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

We recognise that a complex policy that is difficult to understand is less likely to be successfully applied, particularly by smaller government businesses with limited resources to dedicate to competitive neutrality. In some instances (for example, the public interest test), we have recommended slightly different approaches for local and state government business activities, to minimise the regulatory burden on local government. Generally, however, we have recommended changes to make the revised policy easier to apply for all government businesses, regardless of whether they are run by local or state government.

3.2.1 Corporatised or commercialised businesses

The NSW *Guidelines for Pricing of User Charges (TPP 01-02)* do not apply to government businesses that are part of the Commercial Policy Framework (including both commercialised and corporatised businesses).²⁷ Only the remaining significant government business activities that compete with the private sector are subject to the pricing and costing guidelines.

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

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

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

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

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

Some of the submission comments we have received relate to activities of corporatised government entities.²⁸ Confirming that all government business activities should apply the principles in the competitive neutrality policy will also clarify that these activities can be the subject of a competitive neutrality complaint.

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

3.2.2 Not-for-profit businesses

Some existing NSW Government businesses are also classed as 'not for profit' as per *TPP21-07 Distinguishing For-profit from Not-for-profit entities*,²⁹ including Sydney Opera House Trust³⁰ and Venues NSW.³¹ From a competitive neutrality perspective, establishing government businesses as 'not for profit' could mean that there is no requirement to adjust for (or pay) dividends, or potentially tax equivalents.

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

- Under the Competition Principles Agreement, 'non-business, non-profit activities' of publicly owned entities are excluded from the application of competitive neutrality principles and policies. In our view, this is a reference to activities engaged in by an entity rather than the non-profit status of the entity itself. For example, a large government department may operate a small bookshop selling departmental publications. The presence of the bookshop operation would not determine the classification of the department as a whole.³²
- The 2016 *Intergovernmental Agreement on Competition and Productivity-Enhancing Reforms (IGA)*, signed by 6 jurisdictions, including NSW, re-committed to the application of competitive neutrality principles to government business activities that compete with private providers, whether for-profit or not-for-profit.³³ There may be several interpretations of 'not-for-profit', including application to government businesses, private providers that compete against government businesses or both.
- The NSW competitive neutrality policy statement makes no reference to government not-for-profit organisations.

Local Government NSW's submission to the Draft Report noted the principle that competitive neutrality should not apply to not-for-profit or non-business activities.³⁴

Competitive neutrality applies to government business activities. It does not apply to non-business activities. We propose that the test for whether an activity is a business activity is based on the commercial character of the activity, and not the legal form of the entity undertaking it or its profitability (see Chapter 4 for more information).^c

Not-for-profit organisations play a significant role in the economy and the community more broadly.³⁵ In many industries (childcare for example), it is common for not-for-profit organisations to compete against for-profit businesses.

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

^c For the purpose of applying the significance test, we propose that government businesses with turnover below the threshold should assess whether their turnover would exceed the threshold if they were pricing at market price. There is a need for some flexibility regarding the appropriate comparator for this purpose and in some circumstances, a not-for-profit provider may be suitable. See Chapter 4 for more information.

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

Recommendations

1. Bring the competitive neutrality policies into a single document that covers both local and state government business activities.
2. Apply a consistent set of obligations to all entities regardless of their sector or business structure.

3.3 A clear objective and scope

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

The objective of competitive neutrality policy is the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities: Government businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership. These principles only apply to the business activities of publicly owned entities, not to the non-business, non-profit activities of these entities.³⁶

In drafting their own competitive neutrality policies, each jurisdiction has introduced other objectives and set a scope for their policy. Currently, there are some ambiguities within the NSW policies about their purpose and the circumstances that they apply to. Policy aims and objectives are referred to multiple times throughout the different documents making up the competitive neutrality policies, with changes in wording and emphasis. For example, the local government pricing policy states that the objective of competitive neutrality is to achieve a level playing field between government and non-government businesses, but this is not always consistently reflected in the application of the policy, particularly where costing is concerned.³⁷

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

A clear statement of objectives was supported by submissions to the Draft Report from 2 councils and a private business peak body.³⁸

3.3.1 We recommend the objective focuses on efficiency rather than a completely level playing field (equity)

The proposed objectives statement emphasises the efficient allocation of resources between government and private businesses as the objective of competitive neutrality. This is consistent with the current NSW policies and the approach taken by the Australian Government.³⁹

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

It is common for private businesses (both for profit and not-for profit entities) to coexist with government businesses in a variety of markets. They do not always compete on equal terms. Such inequalities arise from a variety of circumstances and it is the goal of competitive neutrality policy to offset these where appropriate.⁴⁰

Efficiency and equity objectives are largely consistent – for example, it is both efficient and fair for a government business to pay the same taxes as its private sector equivalent, unless this would not be in the public interest. There are, however, differences when government business activities use resources that are owned by general government sector entities. If a general government sector entity has a set of resources with spare capacity, a private business will need to invest in another set of resources to compete. It is generally more efficient for the government entity to make use of this spare capacity.

The Australian Productivity Commission has found that avoidable cost pricing will generally promote the efficient use of any spare capacity, because it reflects the resources used to provide the product.⁴¹ Avoidable costs are the costs that could be avoided if a good or service was no longer provided by an entity. This means in many cases that the cost of the resource with spare capacity will not be included in the competitively neutral price charged by the government business activity. This may be perceived as unfair by private businesses, even though it is economically efficient.

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

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

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

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

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

The Competition Principles Agreement is clear that competitive neutrality principles must only be applied to the extent the benefits outweigh the costs.⁴² That is, implementation of competitive neutrality principles needs to be in the public interest. This should be acknowledged in the objectives of the policy.

Likewise, the inclusion of the phrase 'net competitive advantage' in the Competition Principles Agreement implies there is a weighing up process and that an adjustment is only made if the sum of the advantages from government ownership outweighs the disadvantages.⁴³

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

We have heard from stakeholders that local governments often act as a provider of last resort in markets where there aren't sufficient private providers.⁴⁴ The objectives statement clarifies that competitive neutrality does not seek to prevent governments from running businesses.

Recommendation



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

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

What is competitive neutrality and why do we need it?

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

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

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

What are the benefits of competitive neutrality?

Competitive neutrality policy is designed to promote an efficient allocation of resources and effective competition between government and private businesses. The policies are important to achieving a prosperous economy in NSW that meets the demands of the future.

The outcomes from a well-functioning competitive neutrality policy include:

- Opportunities for non-government businesses to grow and to enter new markets (including in regional areas), by giving these businesses confidence that they will not be disadvantaged due to a government owned competitor operating in the same market.
- Incentives for all businesses to innovate, improve their products and become more efficient due to more effective competition, with benefits for consumers.
- Guiding government decisions to activities that generate the most net benefits for the community. This can allow governments to do more with their limited resources.

What is competitive neutrality *not* about?

Competitive neutrality does **not**:

- Address any advantages or disadvantages that come from size, assets, skills or organisational culture because these are types of advantages or disadvantages other competing businesses may also have.
- Ensure that every business will be able to make a profit or compete in every market.
- Promote privatisation or prevent governments from running businesses,
- Prevent subsidies for government business activities where the subsidies are deliberate, considered and in the public interest.

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

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

3.4.1 Human services can be assessed under the current framework, in the same way as other government activities

In 2015, a review of national competition policy (the Harper Review) found that there is scope to extend competitive neutrality principles to markets where governments and other providers are supplying services, including human services (see Box 3.2).

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

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

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

Box 3.2 Harper review of competition policy

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

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

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

- structural separation
- determining the operational form for government business activities, particularly when the activities sit within a broader range of government functions
- transparent costing and funding of Community Service Obligations.

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

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

3.4.2 The case has not been made for extending the scope of competitive neutrality beyond government business activities

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

We also had regard to the appropriate objectives of competitive neutrality. In section 3.3 of this report we outlined our recommendations for clarifying the objectives of the competitive neutrality policy in NSW. We consider that the scope of the revised competitive neutrality policy should be aligned to its objectives. That is, to promote an efficient allocation of resources between government and private businesses (see section 3.3.1).

We do not propose to recommend expanding the scope of competitive neutrality policies beyond significant government business activities because:

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

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. This was supported by several submissions to the Draft Report,⁴⁵ with Albury City Council noting "It is vital to get the process correct within the current scope. Changes to the scope may be possible in future years after the process is well-defined and understood by participants and stakeholders."⁴⁶

Recommendation



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

While we are not recommending any fundamental changes to the policy scope, we are proposing revised tests for determining whether an activity is undertaken by a government entity, is a business activity and is significant. The proposed tests are designed to remove the ambiguities and inconsistencies in the current tests.

Local Government NSW's view is that the proposed changes to the business activity test would expand the scope of competitive neutrality into "non-business, non-profit activities" and stressed that competitive neutrality should not be applied to these activities.⁴⁷ The revised business activity test has a number of elements within it to ensure that it only captures activities that are commercial in nature (see section 4.3 for more information). However, we do accept that revising the tests for what constitutes a 'significant government business activity' will alter the scope of competitive neutrality policy to some extent. Because the current tests are not clear and are likely to have been applied inconsistently by different government entities, it is difficult to determine exactly what the changes will mean. We continue to support improved clarity within the policy and note that this is supported by both government and non-government stakeholders.⁴⁸

For more information on issues related to this discussion:

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

Chapter 4 »

Which activities are subject to competitive neutrality?

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



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

We are recommending changes to what constitutes a significant government business activity. This would provide clearer and more consistent tests that government businesses can use to determine whether they are required to apply competitive neutrality to their activities.

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

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

4.1 Overview of the recommendations

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

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

We recommend that the policy include the following 3 tests:

- **The government ownership test** – An activity carried out by an entity that is:
 - fully owned, or
 - if partly owned, controlled,
 by the NSW state or local government. Examples of entities that satisfy this test include departments and agencies, State Owned Corporations, local councils; and any entities they fully own or, if partly owned, they control.
- **The business activity test** – An activity is a business activity if it:
 - is undertaken by a public corporation, or
 - is bidding to supply goods and services, or
 - involves regular, systematic supply of goods or services with a commercial or business-like character.

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

However, we recommend that some activities (such as the exercise of regulatory and policy functions) are explicitly excluded.

- **The significance test** - An activity will be significant unless it has an annual turnover of less than \$3.7 million^b (which will be indexed over time) or a market review shows it's not significant. We also recommend that in certain circumstances the Minister may declare an activity significant that would not otherwise pass the test.

If any of these tests are not satisfied, then competitive neutrality policy does not need to be applied to the activity. Each of the 3 tests is set out in more detail below.

4.2 The government ownership test

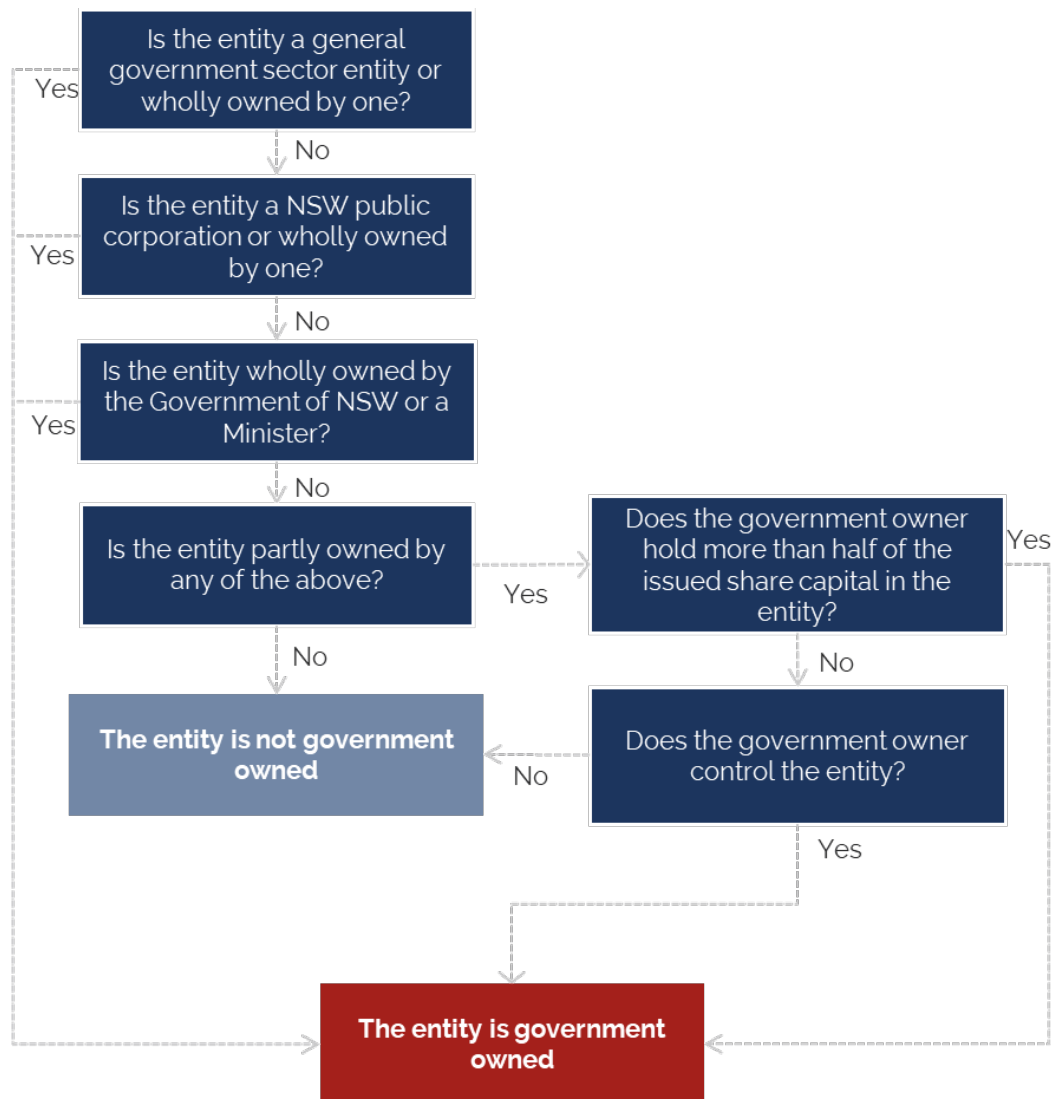
Competitive neutrality applies to government entities that undertake business activities. The first test, and typically the most straightforward, is the government ownership test.

Under our proposed government ownership test, an entity that carries out a business activity is government owned if it is fully owned or, if partly owned, 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 or public financial corporations) and local councils; as well as any entities they fully own, or partially own and control.

Figure 4.1 provides an overview of our recommended approach to the government ownership test. The remaining sections outline the reasons for this approach.

^b To be considered not significant on the basis of low turnover the government business' turnover would need to be below the threshold if it charged market prices for its good and services.

Figure 4.1 Summary of the proposed government ownership test



The following section discusses the current approach to determining whether the government ownership requirement has been satisfied and outlines some of the reasons we are recommending changes to it. Section 4.2.2 provides more information on the specific approach we recommend and why.

4.2.1 The current government ownership test is not fit for purpose

For many businesses, deciding if they are government owned will be straightforward. These businesses will not need to spend time applying the government ownership test, they will already know that they meet the criteria for being government owned.

However, for some types of businesses the situation is more complex, and the current test does not provide a satisfactory way of determining whether competitive neutrality should apply or not. One example of this is partial government ownership. This type of ownership structure is more common than it was when the original policy was drafted. There are numerous examples of government businesses that have been partially privatised with the government retaining some share of ownership.

The current test includes concepts of 'some form of public sector ownership' and being 'subject to Executive control'. These are ambiguous in their application to partially government owned entities. Arguably they do cover partial ownership as:

1. there is no requirement in the current NSW competitive neutrality policy statement for business activities to be wholly government owned — the reference to 'some form' of public sector ownership could be intended to capture partial or minority government owned entities
2. the requirement for Executive control appears to contemplate scenarios where the business activities may not be wholly controlled by government (e.g. the NSW competitive neutrality policy statement refers to universities as not being subject to Executive control).⁴⁹

However, the lack of clarity in the current competitive neutrality policies means it is likely to be extremely challenging for a partially government owned entity engaged in business activities to determine whether and to what extent competitive neutrality policy applies.

The Australian Diagnostic Imaging Association raised concerns about the ambiguity of the meaning of 'Executive control' and its application in its submission to the Issues Paper: "Some government enterprises may dispute the degree of 'executive control' of their operations, which might be used to argue that they are excluded from 'government business' criteria in competitive neutrality tests."⁵⁰

The current policies do not clearly distinguish between the 3 different tests (ownership, business activity and significance), combining the government ownership element with the business activity element. This adds to the complexity of the test and makes it harder to understand and apply. The definition of government ownership is also inconsistent between state and local government.

4.2.2 Changes are needed to make the test easier to apply, more consistent and better able to cope with complex ownership arrangements

We are recommending changes to ensure that the revised policy is fit for purpose no matter what form of ownership a government may have, to simplify the test and to ensure that it can be applied with consistency and certainty.

We recommend replacing the current government ownership tests with a single, two-limb test that uses established categories of government entities and language with clear meaning and definition. This will ensure that any government entity and its competitors can determine whether it falls under the definition with sufficient certainty.

The changes we propose will provide much needed guidance for entities that are partially owned by government. A clearer, more consistent test will also benefit non-government competitors wanting to understand the process and ensure that the policy is better equipped to deal with changes in ownership structures over time. The key changes are discussed below.

The test should be consistent between state and local government

Current competitive neutrality policies take different approaches to determining 'government ownership' for state and local government entities:

- State government: The NSW competitive neutrality policy statement definition of 'government business' includes elements relating to both government ownership and business activities.⁵¹ Public sector ownership and being subject to Executive control are the relevant criteria for government ownership. However, the policy does not define either of these terms.
- Local government: Competitive neutrality policies applying to local government provide no guidance on government ownership. The test for 'government business activity' in the local government policy statement⁵² and local government pricing guideline⁵³ focuses only on the 'business activity' component of the test. It appears to be assumed that council business activities will always be government owned.^c

In order to simplify the policy and ensure that it is applied consistently across NSW, we recommend a single government ownership test for state and local government entities.

This is consistent with the proposed approach in our Draft Report. In response to our Draft Report, Local Government NSW commented that in most cases, local governments can readily determine government ownership, so aligning the tests between state and local government may add unnecessary complexity for councils applying the test.⁵⁴ We do not agree that aligning the tests adds any additional complexity. In contrast, we consider that the benefits of a simple, future-proof test are considerable. Businesses that know they are fully government owned will not need to undertake a detailed application of the government ownership test. As a result, there should not be any additional burden on local councils from aligning the tests.

The test should use established categories of government entities

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

1. the general government sector
2. public non-financial corporations
3. public financial corporations.

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

These classifications are applied across all levels of government in Australia, are well understood within the government sector and should be straightforward for government entities to apply. Classification of an entity into each of the above categories requires an assessment of the level of control exercised by government, so it can be assumed that an entity classified as such is controlled by government. This approach was supported by the Australian Diagnostic Imaging Association in its submission to the Draft Report.⁵⁵

The test should provide a clear way of classifying partially owned entities based on the extent of government control

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

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

Given the variety of legal structures and ways in which control could conceivably be exercised by government, we recommend adopting a principles-based test for determining government control of an entity. The principles-based test would focus on the rights and ability of the government owner to determine decisions affecting the business activities of the entity, rather than the legal form of the entity. Our recommended approach is similar to that taken in South Australia (Box 4.1).

Box 4.1 Partial government ownership in other jurisdictions

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

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

Box 4.1 Partial government ownership in other jurisdictions

The South Australian policy applies when the Government has control over the business activity.⁵⁶ It includes some guidance on government control depending on the type of entity. For example, for an incorporated association it is relevant to consider whether the entity's constitution or rules enable the Government, the Minister, or another instrumentality of the Crown to control the appointment or dismissal of a simple majority of the directors or board members, or to give directions to board members or exercise control over the body.⁵⁷

Competitive neutrality policies for other Australian jurisdictions do not expressly address, or provide very little guidance on, the application of competitive neutrality principles to entities that are partially government owned. Sometimes the application of competitive neutrality principles to such entities can be implied. For example, the Commonwealth policy specifies some entities that are partially government owned as being subject to competitive neutrality.⁵⁸ Tasmanian competitive neutrality policies use terminology such as 'owned or controlled', but do not provide guidance on how control or ownership is to be ascertained.⁵⁹

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

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

1. having a majority of the voting interest
2. the ability to control the composition of the board or governing board (e.g. under the *Corporations Act 2001* (Cth), this is the power of one body to appoint or remove all or the majority of the directors of another body⁶⁰)
3. rights to appoint and determine the remuneration of key personnel
4. rights to direct the entering into, or veto changes to, transactions
5. rights in relation to the acquisition, management or disposal of assets (including veto rights)
6. rights attaching to loans and other contractual arrangements.

Recommendation

5. The 'government ownership test' be revised to improve clarity and make it easier to apply. The proposed test will capture activities undertaken by an entity that is fully government owned or, if partly government owned, controlled by government. The proposed government ownership test is set out in Box 4.2.

Box 4.2 Proposed government ownership test

1. Each of the following entities, and organisational units within those entities, are government owned:
 - a. general government sector entities^e, including:
 - i NSW Government agencies and departments
 - ii councils, county councils or joint organisations or any person exercising the functions of a council, county council or joint organisation^f
 - b. public non-financial corporations, including State Owned Corporations^g
 - c. public financial corporations^h
 - d. an entity (whether incorporated or unincorporated):
 - i wholly owned by the State or any of the entities described in paragraphs (a) to (c), or
 - ii if partly owned by the State or any of the entities described in paragraphs (a) to (c), it is controlled by the State or the relevant entity.

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

2. For the purposes of paragraph 1(d)(ii), the State or a government owned entity described in paragraphs (a) to (c) of paragraph 1 controls another entity if:
 - a. it holds more than half of the issued share capital in the other entity, or
 - b. alternatively, it can do any one or more of the following things – based on legislative powers (e.g. Ministerial powers of direction), the other entity's constitution or rules, or contractual or other arrangements (such as a shareholder agreement or loan agreement):

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

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

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

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

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

Box 4.2 Proposed government ownership test

- i cast, or control the casting of, more than one-half of the maximum number of votes that might be cast at a general meeting of the other entity
 - ii control the appointment or dismissal of a simple majority of the board or other governing body members, or can veto appointments
 - iii control the appointment or dismissal of a simple majority of a key committee or subcommittee, or can veto appointments
 - iv appoint or remove, or determine the remuneration of, key personnel (such as the chair, chief executive officer or finance director)
 - v direct the other entity to enter into transactions, or veto changes to transactions for the benefit of the government owned entity or the State
 - vi direct the other entity to acquire, manage or dispose of assets, or veto such decisions.
3. Where there is more than one government owner of an entity with rights of the kind described above, those rights should be considered in aggregate. For example, 2 government owned entities who can jointly, but not independently, control a third entity, should be taken to each control the third entity. The 2 government owned entities would both be required to ensure the third entity applies competitive neutrality principles to its significant business activities.

4.3 The business activity test

The Competition Principles Agreement makes clear that competitive neutrality principles do not apply to the 'non-business, non-profit activities' of government entities.⁶¹ Given the breadth of activities undertaken by government, deciding whether an activity is a business activity is likely to be the most challenging of the three tests. It is critical that the test is clear enough to provide an answer with sufficient consistency and certainty while still being flexible enough to be applied to the whole range of different activities that government entities are involved in.

Under our proposed business activity test, the following would be business activities, unless they fall under one of the exclusions set out in the test:

- activities undertaken by a public corporation
- activities that are bidding to supply goods and services
- activities that involve regular, systematic supply of goods or services with a commercial or business-like character.

The following activities are listed as exclusions, and are not business activities:

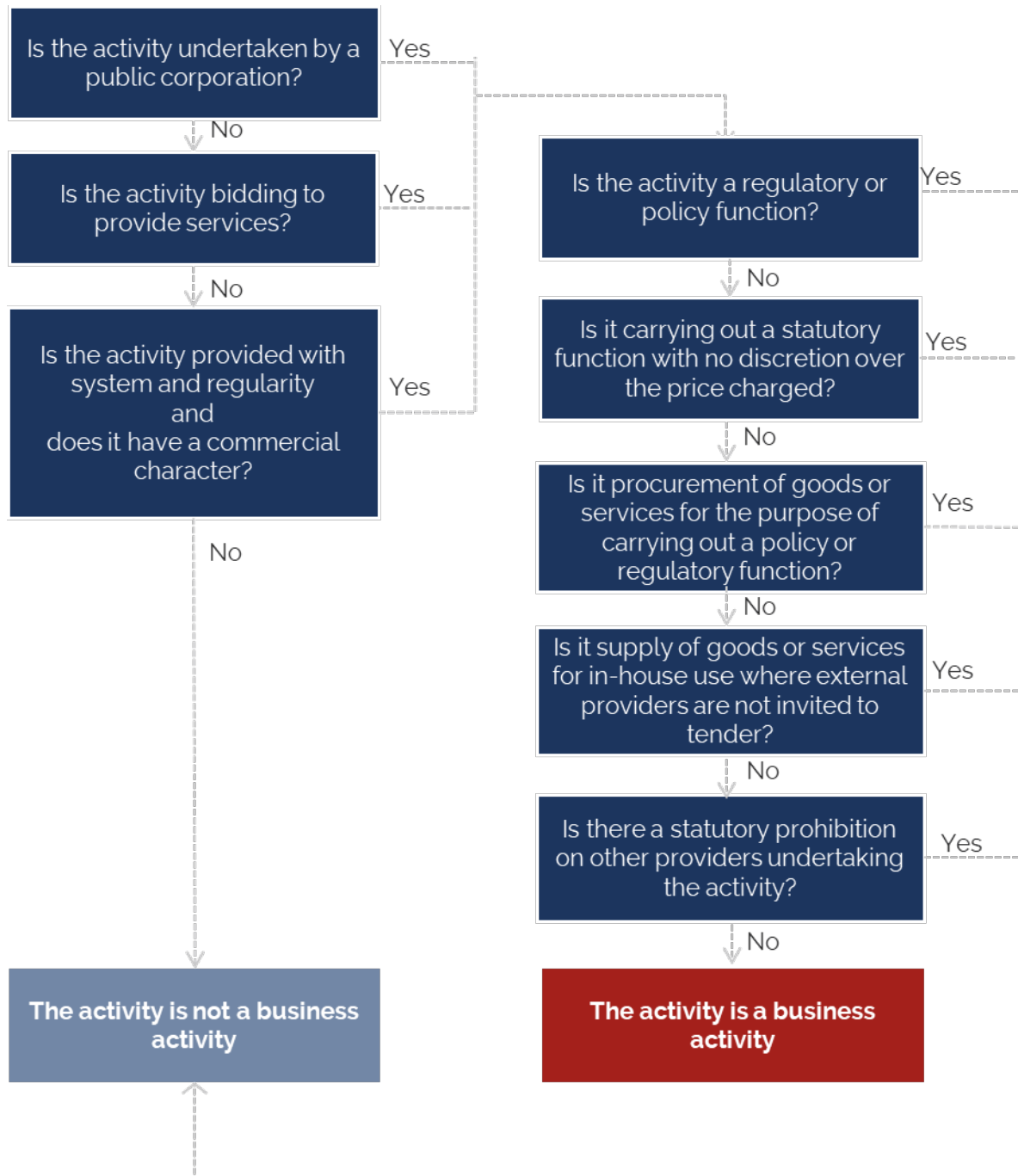
- Policy or regulatory activities – including policy development or carrying out a statutory duty, such as licencing, imposing taxes or levies,

- Carrying out a statutory duty to provide services with no discretion to set their price.^j
- 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 goods 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 where external providers have not been invited to tender.
- Activities where there is no prospect of competition because there is a statutory prohibition on other entities undertaking the business activity (i.e. the activity is a statutory monopoly).

Our recommended test has changed from what was proposed in our Draft Report. The key changes are the inclusion of the statutory monopoly exclusion in the business activity test (previously included in the proposed significance test) and that the proposed exclusions apply equally to the three categories of business activities. See the full test proposed in Box 4.4. The following flow-chart (Figure 4.2) provides an overview of the elements of the proposed business activity test.

^j This exemption would apply only where there is no discretion to set the price at all (e.g. it is specified in legislation or determined by an independent body). The exemption would not be available where the government business retains some discretion, e.g. where a maximum price is specified but the entity has discretion as to the price it sets below that maximum.

Figure 4.2 Proposed business activity test



The following section discusses the current approach to determining whether the business activity requirement has been satisfied and outlines some of the reasons we are recommending changes to it. Section 4.3.2 provides more information on the specific approach we recommend and why.

4.3.1 The current business activity test is complex and unclear

It is important that the business activity test in the revised competitive neutrality policy helps government entities and their competitors to determine which activities are subject to the policy and which are not.

State and local governments provide a range of different services to their communities, which range from activities that are clearly businesses to activities that are clearly not, with a lot of services falling somewhere in between. Even some of the core services provided by state government entities, like public schools and hospitals involve activities that are provided to some extent by private businesses.

Under the current policies, there are different approaches to defining government business activities for state and local government. The current policies include tests that mix elements of government ownership, business activities and significance within the one assessment. In our view, these make the tests for whether competitive neutrality should be applied to an activity more complex than they need to be. The current tests also are not consistent with tests under other legislation and policies that aim to make similar assessments.

The current NSW competitive neutrality policies for state government entities include only limited express exclusions for taxes, fines and regulatory fees.⁶² There are no express exclusions in competitive neutrality policies for local government.

4.3.2 Changes are needed to make the test easier to apply, more consistent and flexible

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

In line with the intent of the Competition Principles Agreement, we propose that activities undertaken by public corporations and that are bidding to provide goods and services are classified as business activities.

For other activities, we consider that the test should focus on commercial character rather than on profitability or user charging. In response to the Draft Report, Local Government NSW disagreed with this approach. Local Government NSW submitted that this definition appears to be too broad and would capture many activities that councils and the community would consider to be standard council services. Local Government NSW is of the view that the test should be based on whether the activity is being conducted with commercial intent, including the intention to make a profit or achieve full cost recovery.⁶³

We consider that there is a need to focus on activities that have a commercial character rather than those where the government entity intends to make a profit. In the context of competitive neutrality policy, the distinction is important because failure to price goods and services at a level that includes a profit or recovers costs may be an indication that competitive neutrality is not being adequately applied. As such, this should not be relied on as justification for not needing to apply competitive neutrality to an activity. The test we have proposed is derived from relevant legal precedent and approaches in other jurisdictions where we consider they are best practice. The proposed test also reflects the requirements of the Competition Principles Agreement.

The test explicitly excludes activities that are widely regarded as non-business activities or that cannot be undertaken by non-government entities.

We consider that the existence of a community service obligation (CSO) should not be a determining factor in whether an activity is a business activity but should instead be considered as part of the public interest test.

We explain each of the changes we are recommending below.

The same test should apply to state and local government

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

Some submissions expressed support for aligning the application of competitive neutrality policy to state and local government entities. Local Government Professionals Australia said, "it is unclear why there are more onerous requirements for councils compared to the NSW Government".⁶⁴ The NSW Productivity Commission recommended that "state and local government definitions of a business activity could be aligned to promote consistency".⁶⁵

This approach is consistent with competitive neutrality policies in other states (Box 4.3). Only Queensland adopts different tests for what constitutes a 'business activity' for state and local government entities.

Box 4.3 Business activity tests in other jurisdictions

Most Australian jurisdictions apply a principles-based test for activities carried out by government entities that are not public non-financial corporations or public financial corporations or otherwise corporatised under state/territory law. Only the Northern Territory adopts a different approach, where the Treasurer can determine that an agency, or part of an agency, is a 'government business division' if it recovers a significant proportion of its operating costs through charges on users.⁶⁶

Several jurisdictions impose requirements for profitability or cost recovery in their 'business activity' tests. In Western Australia, the entity supplying the good or service is required to recover all costs or a significant proportion of them from the supply of the good or service. South Australia requires the activity to have a commercial or profit-making focus. Queensland requires the entity to meet a substantial part of their operating costs or earn a substantial part of their operating revenue from user charges. Victoria requires the costs of providing the goods or services by the entity to be predominantly met by users.

Box 4.3 Business activity tests in other jurisdictions

Several Australian jurisdictions expressly exclude regulatory and policy functions. Queensland, South Australia, Western Australia and Tasmania each have some exclusions including activities that have a predominantly regulatory or policy making role⁶⁷ and/or the imposition of fees and charges in connection with those functions.⁶⁸ The Commonwealth Government, Tasmania and Western Australia exclude taxing and licensing activities.^{69 70 71}

Queensland and Western Australia exclude the supply of goods and/or services by a government entity for its own in-house use where external providers have not been invited to tender to supply the goods and/or services.⁷² South Australia and Tasmania go further, extending the exclusion to certain types of government-to-government service provision. South Australia excludes any government-to-government service provision where, by reason of policy or law, there is no competition with the private sector.⁷³ Tasmania is broader and excludes services provided and used solely by state government departments, whether or not under a tied contract arrangement.⁷⁴

Some jurisdictions have chosen to exclude community service obligations (CSOs) from the meaning of 'government business activity'. Queensland expressly excludes activities that have responsibility for providing a CSO or social policy function as their prime function.⁷⁵ Victoria requires there to be actual or potential competition for an activity to be considered a business. A government entity exclusively responsible for delivering a CSO is identified as one circumstance in which there is no actual or potential competition.⁷⁶ All other jurisdictions consider CSOs as part of applying the public interest test.

The test should automatically include some activities as business activities

We recommend that any activity carried out by a public non-financial corporation or public financial corporation is assumed to be a business activity, unless one of the categories of exemptions applies. This is consistent with the Competition Principles Agreement which requires the application of competitive neutrality principles to significant public non-financial corporations and public financial corporations where it is in the public interest.

All NSW SOCs are public non-financial corporations (e.g. Sydney Water and Hunter Water). We understand that council water and sewerage businesses are also public non-financial corporations.^{k77} Examples of public financial corporations include icare and TCorp.

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

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

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

One stakeholder proposed expressly adding the provision of free and low-cost camping sites to the list of activities stated to be business activities for local government, in addition to commercially operated government owned caravan parks and camping grounds.⁷⁸ Except for the circumstances described above (activities undertaken by a State Owned Corporation or bidding to provide services), we do not recommend specifying a list of entities or specified industries which are deemed to be carrying out business activities because:

- Competitive neutrality policy applies across all industries in which government owned entities engage in business activities. The breadth of potential application means that adopting such a prescriptive approach would likely result in inadvertent over- or under-capture.
- Government business activities are likely to evolve over time. The range of activities undertaken by local governments is now quite different to when competitive neutrality policies were first introduced. The local government pricing guideline currently specifies water and sewerage services, abattoirs, gas production and reticulation as local government business activities.⁷⁹ The submission from Local Government NSW indicates that, of these, councils currently only provide water and sewerage services.⁸⁰

A principles-based approach will enable competitive neutrality principles to be applied consistently by state and local government entities regardless of the industry or evolving nature of the activities.

For other activities, the test should focus on the commercial and business-like nature of the activity

We consider that a best practice approach would be to adopt a set of principles for the NSW competitive neutrality policy business activity test that are broadly consistent with that concept under competition and consumer law. Government entities need to make a similar assessment when determining whether they are 'carrying on a business' and so subject to relevant prohibitions in the *Competition and Consumer Act 2010* (Cth) (Competition and Consumer Act). The concept of 'carrying on a business' for the purposes of the Competition and Consumer Act is partially defined in that Act, and has evolved through case law over time.

This line of cases identifies and explains relevant indicators of government entities carrying on a business, recognising characteristics of the business activities of government entities that are unique or distinct from those of non-government entities. The policy objective of ensuring that the Commonwealth, State/Territory and local governments are, in their commercial activities, subject to the same regime as other corporations — is similar to (although not the same as) the objective of competitive neutrality policy.

We have not sought to codify or replicate the current case law position. Rather, we have drawn on the case law to identify key factors that indicate an activity is business-like, with the aim of developing principles relevant to this context that are clear and easy to apply. Using this information, we recommend a principles-based approach be adopted for the 'business activity' test.

This approach was supported by the Australian Diagnostic Imaging Association in its submission to the Draft Report.⁸¹

The 2 key elements that we consider should be captured within the test are:

- The activity should involve the supply of goods/services with repetition, system and regularity
 - The entity may provide the goods/services to individuals, non-government entities (such as private businesses or not-for-profit entities) or other government entities. For example, the activity of a state government entity that provides services to councils could be a business activity.
 - Engaging in an activity on a single occasion or only as an ad hoc response to an infrequent occurrence or circumstance will not normally be a business activity, as it is not carried on with system and regularity.
- The activity should also have a commercial character and be carried on in a business context, but need not be profitable
 - This could include, for example, activities involving the marketing of goods and/or services (but not promotion of government policy, such as advertising encouraging utilisation of public transport).
 - There must be an element of trade or commerce that a private citizen or trader might undertake. For example, the provision of gym and leisure facilities (with system and regularity) by a council is the type of activity that a private trader might undertake.
 - The managers of the activity have a degree of independence in relation to the production or supply of the good or service and the price at which it is provided. The absence of any restrictions prescribed by law or explicit government policy (including Ministerial direction) will usually be sufficient to demonstrate that the business has a degree of independence in relation to the price and level of production or supply.

We consider the commercial character of the activity to be a critical feature that distinguishes the business activities of an entity from its non-business activities. However, we do not consider focus on profitability or predominant/full cost recovery to be the best indicator of commerciality.

Government entities may engage in business activities, not for the purpose of profit or for full cost recovery, but to achieve a policy objective. This doesn't necessarily detract from the business-like nature of the activity. A focus on profitability or full cost recovery could also perversely incentivise government entities to choose not to pursue profitability or full cost recovery as a means of avoiding the need to apply competitive neutrality policy.

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

While both limbs of the test must be satisfied, the extent to which they have both characteristics can differ. For example, for an activity that is provided below cost to be considered a business activity, it is likely that a greater degree of system and regularity is needed than would be required for an activity that is undertaken for a profit. The test requires the government entity to form an opinion on whether the activity has a business-like character considering all the circumstances.

Our case studies (Appendix B) illustrate what considerations will be relevant when determining whether an activity has the requisite commercial character.

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

Governments undertake a broad range of activities as part of their core government functions. We recommend that the business activity test is clear that these core government functions are not business activities for the purpose of applying competitive neutrality policy. There are other activities where the government has legislated a government entity as the sole provider of particular services. In this case, where there is no prospect of competition, we do not consider competitive neutrality principles should apply.

We recommend that the following activities be explicitly excluded from the meaning of 'business activity':

- **Activities of a policy or regulatory nature**, as these activities are not business activities, but functions inherent to government or carried out in performance of a statutory duty (e.g. the granting of a licence subject to a fee). These activities include:
 - policy development
 - carrying out functions to perform a statutory duty, such as:
 - imposing taxes, levies, licensing or other regulatory fees
 - granting, refusing to grant, revoking, suspending or varying licences or approvals
- **A statutory duty to provide services with no discretion to set their price** (e.g. public hospitals in NSW have a statutory duty to provide certain services to patients free of charge, as do public schools). This exemption would only apply where there is no discretion to set the price at all (e.g. it is specified in legislation or determined by an independent body). The exemption would not be available where the government business retains some discretion, for example, where a maximum price is determined by an independent body but the entity has discretion as to the price it sets below that maximum.

- **Procurement of goods and/or services for the purposes of carrying out policy or regulatory functions** (e.g. a government department procuring consultancy services). While a government entity may acquire goods and services systematically and with regularity to assist it to carry out its policy or regulatory functions, it is not engaging in a business activity when doing so. This exclusion should not apply to the procurement of goods and/or services for the purposes of engaging in business activities. For example, the purchase of inputs to production of goods or services or the purchase of goods for resale.
- **The supply of goods and/or services by a government entity for its own in-house use** where external providers have not been invited to supply the goods and/or services. The exemption is designed to capture services such as in-house legal services, or councils undertaking their own road or facilities maintenance. This exclusion is not intended to apply to government entities who source goods and/or services from another government agency.
- **The supply of goods and/or services where there is no possibility of supply by any other entity** because there is a statutory prohibition on other entities undertaking the business activity (statutory monopoly). We recommend excluding business activities where there is no potential for competition from non-government providers, to recognise that there are unlikely to be net benefits from applying competitive neutrality to those activities. In our Draft Report, this exclusion was captured as part of the significance test. Having considered this in more detail we consider that it is more appropriately captured as an exclusion to the business activity test. Where part of a government entity's activities are provided as a statutory monopoly and part are not, this exclusion only applies to those activities covered by the statutory prohibition and not to all activities of the entity. For example, the NSW Electoral Commission is appointed to conduct and administer Legislative Assembly and Legislative Council elections. However, it may also conduct elections for any other person, body organisation for a fee or charge determined by the Commission (including local government and other organisations). Competitive neutrality would not need to be applied to the conduct of Legislative Assembly and Legislative Council elections, but would need to be applied to electoral services provided by the Electoral Commission to other entities, including local government.

Community service obligations (CSOs) should not automatically be excluded

We also considered whether activities related to the provision of CSOs should be excluded from the meaning of 'business activity'. For state government, a CSO is an activity that satisfies the following criteria:

1. it would not be pursued by a government business operating on a purely commercial basis
2. it has a specified policy objective
3. there is an explicit government agreement, as in either a portfolio Minister directive or government department agreement, with the business that the activity should be pursued, and
4. there is funding from the responsible government department.⁸²

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

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

Incorporating an exclusion for CSOs from the meaning of 'business activity' would present 2 risks given the divergent CSO regimes in place for state and local government entities in NSW:

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

Recommendations



6. The 'business activity test' be revised to improve clarity and make it easier to apply. The proposed test focuses on whether the activity is: undertaken by a public corporation; is bidding for goods and services; or it involves the supply of goods and/or services with system and regularity and has a commercial character; and does not fall into any of the excluded categories. The proposed business activity test is set out in Box 4.4.

Box 4.4 Proposed business activity test

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

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

and the activity is not one of the following, which are excluded from the meaning of 'business activity':

- an activity of a policy or regulatory nature, such as:
 - policy development
 - carrying out functions to perform a statutory duty, such as:
 - imposing taxes, levies, licensing or other regulatory fees;
 - granting, refusing to grant, revoking, suspending or varying licences or approvals;
- a statutory duty to provide services with no discretion to set the price
- procurement of goods and/or services by a government entity for the purposes of carrying out policy or regulatory functions (e.g. the procuring of consultancy services by a government department)
- the supply of goods and/or services by a government entity for its own in-house use where external providers have not been invited to tender to supply the goods and/or services
- an activity for which competition is prohibited under legislation (i.e. the government entity is legislated as the exclusive provider of the activity and there is no potential for competition from other providers).

4.4 The significance test

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

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

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

We recommend that the significance test:

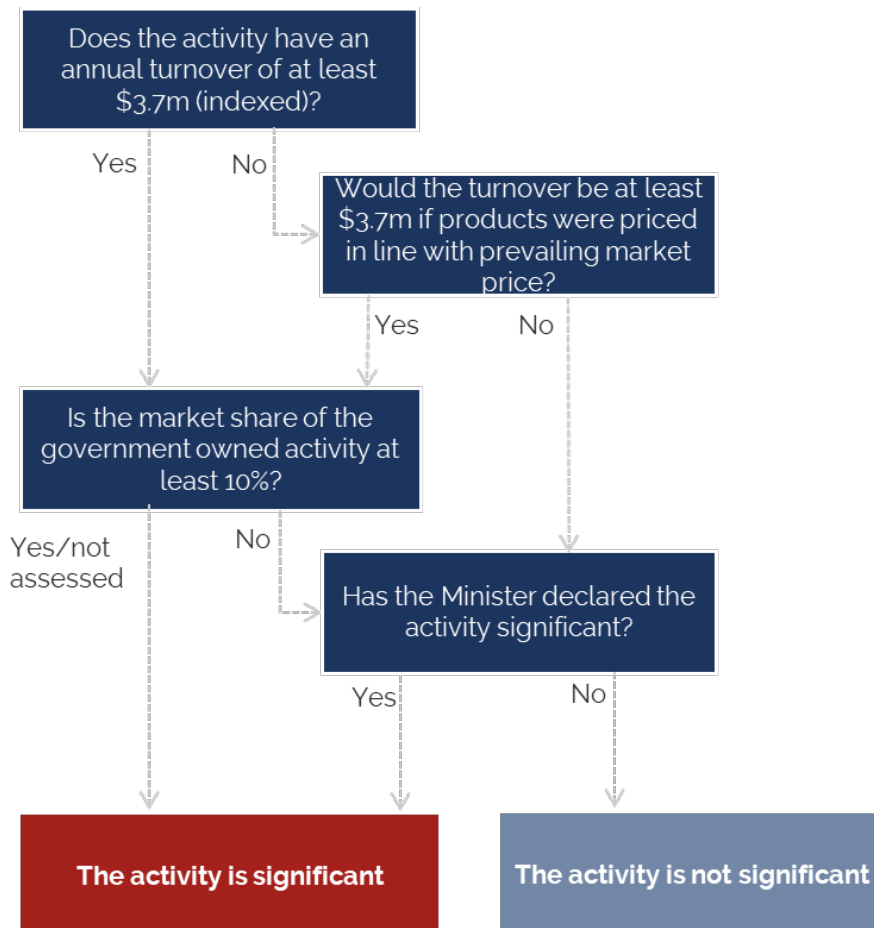
- includes a monetary threshold that is indexed over time – if the annual turnover from the business activity is below the threshold, the activity is not significant. For an activity to be found not to be significant due to low turnover, the government business should ensure that its turnover would still be below the threshold if its goods and services were priced in line with the market.
- for business activities that exceed the turnover threshold, provides an exemption based on market share. This should be simple to estimate for the government business without the need to engage expensive advice from competition experts.
- include provision for the Minister (either the Treasurer or the Minister responsible for administering Part 4C of the IPART Act) to declare business activities significant following a recommendation from IPART.

There is a trade-off between accuracy and simplicity that is inherent in the significance test. At one end of the spectrum are case-by-case assessments that are able to capture and weigh all of the unique circumstances of the government business, providing a greater degree of confidence that the application of competitive neutrality is cost effective. At the other end is a simple monetary threshold that provides certainty and clarity regarding when competitive neutrality must be applied but does not enable nuanced consideration of the market in which the business activity operates. We have intentionally recommended a significance test that is simple and easy to apply, with complementary measures in place to address the risk that the test wrongly identifies an activity's level of significance.

In our view, the right balance is struck by a test that provides a simple and low-cost approximation of when it is likely to be cost effective for a government business activity to apply competitive neutrality. A detailed case-by-case assessment is itself likely to be costly and time consuming. Additional flexibility increases the degree of subjectivity, inconsistency, and is also likely to encourage non-compliance. In our view, the benefits of any additional precision that a more complex assessment might add is likely to be outweighed by the costs. Our recommended test enables government businesses which engage in business activities above the monetary threshold to review their significance in the market by looking at their market share where they consider a business activity may not be significant despite being over the threshold.

The test is the same as proposed in our Draft Report with 2 exceptions: the statutory monopoly exclusion has been moved to the business activity test (see section 4.3.2), and the recommended market assessment for significance has been simplified to consider only market share (see section 4.4.2). See the full significance test proposed in Box 4.8. The following flow-chart (Figure 4.3) provides an overview of the elements of the proposed significance test.

Figure 4.3 Recommended significance test



The following section discusses the current approach to determining whether a business activity is significant and outlines some of the reasons we are recommending changes to it. Section 4.4.2 provides more information on the revised approach we recommend and why.

4.4.1 The current significance test is inconsistent, creates uncertainty and can be costly to apply

The current competitive neutrality policies have different significance tests for state and local government businesses.

For NSW state government business activities, the test for significance is applied on a case-by-case basis by considering whether the business activity has a significant impact on a market. Relevant considerations include:

- the business activity's size

- the business activity's influence on the market
- the resources the business activity commands
- the effect of poor performance.⁸³

Currently in NSW there is no guidance on how to complete a market assessment using these criteria and what would lead to a finding of significance. As a result, it is likely that even where the circumstances are identical, different businesses would come to different conclusions. We received feedback that supports this, with one stakeholder providing information that they had made the decision to engage a lawyer to apply the significance test in the current policy (see Appendix B).

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

- Business activities with turnover above \$2 million are deemed to be significant (Category 1 businesses). The \$2 million threshold was set in 1996. It was chosen after consultation with local governments on the basis that it was likely to capture most local government businesses that have a significant economic impact.
- Business activities with turnover below \$2 million (Category 2 businesses) should be considered on a case-by-case basis. They are "anticipated to have an insignificant distortionary impact on competition at either the State or national levels... [but] may be considered quite significant at the local level."⁸⁴ The local government policy statement explains that the scope and nature of these businesses can vary widely:

"At the smallest scale, the business might be a minor adjunct to a mainstream, non-business council function [such as photocopying sales at the administrative headquarters or sale of compost bins]. At the larger scale, the business activity might involve land subdivision and development, operation of significant entertainment and recreation centres, hire of major items of plant and machinery etc."⁸⁵

For Category 2 businesses, there is no guidance on what the 'case-by-case' consideration means. The local government policy statement appears to give considerable discretion to councils to determine whether or how to apply competitive neutrality to their activities. This policy says that councils should apply full cost attribution to as many Category 2 business activities as is practicable and that councils can determine the extent to which business activities in this category are to be separate from their associated mainstream activities.⁸⁶

4.4.2 Changes are required to make the test simpler and reduce the cost of applying it

We consider that the significance test should be changed to recognise the proposed content/obligations of the policy and to provide a better balance between simplicity, accuracy and regulatory burden. As with other elements of the policy, we consider that a best practice approach would align the test between local and state government where this is reasonable.

To determine significance on a case-by-case basis would potentially require a highly technical and complex assessment of the business' characteristics, industry structure and market. There is a trade-off between having a test that captures as many different circumstances as possible, providing a more accurate picture of significance, and one that can be applied with a fair degree of certainty by government businesses without the need to obtain advice from an expert.

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

Some stakeholders argued that the threshold for significance should be decreased to capture more services. For example, the NSW Productivity Commission submitted that a relatively low threshold for significance¹ may encourage a more robust application of competitive neutrality than the current multi-criteria threshold for state government businesses.⁸⁷ The NSW Productivity Commission recommended lowering the significance threshold as well as providing clearer guidance around market definition and impact.

Other stakeholders contended that monetary thresholds should be increased to capture fewer services. For example, Local Government NSW submitted that the current local government threshold of \$2 million was determined in the mid-1990s and is unrealistically low 25 years later. Local Government NSW submitted that the threshold should be brought into line with the thresholds in place in Queensland, Western Australia (for state government), and the Commonwealth of \$10 million.⁸⁸ It argued that this would remove activities that are not material and reduce the overall regulatory burden.

In the consultation workshops we held, local government staff advised that they find it difficult to determine when they need to apply competitive neutrality to their activities and would like clear guidance on what they need to do and when. For state government entities, there is no low-cost way of determining significance, with the multi-criteria assessment needing to be carried out for every business activity, regardless of size or materiality.

Other Australian states and territories have developed their own approaches to assessing significance and there is considerable variation in these approaches (see Box 4.5).

Box 4.5 The significance test in other jurisdictions

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

- **Deeming** specific entities significant – used in the Commonwealth and Queensland.⁸⁹

¹ Based on the government entity having a competitive impact or being of a size that is "more than nominal or trivial".

Box 4.5 The significance test in other jurisdictions

- **A size-based approach** – most jurisdictions use some form of size test to estimate significance. Size-based tests are more likely to be applied to local government activities. Size may be determined by annual turnover, asset base, customer numbers (for water and sewerage in Queensland) or market share (applied to camping in Tasmania).⁹⁰
- **A case-by-case assessment** – Victoria, Tasmania, ACT and NT use a case-by-case assessment to determine the significance of all business activities.⁹¹ Other jurisdictions use it in combination with other tests. Queensland is the only jurisdiction not to use a case-by-case assessment at all.

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

The table below compares the different tests across Australia.

Jurisdiction	Entity test	Size test	Case-by-case assessment
Commonwealth	<ul style="list-style-type: none"> • Government Business Enterprises and their subsidiaries • Other share-limited trading companies • All designated business units 	<ul style="list-style-type: none"> • \$10m turnover 	<ul style="list-style-type: none"> • Business activities at or above the size threshold
QLD	<ul style="list-style-type: none"> • Government owned corporation • Ministerial decision and list of entities published Under section 39(3) of the <i>Queensland Competition Authority Act 1997</i> (QLD) a 'significant business activity' is one carried out by a GOC or an activity that the Minister decides is a significant business activity. 	<ul style="list-style-type: none"> • 10,000 connections for combined water and sewerage service (LG) • \$9.7m expenditure for other businesses 	<ul style="list-style-type: none"> • No
SA	<ul style="list-style-type: none"> • No 	<ul style="list-style-type: none"> • \$2m annual revenue or • \$20m asset value 	<ul style="list-style-type: none"> • Business activities below the threshold
WA	<ul style="list-style-type: none"> • No 	<ul style="list-style-type: none"> • \$10m annual revenue/turnover or asset base for state government (GUIDE ONLY) • \$200,000 revenue for local government 	<ul style="list-style-type: none"> • All state government business activities • LG business activities below the threshold

Box 4.5 The significance test in other jurisdictions

Tasmania	<ul style="list-style-type: none"> • Government Business Enterprises • Public non-financial corporations • Public financial corporations 	<ul style="list-style-type: none"> • 10% market share for camping facilities^a 	<ul style="list-style-type: none"> • All other business activities
Victoria	<ul style="list-style-type: none"> • No 	<ul style="list-style-type: none"> • No 	<ul style="list-style-type: none"> • All business activities
ACT	<ul style="list-style-type: none"> • No 	<ul style="list-style-type: none"> • No 	<ul style="list-style-type: none"> • All business activities
NT	<ul style="list-style-type: none"> • No 	<ul style="list-style-type: none"> • No 	<ul style="list-style-type: none"> • All business activities

Source: IPART

The revised significance test should include a monetary threshold as it is a simple, low-cost way of identifying when competitive neutrality is too costly

A monetary threshold is a simple to apply, low-cost way of ensuring that government entities do not need to apply competitive neutrality principles to business activities where their administrative costs would be high relative to the overall revenue from the business activity. In our view, the alternative options of either requiring entities to apply competitive neutrality to every activity or to undertake a case-by-case significance assessment for even very small business activities, where there is little prospect that it would show a significant market presence, would be out of proportion to the administrative cost of applying competitive neutrality principles.

There was stakeholder support for continuing a simple process to exclude low revenue business activities from being subject to competitive neutrality or from having to apply a more complex significance test. Wollongong City Council stated that "... we apply a simple process of categorising commercial activities as anything over \$2 million. Our ability to apply accurately any other requirements would be very difficult due to staff expertise and availability in the current setting."⁹²

While monetary thresholds have the benefit of simplicity, they also have disadvantages. Relying too heavily on monetary thresholds to determine whether an activity is significant may not capture some activities with significant market impact. It can also provide an incentive for government businesses to price their services low to stay under the threshold.

On balance, we support the use of a monetary threshold in the significance test, below which competitive neutrality does not need to be applied. We consider that it is the best means of ensuring that the regulatory burden of competitive neutrality is proportionate to the activities in question. We are recommending complementary measures to overcome some of the risks that this approach will not capture activities that are significant (see below). We also recommend the option of a market share assessment for businesses with revenue that exceeds the threshold to reduce the risk that the monetary threshold will classify an activity as significant when it does not have a significant market impact. Further discussion of the recommended threshold value and the complementary measures is set out below.

In response to the Draft Report, the Australian Diagnostic Imaging Association supported the proposed threshold but submitted that the government business entity to which the turnover threshold is required to be applied needs to be considered carefully.⁹³ While annual turnover is already used in the current local government context, we acknowledge that there is a need for some definition around this concept. This would include guidance on which activities should be included when calculating turnover for the test (our views on how we see this working are outlined in the case study in Appendix B) as well as how it is measured. We expect that this would be part of the information and supporting documentation developed to assist with policy implementation.

The current local government threshold, updated for inflation, is an appropriate value for the monetary threshold

The value of the threshold needs to balance the risk of identifying a business as significant that does not have a significant impact in the market with the risk of excluding some business activities from the revised competitive neutrality policy that could be significant, particularly within a local area.

The current threshold for local government businesses is \$2 million annual turnover. This threshold was set in 1996 and has not been updated since then. As a result, the number of businesses that are being required to apply competitive neutrality is likely to have been increasing over time. There was support from local government to raise the threshold to reset it back to the value it would be if it had been indexed to keep pace with the change in inflation over the past 25 years. However, there was also concern from competing businesses that raising the threshold would fail to capture some activities that were having a significant impact on them.

We agree that it is best practice to index monetary amounts (such as, the significance threshold) regularly to prevent an inadvertent change in the scope of the policy. If this had been done in the current policy, the monetary threshold would be \$3.7 million this year.^m

In our Draft Report we proposed to set the turnover threshold for both state and local government at \$3.7 million, and to provide for the threshold to be indexed over time in line with the change in inflation. We noted that:

- It is difficult to quantify the administrative costs of applying competitive neutrality in a meaningful way. It is likely to vary depending on existing accounting systems, and the activities undertaken. As a result, we consider that the threshold initially determined, which has been applied for over 20 years is likely to provide a reasonable approximation of the size of a business that can absorb these costs.
- The administrative costs of competitive neutrality are likely to have risen over time since the \$2 million threshold was set. Updating based on the change in the Consumer Price Indexⁿ provides a simple, easy-to-apply update which is likely to approximate the change in those costs.

^m The current threshold for local government (\$2 million) updated to reflect changes in inflation since the threshold was set in 1996 by indexing it over time in line with the change in the Consumer Price Index (CPI).

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

- The proposed increase in the threshold would reduce the regulatory burden on local government. At the same time, it does not fundamentally change the scope of activities for which competitive neutrality needs to be considered.

All local government business activities with a turnover above \$2 million are currently required to apply competitive neutrality. Local governments are also required to consider businesses with turnover below this level on a case-by-case basis. For local governments, the recommended significance threshold should reduce the number of business activities that are considered significant compared with the current significance test.

In response to the Draft Report, the Australian Diagnostic Imaging Association supported the proposed threshold value.⁹⁴ However, Local Government NSW submitted that the threshold proposed in the Draft Report was too low and called for it to be raised to at least \$5-10 million. Local Government NSW submitted that this “would be a more realistic indicator of significance and is more in line with thresholds set in other states”.⁹⁵

In our view, the recommended monetary threshold for NSW is not low in the context of other states and we consider that it remains an appropriate value. We note that:

- Queensland's \$10 million threshold does not apply to all local government businesses, with some instead having a test based on the number of customer connections.
- While Western Australia has a guide of \$10 million for state businesses, it has a threshold of only \$200,000 for local government, with entities under the threshold also potentially being found significant through a case-by-case assessment.
- The Commonwealth Government is more likely to be involved in nationwide enterprises than smaller, local businesses and for that reason the Commonwealth's \$10 million threshold is not a like-for-like comparator, particularly with local government. Examples of Commonwealth owned business enterprises include NBN Co, Australia Post, Australian Rail Track Corporation and Snowy Hydro Limited.⁹⁶
- In all other Australian jurisdictions, a government entity would need to undertake a case-by-case assessment to determine significance for any government business activity, regardless of how small or insubstantial that business activity may be.

We recommend including provision to keep the threshold up to date by applying annual indexation to update it for changes in the Consumer Price Index. We consider that the revised policy should set out the process for calculating the inflator. We recommend that the [Reserve Bank of Australia Inflation Calculator](#) be used as a tool to help users to update the threshold, as it provides a user-friendly way of indexing by Consumer Price Index.

We recognise that annual indexation may increase the complexity of the significance test. However, we continue to consider that indexation within the policy is best practice. Even with the best of intentions, the policy may not be updated as frequently as is needed to ensure that the threshold stays relevant. The current economic conditions also show that there is potential for the Consumer Price Index to be volatile and as a result, for the threshold to become out of date even if the policy is updated regularly. NSW Treasury may wish to publish the updated estimate in its supporting material to assist government businesses to apply the threshold.

Low turnover government businesses should check that they would still be below the threshold if they charged market prices

Setting a minimum revenue threshold for the application of competitive neutrality principles may perversely incentivise government entities to lower their prices to keep their revenue under the threshold. As undercharging relative to the full cost of supply is one of the key problems that competitive neutrality policy is designed to address, this would reduce the effectiveness of the competitive neutrality policy. To address that concern, we recommend that for a business to be considered as non-significant due to low turnover, the government business' turnover must also be below the threshold if it were to charge a market price for its goods and services.

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

The Australian Diagnostic Imaging Association supports this approach, submitting that "It is appropriate to consider market prices in this analysis (as proposed in the recommendation), rather than actual turnover."⁹⁷

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

Where there are no comparable non-government business activities, the government business should be able to refer to comparable government business activities to determine the market price. For example, it could use nearby local councils that undertake the same activity. It is possible that the comparable government businesses are under-pricing and therefore the "market price" is not competitively neutral. In such instances, IPART has the option of recommending that the Minister declare the activity significant (see discussion on Ministerial declaration below).

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

Local councils already publish the basis for their fees and charges. In many cases this information sets out key information that is relevant to competitive neutrality, including whether prices are set to recover costs, partially recover costs, or set with reference to a market price. As a result, we expect that most local councils would be able to identify when they need to apply the market price test and be able to do this in-house at low cost.

Government businesses whose revenue exceeds the turnover threshold should have the option to undertake a simple market-based assessment of significance

Case-by-case or market-based assessments are a feature of many Australian competitive neutrality policies. They are likely to provide a more accurate indicator of significance than a simple turnover threshold because they can take the individual market circumstances into account. However, they are more costly to apply and can be subjective, particularly where they do not define what circumstances would lead to a finding of significance. While we prefer the simple, clear and easy to apply turnover threshold as an approximation of significance in the first instance, we recognise that it does not tell the full story.

Where a government business has a turnover above the threshold but suspects that it is not significant, we recommend including an option for the government entity to undertake a market-based assessment. This minimises the likelihood that the turnover threshold will capture businesses where there is not significant benefit from applying competitive neutrality to an activity. At the same time, it does not oblige a government business to undertake a market-based assessment.

In specifying what the market-based assessment should include, we again consider it is necessary to find the right balance between simplicity, certainty, and ease of application on the one hand, with individual circumstances, judgment and nuance on the other. We do not want government entities, or their competitors, to be so uncertain about how to undertake a market-based assessment that they find it necessary to engage external expertise to conduct the assessment. Similarly, we don't support a case-by-case assessment that provides so much flexibility for subjective judgment that the same circumstances could lead to very different conclusions.

In the Draft Report, we recommended that the revised competitive neutrality policy include clear and practical guidance on how to do a market-based assessment. This guidance was based on relevant policy in Victoria and Tasmania (which both require a market assessment to be done for all government business activities, regardless of size).⁹⁸ The market-based assessment proposed in the Draft Report is set out below.

Market-based assessment proposed in the Draft Report

Question	Significance determination
1. Does the business activity have market share greater than 10% in the relevant market?	If yes, continue to Question 2. If no, the business activity is not significant.
2. Is the market share of the business activity larger than or comparable to its competitors?	If yes, the business activity is significant. If no, continue to Question 3.

Question	Significance determination
3. Is there evidence that the business activity has a significant influence or competitive impact in the relevant market? ^o	If yes, the business activity is significant. If no, the business activity is not significant.

We received feedback from stakeholders that the proposed market-based limb of the significance test may be difficult to apply in practice due to the number of activities that local government are involved in and data limitations.⁹⁹

We consider that data limitations are unlikely to be a significant issue in practice. Government businesses will only apply the test if they would like to establish that an activity is not significant despite having revenue over \$3.7 million. In this context, they are likely to have a sense of their approximate size in a market. In any event, we consider that it would be prudent to assume that the government business is significant in the absence of any meaningful market data to the contrary. Under the current policy, all local government businesses with a turnover in excess of \$2 million are required to apply competitive neutrality to their activities anyway and may continue to do this under the revised policy if they consider the market-based assessment is too difficult.

Nevertheless, we have considered whether there is scope to further simplify the market-based test to make it easier to apply and more robust. We consider that the 10% market share threshold, combined with the \$3.7 million revenue threshold, is a sufficient benchmark for government businesses to assess whether they are likely to have a significant impact in a market.

We are now recommending that the market-based assessment focus only on market share, removing the second and third draft questions. The reason for this is that where a government business with a market share of at least 10% and revenues of at least \$3.7 million sets its prices below the competitively neutral price consistently, it should see an increase in its market share and therefore, its influence on the market or competitive impact. This will be the case even if the market is otherwise competitive or there are competitors with a greater market share.

While this is a simple threshold for significance, we consider that it is appropriate and will pick up the circumstances that questions 2 and 3 are aimed at identifying. As described above, a government business activity with at least 10% market share and \$3.7 million revenue could have a significant competitive impact and influence the market if it does not apply competitive neutrality to its pricing. Such businesses should be obliged to apply competitive neutrality and consider the costs and benefits of below-cost pricing.

We consider that the revised, simplified test will be easier for government businesses to apply without compromising robustness.

^o The presence of one or more of the following factors may suggest that the business activity has a significant influence or competitive impact:

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

Final recommended market-based assessment

Question	Significance determination
1. Does the business activity have market share greater than 10% in the relevant market? (see Box 4.6 for guidance on how to identify the relevant market and estimate market share)	If yes, the business activity is significant. If no, the business activity is not significant.

Box 4.6 Guidance on how to estimate market share

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

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

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

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

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

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

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

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

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

The Minister should have the power to declare an activity significant

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

We support continuing the current practice of requiring government entities to assess the significance of their own business activities rather than centralise this process through NSW Treasury, the Office of Local Government or IPART. However, this leaves a risk that some business activities with a significant impact, where there would be benefit from applying competitive neutrality, will not be required to apply it.

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

"Public hospital radiology departments undertake a relatively small level of activity (...) However, when these activities are aggregated, the market share of public hospitals in the outpatient radiology market is substantial and has a significant impact on the operation of that market. Accordingly, the significance test should be sufficiently flexible to enable government business activities to be considered in aggregate. In the case of radiology, this would allow IPART to consider the outpatient services provided by all public hospital radiology departments in NSW in a competitive neutrality assessment."¹⁰⁰

The Caravan and Camping Industry Association (CCIA) indicated a preference for IPART to be able to issue a policy statement and guideline, similar to the approach taken in Tasmania.¹⁰¹ The Tasmanian Department of Treasury and Finance issued a new competitive neutrality policy statement setting out the application of competitive neutrality principles to public camping in Tasmania. This policy statement provides that more than 10% of the total number of non-powered camping sites within the geographic market is considered a significant business activity (see Box 4.7).

Box 4.7 Tasmania's approach to defining public camping facilities as significant business activities

In 2017, the Premier's Local Government Council (PLGC) agreed to establish a stakeholder group, comprising representatives from local councils, relevant State Government agencies, the Local Government Association of Tasmania and industry, to provide advice to the Government on the practical implementation of competitive neutrality principles to council-provided recreational vehicle parking and camping facilities. A Steering Committee conducted a review and established a new Policy Statement, National Competition Policy: Applying Competitive Neutrality Principles to public camping in Tasmania.¹⁰²

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

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

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

We recommend that the Minister, either the Treasurer, who is responsible for overseeing the competitive neutrality policy, or the Minister responsible for administering Part 4C of the IPART Act, have the power to make a declaration that a particular business activity is significant for the purpose of competitive neutrality policy. We propose that the Minister would do this after receiving a recommendation from IPART. IPART would be able to make such a recommendation where we consider it appropriate and only after conducting public consultation on the matter. For example, this may be in response to:

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

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

Recommendation



7. The 'significance test' be revised to better target activities where competitive neutrality is likely to be cost effective. The proposed significance test is set out in Box 4.8. An activity would not pass the significance test where:
 - a. the activity has an annual turnover below \$3.7 million (indexed over time), or
 - b. the entity undertaking the activity has assessed it as having a low market impact, evidenced by a market share of less than 10%.

The Minister (either the Treasurer or the Minister responsible for administering Part 4C of the IPART Act) should have the ability to declare an activity significant that would not otherwise pass the significance test.

Box 4.8 Proposed significance test

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

1. The annual turnover from the business activity is less than \$3.7 million, which is to be indexed in accordance with the policy. To be excluded based on this criterion, the turnover threshold must not be exceeded if the price of the business' goods and services was set in line with the market price in the same or similar area.
2. The government entity undertaking the business activity has conducted a recent market review that shows that the activity has a market share of less than 10%

The Treasurer, or the Minister responsible for administering Part 4C of the IPART Act, has the power to declare an activity significant that would not otherwise pass the significance test, following a recommendation from IPART.

Source: IPART

Chapter 5 >>

Competitive neutrality obligations

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

05

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

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

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

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

5.1 Overview of the recommendations

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

Having regard to the proposed objective of the revised competitive neutrality policy, we have made recommendations that would clarify and clearly set out the approach a government entity should take to measure its own costs. The current competitive neutrality policies do not provide much guidance as to how a government entity should decide what approach to use for its costing. As well as providing information on how to apply costing approaches, we recommend that the policy more clearly set out the circumstances where business should consider adopting different costing approaches.

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

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

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

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

5.2 Identifying the cost of undertaking the business activity

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

The Competition Principles Agreement requires the prices set by significant government business activities to reflect 'full cost attribution' and account for other potential cost advantages of government ownership, such as not having to pay certain taxes or benefiting from government guarantees.¹⁰³ Taken together, these comprise the competitively neutral price.

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

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

- **Avoidable cost** includes the increase in the entity's costs associated with providing the significant business activity, i.e. the costs that the entity would avoid if the significant business activity did not exist. It does not include a share of joint costs or overheads.
- **Fully distributed cost** includes direct costs of the business unit as well as a share of the entity's overheads and capital costs.^b

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

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

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

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

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

- The local government pricing guideline leaves it up to councils to choose the costing system that best suits their needs, although an activity-based costing approach^c is recommended.¹⁰⁴
- The NSW pricing guideline notes that avoidable costs can be a more efficient option but recommend using fully distributed costs in the medium to long term.¹⁰⁵ However, the NSW competitive neutrality policy statement states that competitive neutrality will be achieved if the prices charged at least cover avoidable cost.¹⁰⁶

We consider that depending on the circumstances either fully distributed costs or avoidable costs could be used to determine the cost of the business activity. The method to be adopted should depend on the characteristics of the activity and its required resources. The appropriate method may change over time. As a result, we recommend that the revised competitive neutrality policy provides more guidance to government entities on factors to consider when selecting an approach.

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

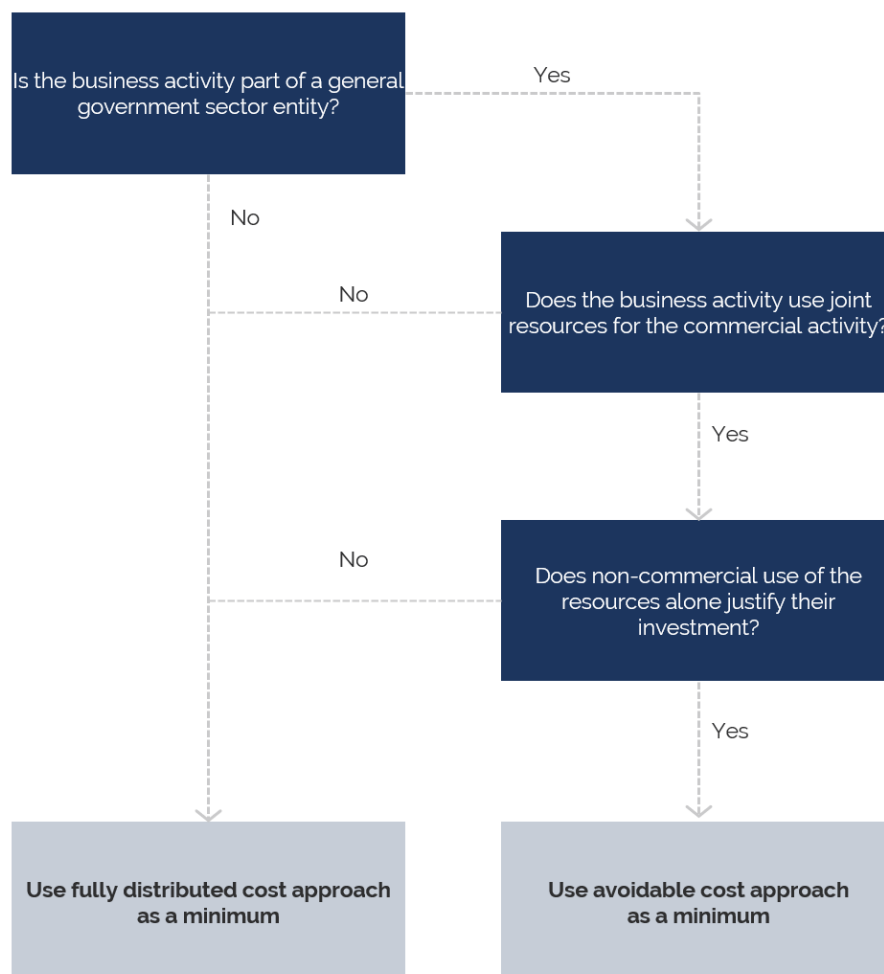
We have developed our proposed costing guidance in line with the objective of efficiency recommended in Chapter 3. It is important to recognise that the pricing approach may differ if the objective was instead to ensure that non-government businesses were able to compete on an equal footing with government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

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

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

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

Figure 5.1 Summary of proposed costing approach guidance



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

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

Box 5.1 Cases when different costing approaches may be appropriate

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

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

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

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

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

This case applies when:

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

Box 5.1 Cases when different costing approaches may be appropriate

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

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

– avoidable cost would be appropriate

This case applies when:

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

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

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

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

5.2.1 Cost allocation guidance

Where the costs of shared resources need to be allocated, it can be challenging to determine how to allocate them. The current policies include guidance on allocating shared resources, which we consider is appropriate but could be expanded upon.

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

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

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

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

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

Some business activities have complex cost structures, making it difficult to estimate the cost of undertaking the activity. For example, the Australian Diagnostic Imaging Association suggested that estimating the cost of providing radiology services is complex and requires technical assumptions to be utilised as part of a costing model.¹⁰⁷ Realistically, assumptions may be required. Businesses should ensure that the basis of assumption is logical and can be justified by evidence. We may ask for a copy of any assumptions and the reasons for them if we receive a complaint or commence an investigation. Overall, the cost allocation should also be consistent with commercial practice.

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

The secure parking case study in Appendix B shows a worked example of cost allocation.

Recommendation



8. The competitive neutrality policy continues to provide information on how to estimate both avoidable costs and fully distributed costs as valid approaches for estimating a government entity's own cost of business, and clearer guidance on how to select the most efficient approach. The recommended guidance on selecting the most efficient approach is set out in Box 5.1.

5.3 Adjusting for cost-based advantages and disadvantages

A key premise of competitive neutrality is that government businesses should not experience net competitive advantages as result of their government ownership. This section outlines some of the possible cost-based advantages and disadvantages faced by government business activities. Estimating the net competitive advantage involves weighing up the competitive advantages against the competitive disadvantages, to create one cost adjustment.

We have considered the current guidance on how to identify and correct for these and propose some changes in order to ensure that the policy is easy to apply. In making our recommendations we aimed to balance the administrative cost of estimating the adjustments with the benefits of having a more accurate estimate.

5.3.1 Advantages

There are certain costs that a government business may not face due to government ownership that would be faced by equivalent private organisations providing similar goods or services. These costs represent the competitive advantages of government ownership. The NSW pricing guideline notes that these should be added to the costs actually incurred by the entity to determine a competitively neutral price.¹⁰⁸ These notional costs fall into several main categories, which are outlined in Table 5.2.

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

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

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

The government business activity should compare itself to a for-profit private competitor when assessing competitive advantages. Not-for-profit businesses enjoy unique advantages compared to for-profit businesses and do not have a requirement to make a profit. Making cost adjustments to reflect advantages relative to not-for-profit competitors may therefore be inadequate to apply competitive neutrality principles.

We recommend a government business compares itself to for-profit private businesses to assess competitive advantages, even if the market it operates in is made up of not-for-profits. If the market that the government business operates in is largely made up of not-for-profits however, it may not be in the public interest for the government business to set its prices based on a for-profit business model. This is because it would essentially require the government businesses to adjust for advantages which its competitors also have. The benefits and costs of setting prices based on a not-for-profit business model can be weighed up in the public interest test (see section 6.4 for a further discussion on how this could be done).

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

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

A government business activity may also enjoy competitive advantages which are not directly related to their costs. The treatment of non-cost advantages is further discussed in Section 5.4.

Cost of capital and required rate of return

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

While government businesses may not have the same impetus to earn a profit, the government is incurring a similar opportunity cost when it undertakes commercial activities. The NSW pricing guideline requires government businesses to explicitly account for this by including the opportunity cost of capital.¹⁰⁹ The opportunity cost of capital is a function of the value of the assets used by the entity to provide the goods and services and a required rate of return on those assets. The guidance on how to calculate the rate of return currently differs for state and local government entities (see Table 5.3).

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

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

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

NSW Treasury's policy is that non-current assets (long-term investments that are not easily converted to cash) must be valued at the cost to replace the asset with a modern equivalent.¹¹⁰ This is not in line with the private sector however, where it is more common to use the historic cost (which is typically lower). The NSW pricing guideline therefore suggests that the cost of capital may need to be adjusted to ensure that the government business activity is not placed at a competitive disadvantage. We support maintaining this flexibility in the asset valuation method.

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

In NSW, entities covered by the NSW Treasury's Commercial Policy Framework will already make dividend payments to reflect a commercial rate of return on their business activities.¹¹¹ As a result, these businesses will not have to make an adjustment for this (as they do not have an advantage relative to a non-government competitor). There may be value in NSW Treasury or a government business owner implementing a dividend policy for a broader set of entities as this would avoid the need for these entities to make an adjustment under the revised competitive neutrality policy and would have several efficiency advantages (Box 5.2).

Box 5.2 Paying dividends and tax equivalents to a business owner

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

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

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

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

For business activities undertaken by entities not covered by the Commercial Policy Framework, we recommend that government business activities estimate their target rate of return. There are different ways to estimate a business' target rate of return. It demands a trade-off between specificity and resources/data required to estimate the target. The main methods adopted by governments for setting the target rate of return of government businesses are outlined in Table 5.4.

Table 5.4 Advantages and disadvantages of different methods for setting target rate of return

Method	Description	Advantages	Disadvantages
Uniform rate of return	The target is the same for all entities. A variation of this is setting a uniform rate that varies slightly depending on the characteristics of the entity.	<ul style="list-style-type: none"> • Easy to apply • Ease of application creates lower risk for errors 	<ul style="list-style-type: none"> • May not be flexible enough to reflect the diversity in levels of market risk faced by businesses • If risk is not adequately taken into account, the adjustment may be inadequate
Benchmarking	The target is set in line with similar listed companies or industry averages	<ul style="list-style-type: none"> • If done correctly, this method accurately reflects market risk 	<ul style="list-style-type: none"> • Relies on data from similar companies being easy to find • Requires comparators, which may not always be available • It may be difficult to isolate factors affecting an individual firm's return from underlying market performance
Weighted average cost of capital (WACC)	A unique value that quantifies the cost of the business' debt and equity while accounting for factors such as market risk.	<ul style="list-style-type: none"> • Reflects the entity's unique circumstances • Widely used by private companies to set target rates of return • Has a strong theoretical basis 	<ul style="list-style-type: none"> • Requires relatively detailed financial data and some financial knowledge to estimate

Source: Commonwealth Competitive Neutrality Complaints Office (CCNCO), [Rate of Return Issues](#), CCNCO Research Paper, December 1998

The Commonwealth recommends smaller businesses set their target rate of return as the 10-year bond rate plus a number of percentage points depending on the perceived risk of the business activity (low, medium, or high risk).¹¹² This has the simplicity of using a uniform figure, while still adding in a factor to reflect an individual business' market risk. The risk factor figures have not been updated since 1998 however, and it is unclear how they were calculated in the first place.

We recommend business activities undertaken by entities not covered by the Commercial Policy Framework estimate their target rate of return as a WACC, using a simplified version of IPART's publicly available WACC model^d with simplified parameters. Businesses with limited assets may use benchmarks. This guidance is summarised in Box 5.3. Specifically, the beta for the WACC (which reflects the activity's risk relative to the market and requires a detailed analysis to determine) would be set to one i.e. the average beta across the whole market. The split between debt and equity (known as gearing) would reflect the activity's actual gearing. We propose to develop step-by-step instructions for estimating the WACC for competitive neutrality purposes, which would be released as part of our greater suite of tools and resources for competitive neutrality (see Chapter 8). With the guidance issued by IPART, we consider the WACC would be easy for government businesses to calculate, while reflecting some of the risks specific to the activity.

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

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

The competitive neutrality policy should also incorporate some flexibility regarding the rate of return method. If a business has limited assets, it may not be appropriate to determine the rate of return based on a WACC. This was in the finding in IPART's investigation of competitive neutrality complaints against the State Valuation Office. In that case, industry benchmarks were used to determine a reasonable profit margin.¹¹³

Box 5.3 Summary of the proposed method for calculating target rate of return

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

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

In the case of a complaint, an analysis of the government business activity's rate of return can be performed to test compliance, as demonstrated in the case study described in Box 5.4.

Box 5.4 Case study – rate of return analysis for PETNET

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

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

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

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

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

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

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

5.3.2 Disadvantages

The NSW competitive neutrality policy statement requires material competitive disadvantages arising from government ownership to be considered when pricing goods and services.¹¹⁴ This is consistent with the Competition Principles Agreement's focus on removing "net advantages" but discourages government entities from quantifying small or immaterial disadvantages.¹¹⁵ The NSW competitive neutrality policy statement recommends that agencies first focus on revising the policies that give rise to the disadvantages if the policies are considered lacking in merit. The local government pricing guideline acknowledges disadvantages of government ownership but does not propose a method for dealing with them.¹¹⁶

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

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

These factors are referenced in the existing competitive neutrality policies and we support continuing to include them in the revised policy. Wollongong City Council's submission to the Issues Paper provided another example, noting that government business activities need to consider social procurement policy (for example, a percentage of contracts must be awarded to small businesses) when selecting suppliers, whereas competitors do not have similar restrictions.¹¹⁷ A more in-depth case study of a competitive disadvantage faced by NBN Co is discussed in Box 5.5.

Box 5.5 Case study – Competitive disadvantage faced by NBN Co

The Australian Government Competitive Neutrality Complaints Office (AGCNCO) conducted a competitive neutrality investigation of NBN Co, following a complaint alleging that NBN Co was not complying with competitive neutrality obligations. In response to the investigation, NBN Co noted various competitive disadvantages including its status as a Statutory Infrastructure Provider. As a Statutory Infrastructure Provider, NBN Co must connect all premises in its network footprint (which covers most parts of Australia) following a reasonable request by a retail service provider. NBN Co is subject to price caps that private Statutory Infrastructure Providers are not.

Due to its price caps, NBN Co can potentially be forced to incur losses, if the capped price does not fully cover the cost of meeting Statutory Infrastructure Provider obligations in certain areas. A Statutory Infrastructure Provider cannot refuse to connect premises on the grounds that it is not commercial to do so.


Box 5.5 Case study – Competitive disadvantage faced by NBN Co

The AGCNCO noted that NBN Co is incurring losses arising from its Statutory Infrastructure Provider obligations in certain areas. It also concluded that these uncompensated losses were a competitive disadvantage of government ownership. To address this, it recommended that NBN Co should quantify the value of any losses it incurs as a result of its Statutory Infrastructure Provider status and include these as an offset in estimating its net competitive advantage.

Note: This case study is drawn from a different Australian jurisdiction, which is not subject to the policies and processes in NSW. A different decision might have been made if examined under the current NSW competitive neutrality framework
Source: Australian Government Competitive Neutrality Complaints Office, [NBN Co, Investigation no. 18](#), November 2022

We recommend maintaining the position in the current NSW competitive neutrality policy statement. As such, we recommend first seeking to remove the disadvantage if possible and, if this is not possible, the disadvantage can be captured as an offset in the business activity's net competitive advantage. As shown by the examples above, it can be difficult to identify whether competitive disadvantages are cost-based or non-cost. This position would therefore apply to both types of disadvantages.

Recommendation

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

5.4 Adjusting for non-cost advantages and disadvantages

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

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

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

We propose that the revised competitive neutrality policy provides that where possible, the advantage or disadvantage be removed altogether, for example by sharing advantageous information with the private sector, restructuring the government business activities to avoid regulatory conflicts of interest, or ceasing bundling of goods/services. In some circumstances, it may be possible to quantify the advantage or disadvantage and deal with it in the same way as cost-based advantages and disadvantages. For example, if the government business activity is subject to more stringent regulations than an equivalent private sector business, it should calculate the time and cost involved in complying with the more stringent regulations and make an adjustment to account for this. This is in line with the approach recommended by the NSW Treasury in its submission to the Issues Paper.¹¹⁸

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

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

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

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

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

However, the VCEC recommended that SEWL:

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

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

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

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

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

These issues can sometimes be addressed outside competitive neutrality policy by introducing specific policies or obligations. For example, the Australian Energy Regulator has imposed ring-fencing guidelines in the electricity sector to prevent distribution network service providers from providing additional services that are cross-subsidised by their distribution services.¹¹⁹ If a non-cost advantage or disadvantage is dealt with via another policy/obligation, like these ring-fencing guidelines, it does not need to be accounted for through competitive neutrality principles.

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

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

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

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

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

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

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

Example 2 – Access to customers through providing related services

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

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

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

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

Recommendations

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

5.5 Price structure and bundled prices

Many private businesses have complex price structures for their products. Where a business offers complementary products, it is common to offer some form of bundled price at a discount compared with the price of purchasing the products separately. The aquatic centre case study in Appendix B provides an example of this practice in the context of a government business.

Where a government entity is offering a mix of products both as a package and separately, and some of those products are also offered by competitors, the pricing for the bundle should not create a "price squeeze" for the competitive products. For example, if a council business offers pool and gym access as a bundle, as well as separately, the implied gym price (that is, bundle price minus pool only price) should not be below the competitively neutral gym price.

This is particularly important where the mix of goods and services are a combination of activities, some of which are subject to competitive neutrality and some of which are not.^e Government businesses should ensure that any bundled prices do not undermine the application of competitive neutrality by checking that the implied price of the significant government business activity in the bundled product is not below the competitively neutral price.

In the aquatic centre case study, the council business bundles gym and pool access (significant business activities) and spa/sauna/steam room access (not a significant business activity). A similar issue would arise where the council decides it is in the public interest to subsidise its pool access. If the council were to offer a bundled price for gym and pool/spa/sauna/steam room access at a large discount to the price of purchasing each component separately this could lead to a competitive neutrality issue, even where its standalone gym access prices are competitively neutral.

^e An example of this is a complaint made against the Fleurieu Regional Aquatic Centre Authority (FRACA) in South Australia for bundling gym services with recreational pool access, which was claimed to be at non-commercial terms. The investigation concluded that FRACA may subsidise the costs of its pool services as a Community Service Obligation, however if FRACA's pool services were used to compete with private sector operators it should not be treated as a CSO. See South Australia Competition Commissioner, Competitive Neutrality complaint against Fleurieu Regional Aquatic Centre Authority as the owner and operator of the Fleurieu Regional Aquatic Centre, February 2020.

When setting prices, government businesses will also need to ensure compliance with any other relevant legislation in addition to ensuring competitive neutrality policy is applied. For example pricing decisions must not contravene the *Consumer and Competition Act 2010* (Cth).

5.6 Structuring a business activity to address competitive neutrality

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

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

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

Table 5.5 Categories of business structure

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

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

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

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

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

it does not follow from this that concerns about competitive neutrality have wholly abated. For starters, where individual enterprises are engaged in a combination of public policy objectives and more conventional business activities, questions often arise about the market-consistency of the business activities. Furthermore, the degree to which government activity is considered "business" matters. Commercial undertakings operated by government departments or autonomous institutions can be a source of non-neutrality, but not all activities are suited for corporatisation.¹²⁰

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

- The NSW competitive neutrality policy statement highlights the program of corporatisation and commercialisation that has been undertaken as a key action that has helped deliver on NSW's competitive neutrality commitments. It outlines the requirements that apply to businesses that have been corporatised or commercialised and how these address competitive neutrality.¹²¹ The remainder of the competitive neutrality policy (*Guidelines for Pricing of User Charges*) apply to other significant government business activities, where they operate in a contestable market.
- The local government policy statement imposes what it refers to as 'corporatisation principles' on all significant government business activities (those over the threshold of \$2 million annual turnover).¹²² Those principles are broadly in line with the 'structural separation' category in Table 5.5 above. The guidelines for pricing and costing local government businesses apply to these activities. Business activities below the threshold are also encouraged to adopt corporatisation principles where this is appropriate.

We recommend that the revised competitive neutrality policy includes a chapter that provides guidance on the different options for structuring government businesses, as a means of addressing competitive neutrality and when each option would be appropriate. In its submission to the Draft Report, the Australian Diagnostic Imaging Association "considers that guidance to government businesses on business structure separation would be invaluable".¹²³

We consider that the guidance should set out some of the benefits, costs and considerations that are relevant to the choice of how to structure a government business activity to meet competitive neutrality obligations. Some suggested guidance is provided in Box 5.9.

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

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

Box 5.8 Not-for-profit organisations

When discussing business structure, not-for-profit entities are a special case as they may be stand-alone entities but do not have equivalent obligations to non-government corporations. Competitive neutrality principles may still apply.

We are proposing that when identifying whether a government business activity has a net competitive advantage compared with other businesses, that it compares itself to for-profit competitors.

Where its competitors are mostly not-for-profits or charities, the government business may decide that it is in the public interest for the government business to also not include dividends or tax equivalents in its prices (see Chapter 6).

This approach means that the form of the government entity itself (whether for-profit or not-for-profit) is not the deciding factor as to whether it is required to include dividends and tax equivalents in its prices.

Further discussion of the application of competitive neutrality principles to not-for-profit entities is provided in Chapter 3.

Recommendation



12. The revised policy includes high level guidance on business structure but does not require a government entity to adopt any particular structure for its business activities. We recommend including the guidance in Box 5.9

Box 5.9 Suggested guidance on business structure in the revised competitive neutrality policy

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

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

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

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

Structural separation is a continuum. Greater separation of commercial activities from non-commercial activities could be expected to provide additional benefits (i.e. greater accountability and incentives to improve performance) but also additional costs (see Table 5.6).

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

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

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

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

Box 5.9 Suggested guidance on business structure in the revised competitive neutrality policy

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

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

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

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

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

Table 5.6 Advantages and disadvantages of different business structures

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

Chapter 6 >>

The public interest test

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



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

The Competition Principles Agreement requires significant government business activities to apply competitive neutrality principles, but only to the extent that the benefits of applying competitive neutrality principles outweigh the costs (the 'public interest' test).¹²⁴ The Competition Principles Agreement also sets out specified matters which, where relevant, must be considered in assessing the public interest (such as CSOs and certain government policies).¹²⁵ The main choices faced by jurisdictions around the application of the public interest test are when it should be applied and what should be considered as part of the test in addition to those required by the Competition Principles Agreement. There are also procedural questions of how often to apply the test and whether the test should be published or consulted on.

6.1 Overview of the recommendations

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

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

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

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

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

6.2 When to apply the public interest test

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

This is a shift from the current approach, where competitive neutrality principles need not be applied if an entity establishes that it would be in the public interest to not apply competitive neutrality.¹²⁶

Only significant government business activities need to estimate a competitively neutral price. If a government business is significant in a market, we consider that they should be obliged to quantify their costs as well as the advantages and disadvantages of government ownership before deciding not to apply competitive neutrality.

Undertaking the public interest test after estimating the competitively neutral price provides greater transparency on the cost of undertaking a business activity, the cost of the proposed subsidy and the merit of pricing below the competitively neutral price. Without this transparency there is a risk that significant government businesses may underestimate the competitive and fiscal impacts of pricing below the competitively neutral price.

It also overcomes the problem identified in the NSW competitive neutrality policy statement that the administrative costs may be overemphasised in the test as they are easier to quantify than the broader benefits of pricing in a competitively neutral way.¹²⁷

We received submissions from 2 councils supporting the proposed approach.¹²⁸ Bega Valley Shire Council's submission recognised "that the current policies are inconsistent in requiring this assessment when a government entity charges below the CN price".¹²⁹

Both the NSW competitive neutrality policy statement and the local government policy statement currently state that competitive neutrality principles are to be applied even where user charges are to be set at less than full cost recovery.¹³⁰ However, an entity may not get to this later step if they find that it is in the public interest to not apply competitive neutrality. The local government policy statement also allows councils to subsidise for any reason, so long as the subsidies are fully disclosed as explicit transactions in councils' internal financial reporting.¹³¹

6.3 How to apply the public interest test

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

There is limited guidance in the current competitive neutrality policies on how a government entity should undertake a public interest test when it is considering not applying competitive neutrality principles. The NSW Productivity Commission submission to the Issues Paper noted that government businesses may not currently have internal capability to accurately quantify costs and benefits as part of the public interest test. The submission suggested that further guidance on the public interest test could be developed, such as recommended methodologies and when a qualitative cost benefit analysis may be appropriate.¹³²

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

1. Define what is being proposed:

- What is the proposed price or non-cost advantage?
- How does it differ from a competitively neutral approach?

2. Assess the benefits of the proposed option:

- Why is it being proposed? What objective is it trying to achieve?
- What are the benefits of the subsidy and who will receive them?

3. Assess the costs of the proposed option:

- What is the expected total cost of the proposed subsidy?
- What impact would the non-price advantage and/or subsidy would have on competitors?

4. Decide whether the benefits outweigh the costs

5. Consider whether the objectives could be achieved by other means that are less costly

Government entities should have regard to the factors set out in Box 6.1 when responding to the questions set out above. We know that some government entities are concerned that the proposed policy changes will reduce their ability to continue to provide subsidised services to support their communities and ensure the people of NSW can access low-cost services. The factors that government entities need to consider when doing a public interest test are wide ranging and include social welfare and equity considerations, regional development and the interests of consumers, among other things. The changes we recommend are designed to clarify the process that should be followed. They do not prevent government entities from running businesses or from subsidising prices where this is in the public interest.

In response to the Draft Report, the Australian Diagnostic Imaging Association supported the proposed approach to the public interest test noting that "It is important that public interest is applied holistically, rather than focusing on the benefit to consumers associated with paying below market price for goods or services."¹³³

This framework contains elements of cost-benefit analysis as described in the NSW Government Guide to Cost Benefit Analysis.¹³⁴ It also incorporates best practice aspects of the policies from other jurisdictions, particularly Victoria.^a

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

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

1. government legislation and policies relating to ecologically sustainable development
2. social welfare and equity considerations, including CSOs
3. government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity
4. economic and regional development, including employment and investment growth
5. the interests of consumers generally or of a class of consumers
6. competitiveness of Australian businesses
7. the efficient allocation of resources.¹³⁵

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

Using these factors to identify the subsidy and its benefits

There are different types of subsidies:

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

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

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

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

Using these factors to assess the costs of the subsidy

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

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

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

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

Weighing up the costs and benefits

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

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

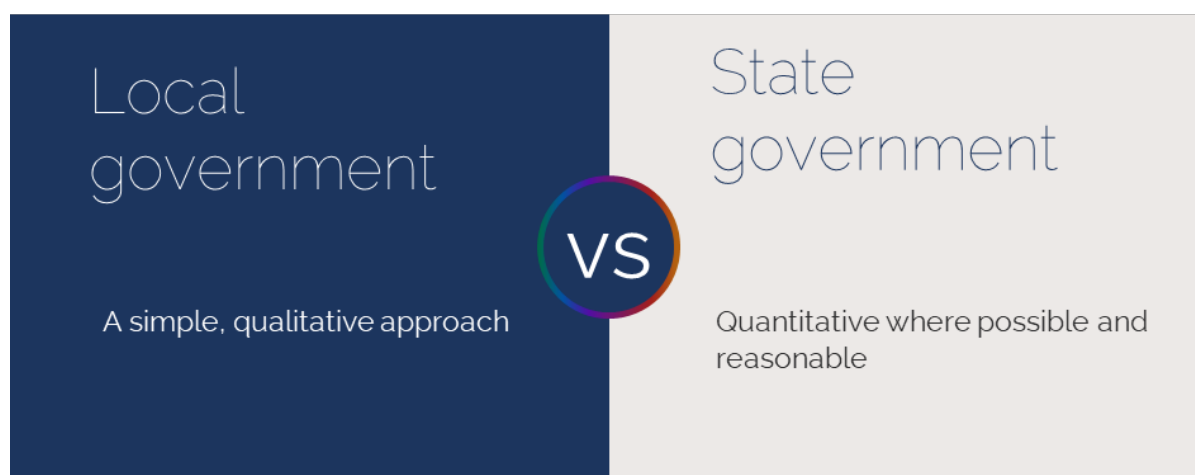
For example, could the same or similar benefits be achieved by a targeted rather than broad subsidy? In some cases, the application of competitive neutrality may still achieve a policy objective if, for example, the competitively neutral price is low enough to meet demand for a good or service.

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

6.3.1 Differentiating between local and state government

Generally, we consider that it is best practice for the revised competitive neutrality policy to apply consistently to state and local government. However, we consider that when it comes to the public interest test, there is a case for some differences in the way the test is required to be carried out. There are 2 main reasons for this:

- Local government is likely to have a higher number of smaller business activities, and may also have fewer resources to undertake such an assessment.
- The current competitive neutrality policies do not impose any obligation on local government to consider the public interest factors when making a decision to subsidise a business activity. While we expect that local councils form a view on the public interest when making these decisions, the framework we have proposed may differ from their current approach.



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

A qualitative approach to the public interest test should minimise the regulatory burden and cost associated with completing the public interest test for local government. We expect that the public interest test is not new for councils applying competitive neutrality. For example, councils have community consultation obligations and identify community priorities when preparing their Community Strategic Plan.¹³⁶ As long as the relevant matters are considered and documented in undertaking the public interest test, councils should be able to draw from documentation prepared and analysis undertaken through existing processes (such as the Integrated Planning and Reporting Framework).

For state government, quantification of costs and benefits of the subsidy should be encouraged where it is possible and proportionate to the significance of the activity. This is consistent with the NSW Government Guide to Cost Benefit Analysis which is a resource that state government agencies may find useful when undertaking the public interest test.¹³⁷

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

Most submissions supported a proportionate approach to the public interest test that differentiates between local and state government.¹³⁸ The Australian Diagnostic Imaging Association noted that the public interest assessment for state government activities should be quantified where possible.¹³⁹

An example of the application of the steps at a local government level is set out at Figure 6.1.

The example in question concerns a council that is considering supplying a green bin service. Another local business offers green bin services alongside other gardening and waste removal services, but the cost is not affordable for some residents. Even if it was affordable, the demand for the services outstrips the supply by the local business. As a result, dead tree branches and other green litter are accumulating in the area, posing a fire hazard. The council has calculated the competitively neutral price (\$20 per collection) and concluded that it will result in a price that is still unaffordable for residents so is considering a subsidised price (\$10 per collection).

Figure 6.1 Proposed public interest test: steps and brief example

01	Define what is being proposed Subsidised green bin service to encourage residents to dispose of their green litter and avoid fire hazards, which pose risks to the whole community.
02	Assess benefits of proposed option An affordable service would increase accessibility, encourage more residents to use the service and would reduce fire risk.
03	Assess costs of proposed option The subsidised service may reduce demand for the private business' services, but this is likely to be limited as there is sufficient demand for both the council and private business services.
04	Do the benefits outweigh the costs? The Council has concluded that the benefits of reduced fire risk outweigh the impact on the private business' services and the cost of the subsidy.
05	Are there less costly means of achieving the objective? An alternative is a rebate for residents who cannot afford the private businesses services, however, this would be costly to administer.

Note: this is a summarised example of the application of the public interest test. While local governments would only be required to take a simple, qualitative approach to the public interest test, more information would likely need to be considered in determining costs and benefits.

Recommendations

- 13. The public interest test be undertaken in accordance with the following proposed framework:
 - a. define what is being proposed and how it differs from the competitively neutral action
 - b. identify the benefits and costs considering the factors set out in Box 6.1.
 - c. assess whether the benefits outweigh the costs
 - d. consider whether there is a less costly way to achieve the benefits.
- 14. Different requirements for undertaking the public interest test be imposed on state and local government:
 - a. For local government business activities, a qualitative assessment for the public interest test is acceptable, although the financial cost of the subsidy must be quantified at a minimum.
 - b. For state government, the public interest assessment must be quantitative where possible and reasonable (i.e. effort and cost involved in quantification of costs and benefits is proportionate to the size of the business activity).

6.3.2 Updating the public interest test

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

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

This recommendation was supported by the Australian Diagnostic Imaging Association.¹⁴⁰

Recommendation

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

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

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

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

Advantages that most other competitors also have

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

- most competitors in the market can access the advantages (for example, most competitors are not-for-profits so do not pay a rate of return on their capital), and
- the government entity has assessed that there is a gap in the market that a government business activity should fill for a reasonable period of time.

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

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

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

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

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

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

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

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

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

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

Community service obligations (CSOs)

The NSW *Guidelines for Community Service Obligations TPP 19-02* (CSO Guidelines) apply to public non-financial corporations and public financial corporations. Examples of CSOs include a requirement to provide a universal service at a fixed price, or to provide certain discounts to particular customers, such as pensioners.¹⁴¹

The CSO Guidelines outline 3 principles for commissioning a CSO from a government business activity¹⁴²:

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

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

Several submissions to the Draft Report supported the policy setting out some circumstances where applying competitive neutrality may not be in the public interest.¹⁴³ The Australian Diagnostic Imaging Association also submitted that it is "imperative to safeguard against use of CSOs as a means to evade competitive neutrality. That is, where CSOs are cited these should be bona fide CSOs rather than a CSO constructed to allow a government business to operate on competitively non-neutral terms."¹⁴⁴

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

Local Government NSW queried how the public interest would apply where a council commences a business activity to introduce competition to a market.¹⁴⁵ For example, a market that is poorly serviced or exploited by an existing business which may have a monopoly in that area. Competitive neutrality does not prevent government businesses from competing in markets. The government business would be free to enter the market, subject to other policy considerations. If it wished to charge below the competitively neutral price, then it would have to undertake a public interest test to assess the costs and benefits of the subsidy.

Recommendation

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

6.5 Publishing and consulting on public interest assessments

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

In NSW currently there is no general requirement to publish public interest assessments, unlike Victoria.¹⁴⁶ In addition to promoting transparency for competitors and the public at large, publishing and consulting on public interest assessments may assist other government entities who may be considering subsidising a particular business activity. However, in considering what to require in the revised competitive neutrality policy, we have been mindful that there may be commercially sensitive information considered in the analysis and that publication of this information may disadvantage the business.

We are proposing that there should be a presumption within the revised competitive neutrality policy that public interest assessments will be published, with confidential information redacted.

Some government businesses raised concerns about the administrative burden associated with publishing public interest tests.¹⁴⁷ To aid government businesses in applying the public interest test and to reduce the administrative burden, we propose to develop a template identifying information for inclusion and information that might be considered commercial in confidence.

Several submissions from local council and private businesses supported the proposed position on publishing and consulting on public interest assessments.¹⁴⁸ The Australian Diagnostic Imaging Association suggested that IPART should carefully interrogate any public interest assessments that are not published on commercial-in-confidence grounds.¹⁴⁹ This could however involve substantial resources. We propose to use template guidance and the complaints process as the means of ensuring the quality of public interest assessments, rather than vetting every assessment.

Consultation could also be part of a public interest assessment. For example, Victoria requires consultation with the public on application of the test.¹⁵⁰ Submissions from non-government businesses supported public consultation on public interest tests.¹⁵¹ While consultation is useful and may assist in identifying unanticipated impacts from introducing a subsidy, we do not propose to recommend consultation be mandatory as we consider that it would impose a considerable burden on government entities, particularly where they need to undertake a number of assessments. It is therefore recommended that consultation on the public interest assessment is encouraged but not mandated.

Recommendations

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

Chapter 7 »

Complaints

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

07

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

We have identified a number of opportunities to improve the complaints handling process. These include simplifying the process to improve accessibility and changes to reduce the number of complaints handling processes and bodies, which currently differ depending on the nature or ownership of the government business activity. This chapter outlines the issues with the current complaints handling process in NSW, explains what we heard in stakeholder submissions and presents our recommended changes to improve the process. The effect of these recommended changes is also shown using 2 case studies summarised in section 7.5 (see Appendix B for more detail), based on the experience of non-government businesses seeking to make a complaint under the current NSW competitive neutrality policy.

7.1 Overview of the recommendations

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

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

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

7.2 A single, consistent complaints handling process

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

Historically very few competitive neutrality complaints have been received in NSW and only one investigation undertaken. There were mixed views from stakeholders about whether this is because the current competitive neutrality policy is working well or whether it is a result of the current complaints handling process being complex and time consuming to navigate.

In its submission to the Issues Paper, Local Government NSW stated that the current process for making a competitive neutrality complaint against a local government business is fit for purpose and appropriate.¹⁵² It noted that councils have not advised it of any difficulties relating to competitive neutrality and that there have been negligible complaints against council business since the introduction of the policy.¹⁵³

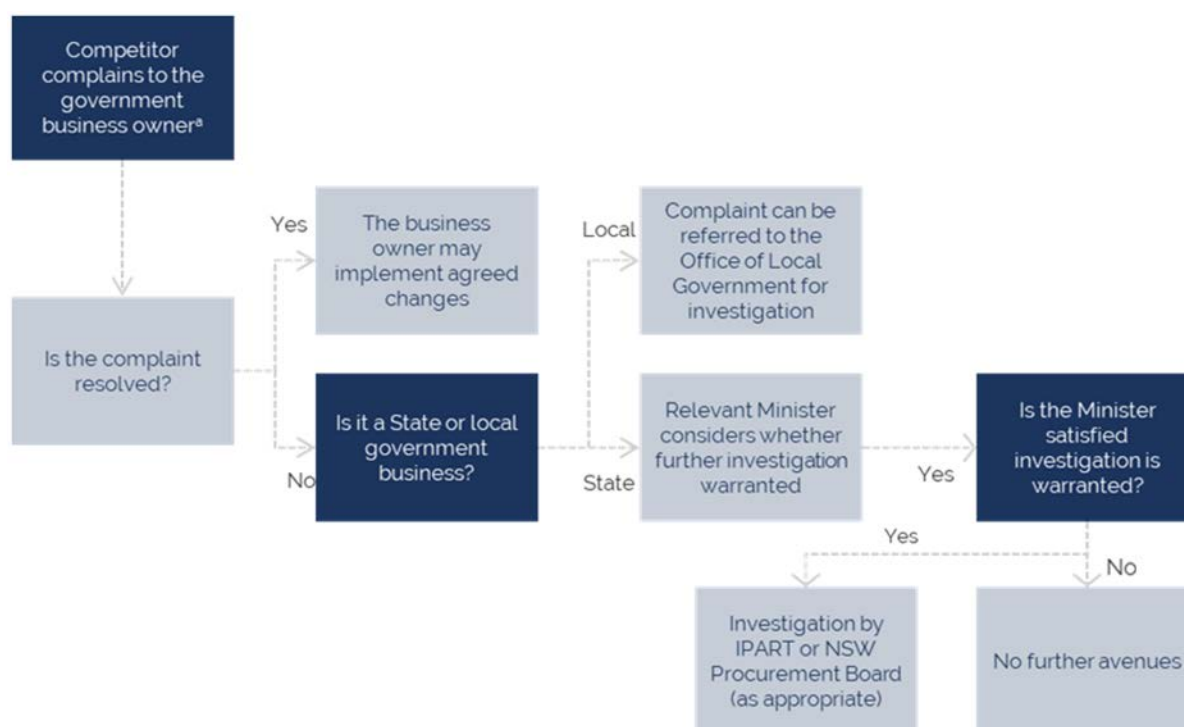
However, concerns with the complexity of the complaints process were raised in several submissions and during the consultation workshops we held. Specifically, potential complainants voiced that they felt the current process is overly complex and burdensome, due to its multi-stage process and high information gathering requirements. These stakeholders told us that they supported changes to the complaints process to make it easier to lodge a complaint.¹⁵⁴ Moreover, in its submission to our Issues Paper, the NSW Productivity Commission recommended that the requirement for the Minister to refer complaints to the complaints body be removed to improve the accessibility of the complaints process.¹⁵⁵

In response to our Draft Report, the Australian Diagnostic Imaging Association (ADIA) supported the proposed changes to bring the complaints process into a single body (IPART) and make it more accessible, submitting that:

Competitive neutrality is an important component of a vibrant, well-functioning economy. However, achieving competitive neutrality relies on an effective policy, administered by an independent regulator. ADIA's experience is that the existing competitive neutrality policy in NSW is inaccessible and ambiguous, and ultimately futile because it is not being used to address cases of clear non-neutrality.¹⁵⁶

We heard of potential complainants who had wanted to make a complaint but struggled to have it recognised after trying for up to 18 months.¹⁵⁷ We also heard of complainants who were met with disinterest when attempting to lodge their complaint.¹⁵⁸ Such experiences are especially problematic for small businesses who may not have the resources to persist with navigating the complaints process.

Figure 7.1 The complaints process in NSW's current policies



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

Source: New South Wales Treasury, Policy Statement on the Application of Competitive Neutrality (TPP02-01), January 2002, pp 17-1; Department of Local Government, Guidelines on the Management of Competitive Neutrality Complaints, 1997; *Independent Pricing and Regulatory Tribunal Act 1992*, Part 4C; *Public Works and Procurement Regulation 2019*, Part 3.

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

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

- Complainants must first raise their complaint with the relevant government business.¹⁵⁹ While in some cases this is appropriate, it may discourage complaints where complainants fear retribution from the government business (e.g. where the government business also has regulatory functions the complainant engages with).
- There are multiple review bodies (Office of Local Government, NSW Procurement Board and IPART) and review processes, depending on the nature of the complaint. This adds unnecessary complexity and creates uncertainty for complainants about where to lodge a complaint and how it will be dealt with.

- Complaints regarding state government businesses must be referred by the relevant Minister (depending on the nature of the complaint), subject to the relevant Minister being satisfied of several requirements. The Minister is not required by statute to provide reasons to the complainant for not referring a complaint to the review body.

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

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

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

7.2.1 Improving access to the complaints process

The priorities for improving access to the complaints system are:

- A more open and accessible process where complaints can be made directly to the complaints body, and there is a single process with a single complaints body.
- Recognition of the concerns competing businesses have in contacting government businesses directly in certain circumstances and appropriate treatment of confidential information on both sides of the complaint.
- A process with low barriers to making a complaint but discretion for the complaints body to proceed with investigation, after having regard to the public interest.

Each of these is discussed further below.

A more open and accessible process

Local Government NSW suggested the Office of Local Government retain complaints handling responsibility for local government.¹⁶⁰ It felt that the current process is already simple and accessible. Other stakeholders supported IPART handling the entire complaints process.¹⁶¹

We consider that IPART is well placed to hear competitive neutrality complaints as the single complaints body, as we are independent from government, we have expertise in competitive neutrality, and we have regulatory functions in relation both state and local government. We also have a track record of acting quickly to conduct independent investigations and resolve issues across a number of different industries.

By allowing complaints to be made directly to IPART, the Minister will no longer need to receive complaints or make referrals for complaints to be investigated.

While Office of Local Government could continue to investigate local government complaints, this would retain a fragmented approach which we have heard complainants find confusing to navigate. It also does not seem sensible to allocate the Office of Local Government responsibility for hearing complaints against state government businesses, as these sit outside the scope of its operations.

Similarly, the scope of the NSW Procurement Board's current role in relation to competitive neutrality is also narrow (limited to complaints about pricing of tender bids by state government businesses).^a Given its other responsibilities largely relate to government procurement, we consider it would not be suitable for the broader complaints handling function.

Recognising concerns around confidentiality and retribution

The process should encourage, but not require, the complainant to first raise the issue with the government business.

Several respondents at the public hearing indicated a preference for government businesses to respond first to a complaint, to avoid stretching IPART's resources.¹⁶² By contrast, several stakeholders to the Issues Paper suggested that the requirement to contact the government owned business in the first instance stopped them from making a complaint. They were concerned about the repercussions, particularly where government entities undertaking business activities are also responsible for regulating their activities.¹⁶³ This concern was reiterated in the Caravan and Camping Industry Association submission to the Draft Report.¹⁶⁴ In light of this concern, we recommend that complainants be allowed to contact IPART directly. IPART should encourage, but not require, the complainant to first raise the issue with the government business.

There should be some limited scope for complainants' identities to be kept confidential (upon request to IPART), subject to any overriding legal obligation to disclose the confidential information (e.g. to accord the subject of the investigation procedural fairness or in response to an access application under the *Government Information (Public Access) Act 2009*). This was supported by the Caravan and Camping Industry Association for similar reasons to those raised in support of complaining directly to IPART.¹⁶⁵

The current provisions in Part 4C of the *Independent Pricing and Regulatory Tribunal Act 1992* (IPART Act) about treatment of confidential information should be retained. These provisions include the authority for the Tribunal to give directions prohibiting or restricting the disclosure of confidential information provided for the purposes of an investigation.

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

Reducing the barriers to making a complaint

Removing the requirement for a complaint to be made by an actual or potential competitor, consistent with the process in the Commonwealth and Victoria, would allow complaints to be raised by non-competitors, such as ratepayers, consumers and private businesses who purchase services from government businesses.^b This was supported by several submissions to the Draft Report.¹⁶⁶

Allowing complaints to be made at low costs with relatively little information allows for patterns and systemic issues to be identified. However, it may also encourage vexatious or frivolous complaints, a concern raised by Local Government NSW.¹⁶⁷ To address this, we propose to recommend that IPART is able to determine whether to proceed with an investigation after considering the basis for the complaint and the likely public interest in pursuing it. This is similar to the NSW Ombudsman's process.^c

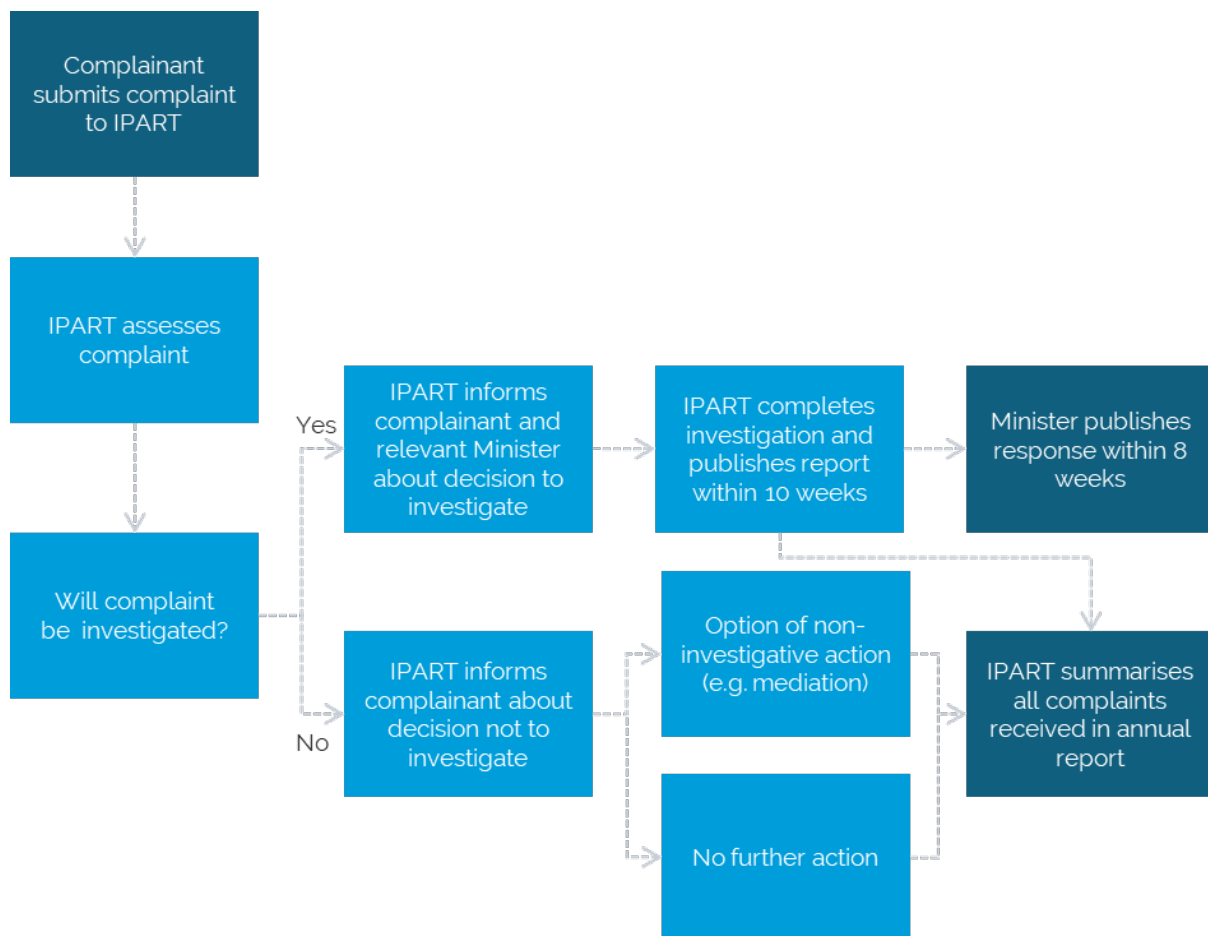
Several submissions made suggestions on information that IPART should report on complaints at an aggregate level.¹⁶⁸ IPART has an obligation to include statistical summaries of complaints and investigations in its annual report.¹⁶⁹ As part of this we will provide high level reporting on the number of complaints received, those that we have agreed to investigate and outcomes of the investigation, including compliance with IPART's recommendations.

The recommended revised complaints process is set out at Figure 7.2.

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

^c The NSW Ombudsman has a large amount of discretion under the *Ombudsman Act 1974* (NSW) regarding which complaints to investigate. It has released guidance explaining what factors it will consider, including resourcing and the public interest, when exercising this discretion.

Figure 7.2 Revised complaints process



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

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

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

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

The *Public Interest Disclosures Act 1994* sets in place a system to encourage people who work in the NSW public sector to report serious wrongdoing in the sector without fear of being sued for defamation or breach of confidence or action in reprisal for their making a report.

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

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

Recommendation



19. The complaints process be made more open and accessible with a single process and a single investigative body (IPART). Complainants would be able to make complaints directly to the investigative body removing the need for Ministerial referral. Restrictions on who can make a complaint and requirements to contact the government business first would be relaxed. Amendments to Part 4C of the IPART Act, section 173 of the *Public Works and Procurement Act 1912* and Part 3 of the *Public Works and Procurement Regulation 2019* should be made to give effect to this recommendation.

7.3 IPART's role as complaints body

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

Box 7.1 The Victorian approach to complaints

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

Box 7.1 The Victorian approach to complaints

- The complaints body cannot initiate an investigation.
- The complaints body accepts complaints from a directly affected person or business, as well as from industry or community groups.
- The complaints body abides by principles of procedural fairness and investigates accepted complaints fairly, independently and rigorously and comes to a finding on the basis of the best available information.
- The complaints body consults with, and seek comments from, all parties involved before finalising its investigation.
- The complaints body provides finalised investigation reports - excluding any commercial in confidence information - to the parties and publishes them on its website.
- The complaints body has no enforcement powers and cannot recommend compensation or termination of contractual arrangements.

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

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

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

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

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

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

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

When a complaint has been accepted the Commissioner will:

Box 7.1 The Victorian approach to complaints

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

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

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

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

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

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

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

This is consistent with the approach taken in Victoria, which requires complaints to be made in writing using its competitive neutrality complaints proforma. The Victorian proforma requires the following information:¹⁷⁰

- a description of the nature of the business affected, including any special features that the Commissioner needs to be aware of
- the identity of the government agency
- a summary of the complaint and description of the type of unfair advantage
- evidence that supports the complaint (for example, sales data and pricing information for similar products or services)
- where relevant, other supporting information - such as copies of correspondence, references to material, and images - can be included
- if the complaint includes commercially sensitive information which the complainant does not wish to be disclosed, it should be marked clearly as "Commercial in Confidence".

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

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

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

- the ability to decide not to investigate a complaint (in which case we would provide reasons for our decision to the complainant)
- the option of non-investigative action (for example, mediation)
- the ability to consider separate complaints of a similar nature jointly. This was supported by the Australian Diagnostic Imaging Association in its submission to the Draft Report.¹⁷¹

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

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

Where IPART would decide to commence an investigation, we would use our best endeavours to complete the investigation and report publicly within 10 weeks after receiving the complaint. We propose that there should be an obligation to notify the portfolio Minister responsible for an entity that is the subject of a complaint when an investigation into a complaint commences. Additionally, we propose that the requirement that a written response from the responsible Minister be made public within 8 weeks of IPART's report be retained. These recommendations are broadly consistent with existing IPART processes for handling competitive neutrality complaints under the IPART Act.¹⁷²

Recommendation



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

7.4 Possible outcomes of a complaint

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

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

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

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

IPART would continue to have no enforcement powers to compel a government business to implement its recommendations, nor would IPART be able to recommend compensation or termination of contractual arrangements. These recommendations were supported by Albury City Council and the Australian Diagnostic Imaging Association.¹⁷³ Section 8.5 further discusses IPART's potential enforcement powers.

Recommendation



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

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

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

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

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

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

Recommendation



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

7.5 Case studies of the complaints process

We have done customer journey mapping case studies to compare the current competitive neutrality complaints process against our proposed process. These are both based on real experiences shared with us by stakeholders on a confidential basis.^e

^e Some of the details in the case studies have been changed to prevent disclosing the identities of the sources.

The information we have been provided clearly shows that the current process is not delivering satisfactory outcomes. Despite the fact that no complaints have been made in NSW, there are non-government businesses that are unhappy with the way competitive neutrality policy is working. These businesses have put significant time and resources into pursuing a complaint but have not had their concerns addressed.

The following figures provide an overview of the case studies. More detailed information including an explanation of how we estimated the costs is provided in Appendix B.

Figure 7.3 Case study of Company A's complaint experience

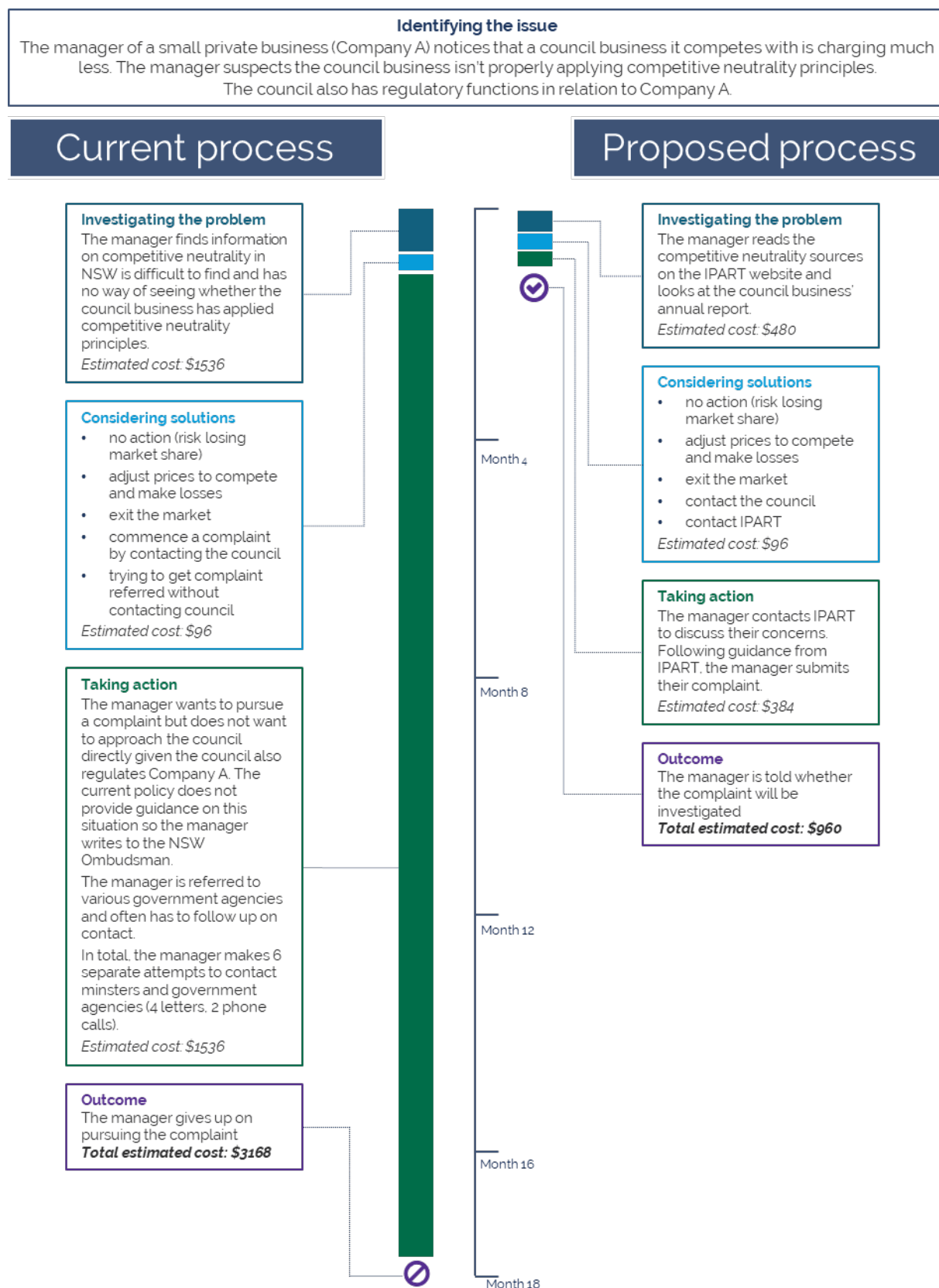
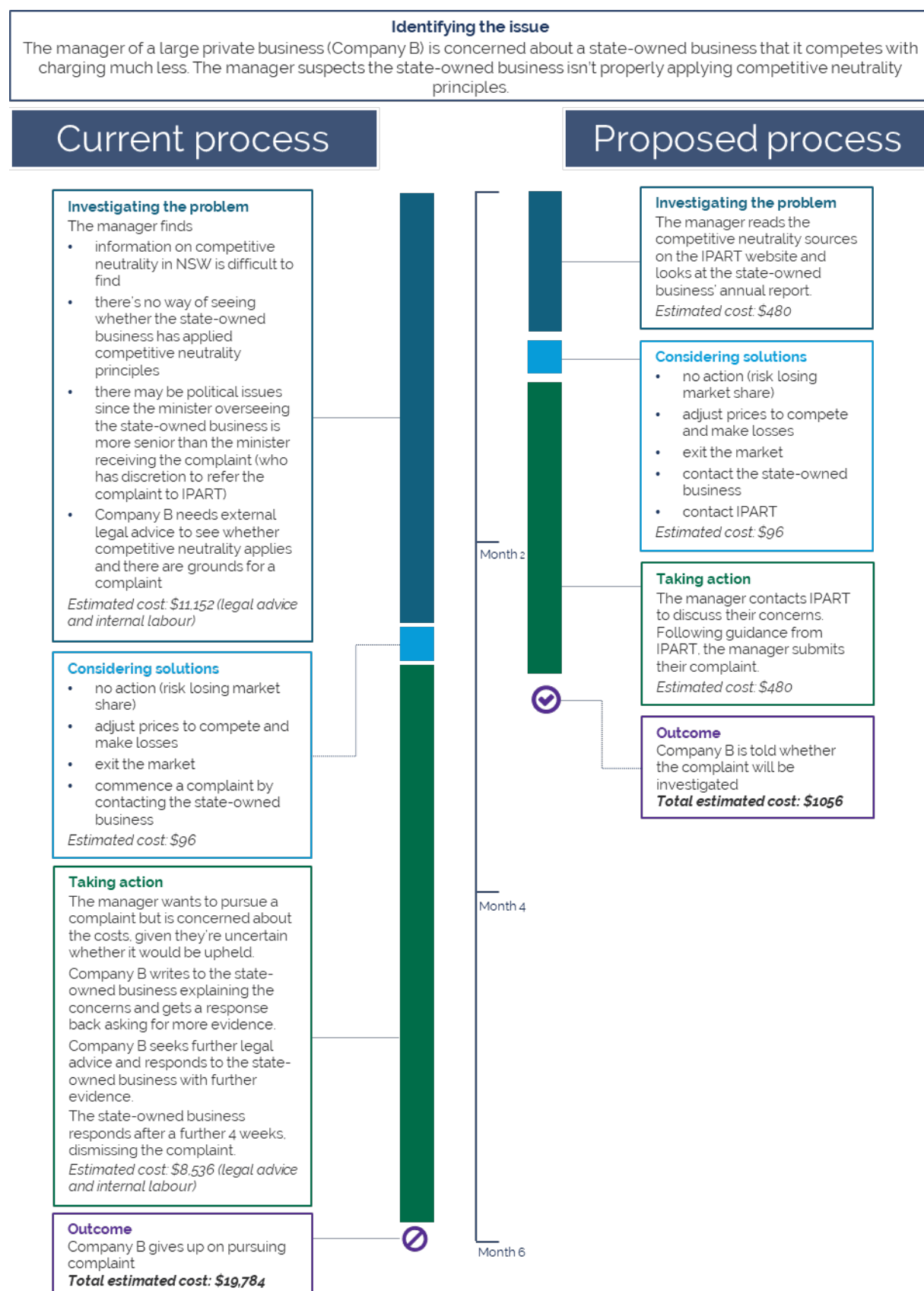


Figure 7.4 Case study of Company B's complaint experience



Chapter 8 >>

Governance, training and transparency

Ensuring that the policies are implemented as intended and periodically improved



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

Compliance with competitive neutrality is the responsibility of individual government businesses, or the government entities that control them, and is tested through the complaints process. Without an appropriate level of transparency, there is little distinction between whether a government business is legitimately exempt from competitive policy or whether it has not applied competitive neutrality principles at all. This can leave competing businesses confused about whether they should pursue a complaint and the prospects of its success.

It is also important that sufficient advice and guidance is available to support government entities to implement the revised competitive neutrality policy correctly in the first place.

8.1 Overview of the recommendations

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

There was also an appetite for greater provision of resources, training and advice on competitive neutrality issues from government and non-government stakeholders alike. We recommend that IPART develops a suite of resources and tools for government entities to use, such as templates and checklists. This is based on feedback from stakeholders at workshops, in submissions and at the public hearing. These resources will complement the provision of advice by NSW Treasury to government entities.

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

We considered stronger compliance measures such as voluntary accreditation (where a government business seeks approval for its competitive neutrality approach from an independent body) or penalties for non-compliance. At this stage we don't recommend stronger compliance measures.

The combination of a simplified complaints process (proposed in Chapter 7), clearer guidance and educational resources and improved reporting should improve compliance with competitive neutrality and help identify problem areas. Stronger measures could be considered as part of future reviews, for instance if complaints under the proposed complaints system indicate systemic issues.

8.2 Reporting obligations to increase transparency and compliance

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

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

An effective reporting framework helps raise awareness of competitive neutrality and gives competing businesses confidence that the government businesses they compete with are playing by the rules



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

NSW councils are required to report on progress in implementing competitive neutrality in their annual reports and the Office of Local Government is required to report on overall progress in its annual report.¹⁷⁴ Councils are required to include in their annual reports:

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

- a comparison of actual performance during the year with the projected performance of category 1 businesses, including an explanation of any difference.¹⁷⁵

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

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

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

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

8.2.1 Annual reporting by agencies would improve transparency

The Harper Review recommended that all Australian governments should require government businesses to include a statement on compliance with competitive neutrality principles in their annual reports.¹⁷⁶ This is already the case in the Commonwealth, Queensland, Tasmania, and Victoria.¹⁷⁷

In submissions to our Issues Paper and in stakeholder workshops, various non-government stakeholders suggested that government businesses should have to provide enough information in their annual reports to give their competitors confidence that they are being competitively neutral.¹⁷⁸

However, some government stakeholders expressed concern about being required to publish commercially sensitive information in their annual reports.¹⁷⁹ Since their competitors would not need to do the same, they argued that this would place government businesses at an unfair disadvantage.

We consider that, as proposed by NSW Treasury in its submission to the Issues Paper,¹⁸⁰ the revised competitive neutrality policy should improve reporting and access to public information. This involves government entities providing the information set out in Figure 8.1 in their annual reports. This would be subject to any commercial confidentiality restrictions.

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



Statements of **compliance reporting** for all government owned business activities. This involves identifying business activities run by the government entity, including where competitive neutrality has not been applied because of the public interest test or because they do not meet the significance test.



Summary of the **costs and benefits of applying competitive neutrality** where a public interest test has been applied to exempt a significant government business activity and the associated size of the subsidy. This would apply to activities which were operating during that year.



Steps taken to comply with competitive neutrality policy (including the last date the tests for whether competitive neutrality needs to be applied were assessed).



Basis of pricing decisions (fully distributed costs, avoidable costs, market pricing or other) where competitive neutrality has been applied.



Number of complaints received about competitive neutrality, their outcome and any changes made by the business in response.

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

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

In its submission to our Issues Paper, Local Government NSW pointed out that councils already comply with multiple reporting and regulatory obligations and suggested that no additional obligations be introduced.¹⁸¹ Local Government NSW questioned the proportionality of the regulatory and reporting obligation (in terms of time, cost, and IT systems), and compatibility with pre-existing frameworks.¹⁸²

Other submissions from councils, a government business and business peak bodies to our Draft Report supported basic reporting requirements in annual reports.¹⁸³

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

To reduce the reporting burden for councils providing competitive neutrality information, the Caravan & Camping Industry Association of NSW has suggested templates and other guidance materials be created for councils. These documents would clearly set out the minimum reporting requirements.¹⁸⁴ As discussed in section 8.3, we agree with this proposal.

Some stakeholders suggested that government entities supplement annual reporting with additional website content on competitive neutrality.¹⁸⁵ We consider that, at minimum, local government should publish the following information on their websites:

- how to make a complaint
- links to their annual reporting on competitive neutrality and their active public interest assessments.

Recommendation



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



24. Agencies provide information on how to make a competitive neutrality complaint on their website, in addition to links to annual reporting on competitive neutrality and their active public interest assessments.

8.2.2 Annual reporting by IPART

IPART is required to include a statistical summary of complaints received by it, investigations conducted by it, and complaints disposed of by it, for the relevant year in its annual report.¹⁸⁶ This annual report is presented to Parliament.¹⁸⁷

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

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

As part of this reporting, we will follow up on whether recommendations to businesses resulting from complaints investigations have been implemented. More broadly, we may comment on the implementation of any changes to competitive neutrality policies arising out of this review. We will also report on the number of complaints by industry, sector and size, to inform Parliament about the emerging data on the size of the problem.

8.3 Greater provision of advice, resources and training

Our competitive neutrality workshops revealed that the levels of awareness of the competitive neutrality policies is low across state and local government and further guidance is needed to support these stakeholders to implement competitive neutrality principles. Several submissions from government and non-government stakeholders to the Issues Paper and Draft Report also called for more guidance.¹⁸⁸ The Local Government NSW submission to the Issues Paper noted that resources including simple guidelines, checklists and templates would increase awareness and reduce the administrative burden of complying with competitive neutrality.¹⁸⁹ It reiterated this in its submission to the Draft Report and requested that the costs of implementation and transition, including ongoing additional staffing costs, be met by the state government.¹⁹⁰

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

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

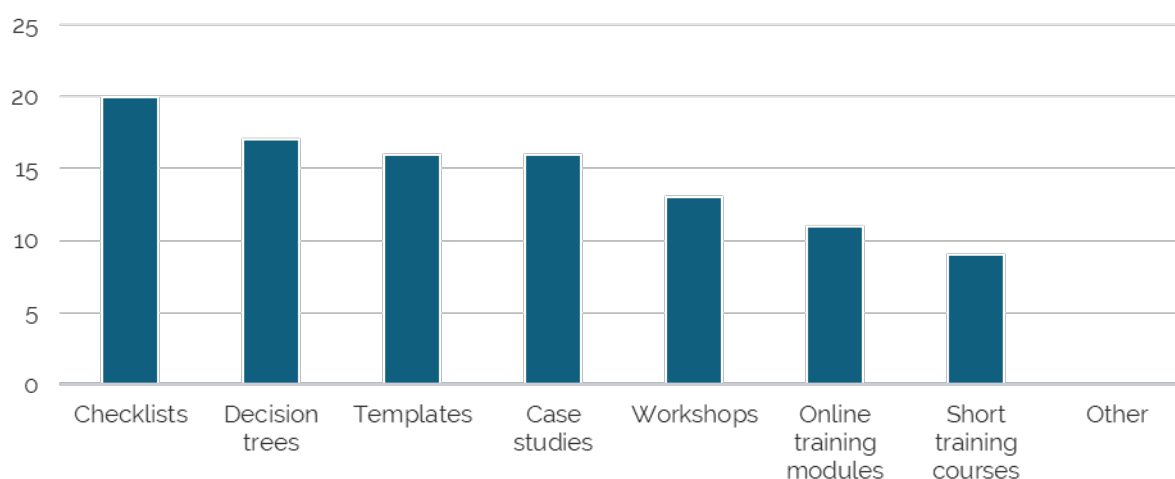
These resources would offer a cost-effective means of supplementing a revised, simplified policy and the provision of advice by NSW Treasury to local and state government agencies. Some examples of resources we propose to develop are:

- checklist of criteria to assess the significance of a government business activity
- decision tree of factors which could trigger the need to reassess significance of government business activities
- further guidance to conduct a public interest test, including undertaking a cost-benefit analysis
- decision tree to assess which pricing approach is appropriate for a government business activity
- guidance to account for both advantages and disadvantages of Government ownership
- templates for annual reporting of competitive neutrality compliance

- case studies to illustrate how the tests would apply to activities of particular interest to state and local government entities.

In our public hearing, attendees had the opportunity to vote for the type of resource that would be most useful to them (Figure 8.2). Checklists, decision trees, templates and case studies were considered most useful.

Figure 8.2 Public hearing survey results: what format of resources would be most useful to meet you to apply the revised policy? Select all that apply



Source: IPART competitive neutrality public hearing, 13 February 2023.

Additionally, we propose to co-design guidance resources with representatives of state and local government businesses, and potential complainants. IPART would facilitate the co-design process and would invite interested stakeholders to participate. This will ensure that the resources are relevant, fit for purpose and are compatible with existing procedures and systems (e.g. compatibility between proposed costing obligations and existing accounting methods).

This will help competitive neutrality principles to be embedded into government entities' 'Business as Usual' approach as suggested by LG Professionals NSW.¹⁹¹

Recommendations

25. NSW Treasury continue to provide advice to support state government entities to understand and apply competitive neutrality policies and principles. This advice would also be extended to local government entities, if the local and state government policies are combined (Recommendation 1).
26. A suite of resources and tools, such as templates and checklists, be developed by the complaints handling body through a co-design process to support stakeholders to understand and apply competitive neutrality policies and principles.

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

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

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

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

In its submission to our Issues Paper, the NSW Productivity Commission (part of NSW Treasury) suggested that NSW Treasury, as the policy issuer, review the NSW revised competitive neutrality policy and process documents every 5 years and that this requirement be built into the policy itself.¹⁹² This would align with review requirements that apply to other NSW Treasury policy documents and could include an additional process for minor ad hoc changes with minimal formality to allow for any necessary corrections to be made outside of the 5-yearly review.

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

Other submissions suggested that the revised competitive neutrality policy should be subject to a periodic review, which should happen at least every 10 years.¹⁹³ These submissions did not identify who such reviews should be done by (for example, NSW Treasury as the policy holder or IPART as an independent body).

We recommend that the policy be reviewed by NSW Treasury, as the policy owner, every five years, consistent with other NSW Treasury policies. This recommendation was supported by Albury City Council and Australian Diagnostic Imaging Association in their submissions to the Draft Report.¹⁹⁴

Data collection and reporting will be an important element of future reviews. This is because it aids in understanding the NSW competitive neutrality landscape and can inform future improvements to the policy. If our recommendations on annual reporting requirements (recommendations 23 and 24) are implemented, then more data will be publicly available to inform future reviews. Compiling this data on an annual basis would amount to a significant administrative burden, due to the wide scope of business activities at the state and local government level. We consider that a 5-year reporting interval would be appropriate, and would coincide with the review of the policy.

Recommendation



27. NSW Treasury review the competitive neutrality policy every 5 years, consistent with other Treasury review processes. As part of this review, they should report on the following data, at a minimum:
- the total number of government businesses in NSW, the number that apply competitive neutrality, the number that pass the government activity and significance tests, and the number that apply the public interest test, and
 - their sector, industry and size (e.g. by revenue, turnover or assets)

8.5 There is insufficient evidence to justify stronger compliance measures at this stage

We have proposed improvements to the current policy, which we consider will improve compliance with competitive neutrality. The changes should also make it easier to gather better data on where competitive neutrality and other competition issues exist. That evidence can inform future reviews of the policies.

The proposed improvements include:

- making the policy easier to apply, by clarifying and providing greater guidance on its scope, objectives, and obligations
- improving the transparency of reporting on competitive neutrality and making it easier for affected parties to make a complaint where they feel the rules have not been followed.

Relying on complaints, transparency, and improved guidance to promote competitive neutrality principles relies on the reputational risk from an adverse investigative finding, and awareness of competitive neutrality to drive compliance. By contrast, more formal compliance processes include:

- voluntary accreditation (discussed in the following section), which involves one or more government businesses approaching an independent body, such as IPART, to seek approval for its competitive neutrality approach
- compliance auditing by an independent organisation such as IPART, NSW Treasury as the policy owner or the Audit Office, and
- penalties for non-compliance.

Voluntary accreditation and compliance auditing are resource intensive for the government business and the relevant independent body. Penalties are also expensive to administer and are typically associated with serious contraventions of rules.

At this stage, there is insufficient evidence of the size and impact of the problem to justify more formal and/or stringent compliance processes. IPART may receive higher numbers of complaints following the simplification of the complaints process and enhancements to reporting requirements. In this case, the NSW Government could review whether these more stringent compliance processes are worth pursuing.

Local Government NSW also mentioned the need to raise greater public and business awareness of competitive neutrality, including the public interest test.¹⁹⁵ We consider that greater transparency through basic annual reporting and publishing of public interest tests will help raise public awareness of competitive neutrality.

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

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

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

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

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

IPART may receive higher numbers of complaints following the simplification of the complaints process and enhancements to reporting requirements. In this case, the NSW Government could review whether accreditation would be worth pursuing in future.

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

Chapter 9 >>

Other issues

Related issues that are outside the scope of competitive neutrality policy

09

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

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

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

9.1 Overview of the recommendations

We consider that issues relating to local government procurement terms and conditions should be overseen by the Office of Local Government and should sit outside the scope of competitive neutrality policy. The current local government pricing guideline includes a section on how councils putting services out to tender should construct their processes and assess bids. However, other aspects of procurement sit outside the competitive neutrality policies, and there are state and local government bodies set up to oversee these processes. We recommend the Office of Local Government review the rules around local government procurement to ensure that they adequately incentivise and support local government entities to promote competition when they purchase services.

We also recommend the NSW Government consider putting processes in place to ensure competition impacts are considered when policy decisions that may impact on competition are made. Submissions raised numerous examples of policy decisions that may have adversely impacted competition in a market. Policy development is a core government function and should not be subject to competitive neutrality. It is, however, important that the impact on competition is considered when policy decisions are made.

A systematic process for ensuring that these impacts are picked up as part of the policy development process should help minimise these issues. We acknowledge that the regulatory impact assessment process (set out in NSW Treasury's *Guide to Better Regulation*)¹⁹⁶ requires government agencies to consider competition impacts when developing legislation and regulations and exercising administrative powers. Some policy decisions that impact on competition are not picked up by the regulatory impact assessment process because, for example, they are set out in policy documents or relate to funding. It is these decisions that require more systematic consideration of competition impacts.

9.2 Local government procurement terms and conditions

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

For example, a local council issues an invitation to tender for waste and recycling collection services. If it is the council's preference to retain the collection service in house, then council will load the terms and conditions with fines and penalties and unfair assignment of risk. This then creates a competitive disadvantage to the private business sector thereby not allowing for competitive neutrality. Competitive neutrality cannot just be about pricing. It must be about ensuring a level playing field for all parties from start to finish.¹⁹⁷

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

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

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

- When councils are purchasing services, the guideline encourages the council to consider financial risks and contractors' liability associated with appointment of an external service provider and factor this into the price of external bids.
- When councils are tendering to provide services, it requires councils to include the full costs of providing the service in their bid (i.e. all direct and indirect costs, tax equivalents, debt guarantee fees and rate of return). The council is then required to evaluate each bid on a common basis.¹⁹⁸

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

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

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

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

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

As a result, we recommend:

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

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

Recommendation



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

9.3 Impact of policy decisions on competition

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

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

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

9.3.1 Selectively subsidising services in a market

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

Stakeholders have expressed concern that the NSW Government's provision of free preschool for children, through the NSW Start Strong Free Preschool program, has adversely affected enrolments for small business [early childhood education] services in recent years. The program requires services to be a not-for-profit community-based preschool or mobile preschool service to participate.¹⁹⁹

The Small Business Commission noted that the NSW Government has made changes to address some of these impacts in this particular case, including by introducing the Start Strong Long Day Care program. The potential competitive advantages are available to non-government providers as well as government businesses, and therefore this is out of scope of competitive neutrality policy. However, our view is that the government should ensure that it systematically considers impacts on competition in advance of deciding to subsidise services in any industry.

9.3.2 Minority ownership of a business

Our Terms of Reference required us to investigate how competitive neutrality principles should apply when government has a minority ownership stake in a business. Businesses with minority government ownership may benefit from access to cheaper finance or perceptions of lower risk but are not captured by the current competitive neutrality policy because the Government does not 'control' the entity. This would still be the case under the revised policy updated with our recommendations if the government does not control the minority owned entity.

In 2000 the COAG decided that in these circumstances, a 'best endeavours' approach requires, at a minimum, that governments provide a transparent statement of competitive neutrality obligations to the business in which they have a minority stake. COAG suggested governments could also:

- have staff available to answer the business' questions
- prepare information for and meet with the business regularly
- request regular reports from the business
- undertake joint reviews with the business of its competitive neutrality policies.²⁰⁰

However, the competitive neutrality policies in NSW have not been updated to reflect this decision. The NSW Government's current approach is to encourage the relevant government business to comply with competitive neutrality principles.²⁰¹

In response to our Issues Paper, NSW Treasury recommended competitive neutrality and other policy implications should be considered as part of investment decisions, submitting that:

Given the possible competitive neutrality advantages from even a minority government equity share, the NSW Government should commit to applying competitive neutrality principles, to the extent relevant, to all equity investments. This would require the NSW Government to undertake a considered and transparent assessment of competitive neutrality prior to becoming a part owner of a business or divesting a controlling share of a government business. This is the point at which the NSW Government can implement competitive neutrality principles, for example through contractual arrangements. Other policy considerations should also apply, including whether it is an appropriate role for government and broader competition policy implications.²⁰²

As specified by the government ownership test, we recommend the revised competitive neutrality policy should only apply to fully government owned business activities or, if a business activity is partly owned by government, where the business activity is controlled by government. Therefore, business activities where the government has a minority stake without control would not be subject to the revised competitive neutrality policy. However, we agree with NSW Treasury's submission and consider that the NSW Government should consider impacts on competition and competitive neutrality principles before it becomes a part owner of a business or when it divests a controlling share of a government business.

The decision to invest or divest is a policy decision, not a business activity to which competitive neutrality applies. However, when it makes these policy decisions, the NSW Government should consider whether competitive neutrality principles would apply to future operations of the business and structure the business accordingly. This will inform decisions around control and what mechanisms need to be put in place to ensure competitive neutrality principles can be applied to business activities. We also recommend the NSW Government consider the broader competition implications and whether the investment is appropriate for government. For example, government investment in an individual business may be seen as giving unfair preference to that business over other similar businesses in the sector. The competition implications also need to be weighed against other policy objectives.

9.3.3 Providing grants to businesses

Government economic activities such as providing grants may impact competition but would not be captured under the revised competitive neutrality policy. We are not proposing to broaden the scope of competitive neutrality policy to capture businesses that receive government grants. However, we recommend that the NSW Government consider impacts on competition when administering grants to ensure that they do not distort competition in the market. The NSW Government could include these considerations in its Grants Administration Guide.²⁰³

9.3.4 Unequal access to data and the role of open data

Government actions and decisions can impact on competition, whether intentionally or not. For example, governments providing certain businesses with access to data, or publishing data and later removing access to it, can impact businesses who rely on that data. While there may be good policy reasons to provide limited access or remove access to data, we think there is benefit in encouraging government entities to consider impacts on competition when making these decisions. We also encourage government entities to consider open data initiatives where possible. We consider some of these issues could be addressed by open data, and open data could play a role in enabling competition and reinforcing trust in government.

Recommendation



29. The NSW Government review its processes to ensure that it systematically considers impacts on competition when making policy decisions that are likely to impact competition and which may not be picked up by regulatory impact assessments. This includes:
- a. subsidising services in a market
 - b. acquiring minority government ownership of a business when competitive neutrality policy does not apply because the government does not fully own or, if it partly owns the business, does not control the business
 - c. providing grants to businesses
 - d. providing or removing access to data.

9.4 Other issues relating to fair processes

Competitive neutrality is one of many policies and processes that promote competition and fairness for private businesses competing against government entities. Other existing competition policy levers could be used in addition to, or instead of, any proposed changes to competitive neutrality policies. The NSW Department of Premier and Cabinet (DPC) submitted that IPART should review any proposed reforms to the competitive neutrality policies in the context of other competition policy levers, such as:

- the application of the NSW procurement policy
- a review of any differences in regulations for government and private businesses operating in the same sector
- enforcement of existing national competition policy and regulations through the Australian Competition and Consumer Commission (ACCC).²⁰⁴

In addition to the policy levers raised by DPC, the Competition Principles Agreement contains a guiding principle that legislation should not restrict competition unless the benefits of the restriction outweigh the costs, and its objectives can only be achieved this way.²⁰⁵ Under the Competition Principles Agreement, state governments are required to review legislation with potential competitive impacts systematically every 10 years,²⁰⁶ including examining the net public benefits of keeping or removing competitive restrictions. The NSW Government also promotes fair and open competition through its procurement objectives.²⁰⁷

The sections below discuss issues raised by stakeholders that we consider are outside the scope of competitive neutrality policy and should be addressed through other policy levers.

9.4.1 Concerns about unfair advantages enjoyed by public universities

Independent Higher Education Australia (IHEA) submitted that public universities have many advantages that prevent private higher education providers from competing on a level playing field.²⁰⁸ The advantages they discussed include:

- the FEE-HELP loan fee of 20%, which applies to education and training for independent sector students, not being imposed on students attending public and private universities
- disability funding only being available to Table A university providers
- the independent sector having more exposure to regulatory processes
- public universities not adequately calculating the true cost base of postgraduate courses.

IHEA's concerns relate to a wide range of issues around access to funding and different regulatory arrangements that apply to public and private higher education providers. While IHEA notes that the regulation of the Higher Education sector is mostly conducted at the federal level, it also argues that many of the independent sector businesses operate and are headquartered in NSW and face competition from NSW public universities. However, our view is that these issues are outside the scope of NSW's competitive neutrality policy as they relate to federal funding decisions and regulations. Further, NSW public universities are not within the control of the NSW Government.^c

IHEA's submission advocates for NSW competitive neutrality policy to be broadened to apply to public universities' educational activities. Currently, competitive neutrality principles only apply to the non-education activities of public universities. We do not consider the competitive neutrality policies should be expanded to include the educational activities of public universities, as the tests can be used to determine whether competitive neutrality principles apply.

^c This will be clarified under the proposed definition of government ownership, which uses NSW and local government general government sector classifications under the GFS should address the issue. Under the GFS, universities fall within a general government sector category called 'control not otherwise defined'. Public universities are categorised at the national level because they are considered to be implementing policy (i.e. tertiary education) that is primarily of concern at a national level.

9.4.2 Concerns about land use and development

Urban Taskforce raised concerns about government entities having unfair advantages when accessing industrial land for redevelopment and residential land releases. It also raised concerns about Transport for NSW's approach to compulsory acquisitions. Urban Taskforce submitted that:

- different rules appear to apply to the private sector versus the public sector when it comes to industrial land
- Landcom appears to receive preferential treatment when it comes to residential land releases
- there is a perception, reflected in a recent Parliamentary Inquiry report, that Transport for NSW, along with the office of the Valuer General, is pursuing land acquisition in poor faith, often involving low initial offers and drawn-out processes.²⁰⁹

Our view is that these issues are outside the scope of competitive neutrality policy and would be better dealt with through another policy. It appears that Urban Taskforce's concerns about compulsory acquisitions are being addressed through the Parliamentary Inquiry into acquisition of land for major transport projects, which made several recommendations including that the NSW Government commission an independent review into land acquisitions.²¹⁰

9.4.3 Concerns about Medicare rebates for public hospitals

The Australian Diagnostic Imaging Association raised concerns about public hospitals providing outpatient radiology services benefitting from access to both state government funding and Medicare rebates, while private providers have access to the Medicare rebate only. In its submission to our Issues Paper, the Australian Diagnostic Imaging Association contended that "in order to ensure competitive neutrality, consideration could be given to reducing the financial support provided to government owned businesses or reduce the reward on the point of providing the good or service (in radiology's case, the Medicare rebate)."²¹¹ Changing the Medicare rebate is a federal issue and is outside the scope of NSW competitive neutrality policies and our review.

The Australian Diagnostic Imaging Association (ADIA) made a subsequent submission to our Draft Report, stating that:

ADIA agrees with IPART's findings that the quantum of and access to Medicare rebates is out of scope for NSW competitive neutrality policy; that policy responsibility rests with the Commonwealth. What services NSW public hospitals choose to provide to outpatients and how those services are priced to the consumer is in scope.²¹²

We consider that to the extent that these activities fall within scope of the competitive neutrality policy (i.e. constitute significant government business activities), they will need to apply competitive neutrality costing and pricing guidance to those activities.

9.4.4 Concerns about oversight of statutory service providers

In response to our Draft Report, Local Government Professionals Australia, NSW submitted that the oversight of government businesses that are statutory service providers (such as Audit Office of NSW and Revenue NSW) has not been adequately addressed in our review so far.²¹³ Specifically, Local Government Professionals Australia, NSW suggested Audit Office of NSW processes has created a monopoly service approach that does not provide for auditor selection.

The Audit Office of NSW is a statutory authority which conducts audits of NSW Government agencies (including councils) under the *Government Sector Audit Act 1983* and *Local Government Act 1993*.²¹⁴ It has a role under statute as the auditor of councils and other auditable entities which is distinct from other types of auditors. This statutory duty falls out of the scope of competitive neutrality, as it would not pass the business activity test (see Section 4.3). We have not identified any business activities carried out by the Audit Office of NSW, which could potentially be subject to competitive neutrality principles.

9.4.5 Concerns about charges for water and sewerage services for fire service capacity

An anonymous submission raised concerns about Bathurst Regional Council's annual availability charges for water and sewerage services.²¹⁵ The submitter alleged that the Council:

- unlawfully included a charge for "fire service supply capacity" in annual charges for water and sewerage services to non-residential properties under section 501 of the Local Government Act, and
- failed to comply with the *Guidelines for Best-Practice Management of Water Supply and Sewerage*.^d

Whether a council, or one of its businesses, is complying with statutory requirements for the making and levying of charges is not a competitive neutrality issue and is therefore, outside the scope of the review.

^d We have not sought to verify the accuracy of the allegations raised, as they are out of scope of the review.

Chapter 10 »

Impact of the proposed changes

Our assessment of the likely impact of the changes we are proposing on government businesses

10

We are recommending a suite of improvements to NSW's competitive neutrality policies. The key changes would bring the current set of policies under a single revised policy with clearer, more consistent definitions and obligations across government businesses. Other key changes are aimed at making the complaints process more accessible and government business' application of competitive neutrality policy more transparent.

These changes will necessarily impose some additional costs on government businesses and may require additional training for staff. All government businesses will need to educate themselves on the revised policy and go through a process of re-evaluating their activities to determine whether they are significant, checking their costing and adjustment processes to ensure they are consistent with the revised policy and putting systems in place to record and report on their application of competitive neutrality.

We have been mindful of the impact of these changes as part of our assessment. We have made recommendations that aim to reduce the costs and impacts on staff where we considered it was consistent with the overall aims of the review. For example, we have proposed a more qualitative public interest test for local government businesses in recognition of the fact that they will have to apply this test more often than they would have had to under the current competitive neutrality policies. We have also increased the monetary threshold for the significance test, in recognition of the fact that threshold has been unchanged since it was established in 1996.

10.1 Overview of the recommendations

We are strongly of the view that the transition costs to government businesses in making the changes required to comply with the revised policy are outweighed by the benefits to small and large businesses, to the economy more broadly and to the people of NSW. Nevertheless, we recognise that it will take time for government businesses to change their processes and review their activities. We are proposing that the NSW Government considers a transition strategy for the revised policy that will allow government businesses to adapt to the changes over time. We propose that this transition only occur when resources have been developed to assist government businesses, particularly local government, to adapt to the changes.

We consider that the transition costs associated with the recommendations are an unavoidable consequence of producing an improved revised policy that is clearer, more consistent and more effective. These changes are needed to ensure that government businesses compete on their merits and that the most efficient, dynamic, and innovative businesses are the ones that flourish. A clear and consistent competitive neutrality policy gives businesses the confidence to invest and provides a mechanism for competing businesses to have their concerns heard.

10.2 Transition period

We recommend a practical approach to transition, where the transition to a revised policy should only occur when tools and resources have been developed, ideally through a co-design process, to assist government businesses to adapt to the changes.

Submissions from a range of entities (state and local government businesses, non-government competitors and Local Government NSW) supported a transition period.²¹⁶

We recommend that the transition period provide an appropriate timeframe for government businesses to review their business activities against the revised tests and to update their internal policies and processes to reflect the requirements of the new policy. The duration of the transition period should be determined in an implementation plan released as part of guidance on the revised policy.

Submissions from private business peak bodies suggested that the transition period be short.²¹⁷ For example, Caravan and Camping Industry Association advocated that "once all resources are developed and readily available government businesses should be required to make the transition within 12 months."²¹⁸ We cannot, however, recommend a definite timeline for the transition, given that it is dependent on when the policy commences and its final characteristics.

Recommendation



30. Provide a transition period to give government businesses time to adjust to the changes. We recommend that this transition period commence once NSW Treasury and IPART have developed and published the advice, resources and training necessary to support and guide government businesses to implement the proposed changes.

10.3 Impact analysis







Local Government NSW argued that the "IPART's proposals would appear to greatly add to the existing regulatory burden and community accountability responsibilities... The additional burden may result in councils having to employ additional staff on a permanent basis and invest in new or upgraded reporting software, with councils potentially incurring significant additional costs."²¹⁹

On the other hand, Bega Valley Shire Council noted that the impacts on its operations from changes to competitive neutrality policies and processes are expected to be "insignificant".²²⁰

Overall, we consider that the administrative burden from the proposed changes is likely to be low relative to the existing policies and processes.

In making our recommendations, we have been mindful of the transition and administrative costs and encourage additional support for government businesses. Examples of this are outlined in Figure 10.1 below:

Figure 10.1 Recommended support for government businesses to adopt revised policy

	Designing the tests to be proportionate and easier to apply; for example, increasing the revenue threshold below which competitive neutrality does not apply.
	Creating additional guidance resources for implementing the policy where needed (e.g. flowcharts, case studies and checklists). (See recommendations 10, 12 and 14)
	Minimising burden of requirements as much as possible, for example by allowing a qualitative public interest test for local government and proportionate public interest tests for state government businesses. (See recommendation 14)
	IPART or Treasury to develop templates for government businesses to use in their application of competitive neutrality principles (e.g. annual reporting, applying the public interest test). (See recommendations 25 and 27)
	Encouraging guidance resources to be co-designed with representatives from state and local government businesses to ensure that resources are fit for purpose and compatible with existing procedures. (See recommendation 25)
	Consider a government-wide transition strategy that allows government businesses to adapt to the changes over time. (See recommendation 30)

Any increase in administrative costs is outweighed by the benefits from an effective, transparent, and easier to apply competitive neutrality policy. These benefits are experienced broadly by the community (see Chapter 1 for a discussion of these benefits). They are also experienced by non-government businesses that compete with government businesses. The customer journey mapping case studies in Chapter 7 provide examples of the cost savings that could be achieved for individual complainants and government businesses arising from our recommendations.

We are aware that some government entities currently apply competitive neutrality more stringently than would be required by the revised policy we recommend. We support and encourage government businesses to do this where they consider it is in the public interest. Box 10.1 provides an example of the application of competitive neutrality by Corrective Services NSW.

Box 10.1 Case study – application of competitive neutrality by Corrective Services NSW

Corrective Services Industries, the commercial arm of Corrective Services NSW, is a government business that provides employment and training for prison inmates across NSW. It provides a range of goods and services in competition with the private sector, including textiles, furniture-building, food services and agriculture.

Most of its goods and services are provided for in-house use, but some of its goods and services are provided externally, primarily to other government departments (and so are subject to NSW's competitive neutrality policies).

The revenue threshold that Corrective Services Industries uses to determine when to apply competitive neutrality is currently \$100,000. This is significantly lower than the \$3.7 million proposed in this Report.

Corrective Services Industries has commissioned studies to assist it to determine prices for the goods and services it produced. The studies found that although Corrective Services Industries is not required to pay minimum wages for inmate labour, and, in fact, pays inmates significantly less than this for their work, this did not provide a net competitive advantage once the disadvantages associated with its operations are incorporated.

The studies concluded that 'The low inmate labour rate is largely offset by low inmate productivity (relative to the regular workforce within community facilities) and by high overhead costs (particularly those associated with the attainment of social objectives).'

The Correctional Industries Consultative Council of NSW (the Council) is an integral part of NSW's Correctional Industries. One of the roles of the Council is 'to provide confidence to the community at large that the operations of correctional industries in NSW do not unreasonably impact upon other businesses in Australia'.

This includes maintaining a grievance handling mechanism for grievances raised by business, unions, Members of Parliament or from members of the public in relation to correctional industries activities in the marketplace.

Source: Corrective Services Industry <https://www.csi.nsw.gov.au/Pages/homepage.aspx> website; IPART meeting with Corrective Services NSW (April 2023).

As well as ensuring that changes to the policy do not impose unreasonable costs, it is also important to consider the costs of not making changes. The policy has not been reviewed for 20 years, and we have identified a number of areas where the policy is out of date, ambiguous or not fit for purpose given the changes that have occurred over this time. The costs of not improving the policy are considerable and are borne by a range of stakeholders (see Figure 10.2). The changes we are proposing should make the policy easier to implement, so that the costs of implementation would be lower than the costs of maintaining and adhering to the current policies.

We also consider the high level impacts of the specific changes we have recommended in Table 10.1

Figure 10.2 Burden of getting it wrong



Private Business, especially small business:

- Time and money spent without a clear outcome.
- May exit market or lose market share.



Customers: Loss of choice, value and innovation.



Taxpayer: Public funds may not be used effectively - subsidies may not be in the public interest.



Government business: potentially inefficient service delivery – for example, the government may be providing too much of a good or service.

Table 10.1 High level impacts of proposed changes

Section	Benefits	Costs
Significant government business activities test	<ul style="list-style-type: none"> • In the long run, a clearer, easier to apply revised policy will reduce costs for government businesses. 	<ul style="list-style-type: none"> • The current tests for government ownership, business activity and significance are not well specified. • There are factors in the proposed tests that move in both directions – for example, raising the revenue threshold should mean fewer businesses are captured, but there is the potential for the Minister to declare an activity significant. • It is therefore difficult to assess whether more or less businesses will be captured under the proposed tests.

Section	Benefits	Costs
Costing obligations	<ul style="list-style-type: none"> Change in the rate of return calculation should make the process simpler and more certain for government businesses. However, it would require a business activity to have good information on its debts and equities. Adjustment for the advantages and disadvantages of government ownership remains the same, but the clarification provided may help government business activities to estimate their net competitive advantage. Clarification for non-cost advantages may assist with the complaints process and assist with identifying what to account for. <ul style="list-style-type: none"> Including this guidance is likely to be particularly beneficial for government businesses that are larger, corporatised entities where their market position gives them access to advantages that other businesses do not have. Benefits to the community (most efficient, dynamic, and innovative businesses are the ones that flourish) from better application of the policies. 	<ul style="list-style-type: none"> The recommended approach to costing sets out more specific guidance, which means government business activities may have to alter their costing approach for calculating the competitively neutral price, depending on what their current approach is. SOCs and other government businesses that fall under the scope of NSW Treasury's Commercial Policy Framework will need to apply competitive neutrality to their activities. <ul style="list-style-type: none"> For the most part, this will not impose any additional cost on these businesses compared with the current policies. Where their structure has removed any advantages they would otherwise have had (for example, by requiring them to pay dividends or taxes), they will not need to take any action to address these under the revised competitive neutrality policy.
Public interest test	<ul style="list-style-type: none"> Application of the public interest test ensures that subsidies are deliberate and considered. Greater transparency around the public interest test can help reduce the number of complaints, by enabling complainants to understand competitive neutrality has not been applied. We have recommended a qualitative public interest test for local government and the development of a template to help government businesses to apply the public interest test. 	<ul style="list-style-type: none"> We do not consider that applying and publishing the public interest test will impose a significant additional cost on local governments since we expect that they are already familiar with the objectives, benefits and financial costs of subsidies that are currently in place.
Complaints	<ul style="list-style-type: none"> We consider the proposed changes will make the complaints process more accessible for complainants, without encouraging spurious complaints. IPART will have discretion on what complaints to investigate. 	<ul style="list-style-type: none"> The changes may lead to an increase in complaints, but information from other jurisdictions suggests that the resources required to address complaints are unlikely to be significant.

Section	Benefits	Costs
Governance, training and transparency	<ul style="list-style-type: none"> Increased frequency of competitive neutrality policy review should allow continuous engagement with stakeholders and process improvements. Annual reporting should improve transparency of government activities, which helps to inform stakeholders such as the public and competing businesses, potentially reducing the time government businesses will need to deal with complaints. We have recommended that IPART and NSW Treasury provide more advice, tools, resources and training about competitive neutrality. <ul style="list-style-type: none"> This should help improve awareness of stakeholders but also assist government businesses to implement competitive neutrality at a lower cost. 	<ul style="list-style-type: none"> The proposed reporting requirements are largely consistent with existing reporting requirements for local government. Some additional information would need to be published. This may raise administrative costs for government businesses, particularly until the new processes are bedded down.

10.3.1 Better Regulation principles

In response to our Draft Report, Local Government NSW contended that:

...the proposed CN arrangements would appear to be largely inconsistent with the NSW Government's Better Regulation Principles: the need for government action has not been established, benefits have not been shown to outweigh costs and the proposed action does not appear to be proportional.²²¹

The NSW government, along with all other Australian governments, agreed to implement a competitive neutrality regime that delivers on the aims of the Competition Principles Agreement. We were asked to review NSW's approach to delivering that regime, including whether it meets its aims, whether it is best practice and what improvements can be made to it.^a We consider that our approach to the review and recommendations are consistent with the Better Regulation principles contained in NSW Treasury's *Guide to Better Regulation*.²²²

There is evidence that the current policy is not fit for purpose and is not best practice for delivering on NSW's commitment under the Competition Principles Agreement. There is evidence that the obligations under the current policy are not being universally implemented by existing government businesses. We have been presented with clear evidence that competing businesses are not able to have their complaints heard.

The objective of government action is clear: to deliver on the aims of the competitive neutrality obligations of the state and local governments under the Competition Principles Agreement.

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

We have considered the costs and benefits of a range of options and recommended effective and proportional responses to the issues identified. For example:

- We have been mindful of not solving problems that don't exist.
- There is provision for pricing below the competitively neutral price when this is in the public interest.
- We have recommended adopting best practice approaches that are simpler, clearer, easier to apply and more consistent in order to reduce regulatory burden.

Our review has been informed by community consultation. Many of our proposed improvements simplify and update the current policies.

We have also recommended periodic review of the policy, to ensure that it is working as intended and is informed by the best available evidence.

Appendices

Appendix A >>

Glossary

Commonly used terms within the Final Report



Term	Definition
Community Service Obligations (CSOs)	These are non-commercial activities that the NSW Government has asked a government business to undertake, which address a policy objective. These activities do not achieve a commercial return and would not be undertaken by comparable private sector businesses.
Competitive neutrality framework	This is the suite of legislation, policies and processes that establish competitive neutrality within NSW
Competitive neutrality policies	<p>The 7 policies and processes which establish competitive neutrality within NSW and are subject to this review which are:</p> <ul style="list-style-type: none"> • NSW Government Policy Statement on the Application of Competitive Neutrality (TPP 02-1), 2002. • Guidelines for pricing of user charges (TPP 01-02), 2001 • Part 4C of the IPART Act • Section 173 of the <i>Public Works and Procurement Act 1912</i> and Part 3 of the <i>Public Works and Procurement Regulation 2019</i> • Pricing and Costing for Council Businesses – a Guide to Competitive Neutrality, 1997 • Policy Statement on the Application of National Competition Policy to Local Government, 1996 • Department of Local Government - Guidelines on the Management of Competitive Neutrality Complaints, 1997.
Competition Policy Agreements	The set of 3 intergovernmental agreements from 1995 that establish Australia's National Competition Policy. The 3 agreements are the Competition Principles Agreement, the Conduct Code Agreement and the Agreement to Implement the National Competition Policy and Related Reforms.
Competition Principles Agreement	The intergovernmental agreement that sets out the broad principles of competitive neutrality as agreed between Australian jurisdictions. It is a part of the Competition Policy Agreements.
Corporatisation	<p>This creates an arms-length relationship between government and the government business activity. For example, SOCs have been incorporated as separate organisations. Their boards and management operate within incentive structures that mirror, to the extent possible, those faced by the private sector. Local government businesses activities do not necessarily have to be formally or legally incorporated as separate organisations.</p> <p>Corporatisation requires them to be separately identified within the operations of council and have accounting and other operations structured in a way that provides a distinct reporting framework.</p>
Full cost attribution	This includes a range of costing methods that competitive neutrality policies require government businesses to use to set prices that at least cover the costs of carrying out the business activity.
GFS	The Australian Bureau of Statistics Government Finance Statistics
General government businesses	These are funded directly or indirectly (via consolidated fund) by taxes or fees or fines, through being dependent on other agencies which are directly or indirectly funded by taxes or fees or fines, or through having regulatory functions which enable them to raise taxes, fees or fines.
General government sector agency	Has the meaning given in the GFS
Government business	Means a government entity engaged in business activities
Government entity	Means an entity fully owned or, if partly owned, controlled by government
IPART Act	<i>Independent Pricing and Regulatory Tribunal Act 1992</i>
Local government businesses	The NSW competitive neutrality framework specifies that the provision and operation of water supply, sewerage, gas production and reticulation and abattoirs are activities of local government businesses. Other activities are determined as local government businesses by the circumstances. Generally, a business activity will involve the supply of goods and services for a fee or charge. However, not all activities involving the supply of goods and services would necessarily be classified as business activities.
Local government policy statement	The NSW Government Policy Statement on the Application of National Competition Policy to Local Government, 1996
Local government pricing guideline	Pricing and Costing for Council Businesses – a Guide to Competitive Neutrality, 1997

Term	Definition
Non-government businesses	Business activities that are not local, state or Commonwealth government businesses.
NSW competitive neutrality policy statement	The NSW Policy Statement on the Application of Competitive Neutrality (TPP02-1), 2002.
NSW pricing guideline	The NSW Treasury Guidelines for pricing of user charges, Policy & Guidelines Paper (TPP 01-02), 2001.
Public financial corporations	Has the meaning given in the GFS NSW has 2 public financial corporations- icare and TCorp. For these, the NSW Treasury plays a similar role in monitoring and managing performance as for the SOCs.
Public non-financial corporations	These include both SOCs and self-contained organisational units within the public sector. They are principally engaged in trading activities that could, in principle, be provided through the marketplace without compromising the government's social and economic objectives. They raise most of their income from user charges.
Public trading enterprises	Due to Australian Bureau of Statistics GFS classification changes, they are now called public non-financial corporations.
Significant local government businesses	NSW competitive neutrality policies apply to these. Under current competitive neutrality policies, local government businesses are considered significant based on a monetary threshold using annual sales turnover: <ul style="list-style-type: none"> businesses with sales turnover of more than \$2 million are significant (referred to as category 1 businesses) businesses with a lower sales turnover (category 2 businesses) are considered significant on a case by case basis. Councils should apply full cost attribution to as many of these businesses as is practicable.
Significant state government businesses	NSW competitive neutrality policies apply to these. Under current competitive neutrality policies, state government businesses are considered significant on a case by case basis. Relevant considerations include the: <ul style="list-style-type: none"> business' size business' influence on the market resources commanded effect of poor performance
State Owned Corporations (SOCs)	These are public non-financial corporations that have been corporatised. Corporatisation creates an arms-length relationship with government to ensure that boards and management operate within incentive structures that mirror, to the extent possible, those faced by the private sector. There are 8 SOCs in NSW: <ul style="list-style-type: none"> Essential Energy Forestry Corporation of NSW Hunter Water Corporation Landcom Port Authority of NSW Sydney Water Corporation Transport Asset Holding Entity of NSW WaterNSW.
State government businesses	The current NSW competitive neutrality policies use the term government business to describe parts of the public sector that are principally engaged in trading activities, including the provision of goods and services to other parts of the public sector. The main types of state government businesses include public trading enterprises, SOCs, general government businesses and public financial corporations.

Appendix B

Case studies

Case studies applying our recommendations

B

This appendix provides several case studies of applying our recommendations in practice. The case study in Section B.1 shows how a government business could approach applying the tests for determining which of its activities are significant government business activities, and therefore, will need to apply competitive neutrality to them. Section B.2 shows application of the tests for a different example, as well as determining the competitively neutral price and applying the public interest test. Section B.3 provides supplementary material to the complaints customer journey case studies presented in Chapter 7, based on real experiences shared with us confidentially.

The conclusions drawn are based on the factors described in the case study, some of which have been deliberately simplified. Other than the complaints case studies, we have not used real data. We are not suggesting that the same outcomes would always apply to similar businesses or situations.

B.1 Case study of competitive neutrality tests - mixed use council aquatic centre

This case study aims to assist government businesses (especially local government businesses) in applying each of the proposed tests and to provide practical guidance on what factors should be considered for each test.

B.1.1 Key Information

A council runs 4 aquatic centres and a water play park at a park. It wants to know whether it needs to apply competitive neutrality principles to these activities.

Table B.1 Activities provided by the council

	Recreational swimming	Water play	Spa/sauna /steam room	Gym facilities	Swimming Lessons	Café/retail swim store - rental	Function space - rental
Aquatic centre 1	Y	Y	Y	Y	Y	Y	Y
Aquatic centre 2	Y	Y	Y	Y	Y	Y	N
Aquatic centre 3	Y	Y	N	Y	Y	Y	Y
Aquatic centre 4	Y	Y	N	N	Y	Y	N
Water play park	N	Y	N	N	N	N	N

The water play park is free and unfenced within one of the council's public parks.

The council's current fee structure for the 4 aquatic centres is as follows:

- Membership bundle including access to swimming pool and gym: \$25 per week

-
- Casual pool visit: \$9
 - Casual gym visit: \$24
 - Casual spa/sauna/steam room: \$9
 - Casual swim and spa/steam room/sauna: \$16
 - Swimming classes: \$30 per lesson

B.1.2 Government ownership test

The council determines that all 4 aquatic centres and the water play park pass the government ownership test. They are directly owned by the council and managed by an organisational unit of the council.

B.1.3 Business activity test

An activity is a business activity if it satisfies any 1 of 3 criteria (see Box 4.4 in Chapter 4). The activities are not undertaken by a public corporation (the first criterion), nor do they involve bidding to provide services (the second criterion). Therefore, the council applies the principles-based test under the third criterion to determine whether the activities provided by the centres are business activities.

To pass the principles-based aspect of the business activity test, the activity must:

1. involve the supply of goods and services, with system and regularity, and
2. have a commercial character (whether or not it is profitable), and
3. not be an exempt activity:
 - a. an activity of a policy or regulatory nature, such as:
 - i. policy development
 - ii. carrying out functions to perform a statutory duty, such as:
 - (1) imposing taxes, levies, licensing or regulatory fees
 - (2) granting, refusing to grant, revoking, suspending or varying licences or approvals
 - b. a statutory duty to providing services with no discretion to set their price
 - c. procurement of goods and/or services by a government entity for the purposes of carrying out policy or regulatory functions
 - d. the supply of goods and/or services by a government entity for its own in-house use where external providers have not been invited to tender to supply the goods and/or services
 - e. an activity for which competition is prohibited under legislation (i.e. the entity is legislated as the exclusive provider of the activity and there is no possibility of competition from other providers).

Table B.2 Applying the business activity test

	Recreational swimming	Water play	Spa/sauna/steam room	Gym access	Swimming Lessons	Café/retail swim store	Function space
The activity: a. involves the supply of goods and/or services, with system and regularity,	Y	Y	Y	Y	Y	Y	Y
and b. has a commercial character (whether or not it is profitable)	Y	N	Y	Y	Y	Y	Y
Exempt activity	N	N	N	N	N	N	N

To determine which activities are business activities, the council looked at each activity undertaken across the aquatic centres and water play park separately and considered whether that activity has the requisite commercial character. In this case, the council was confident that the activities it identified should be analysed separately. If in doubt, however, government businesses should use a market assessment to work how to determine whether to group or separate activities for the purposes of the business activity test.^a The council considered the circumstances under which the activity is provided when coming to its conclusions.

In this case study, the council determined that:^b

- The supply of **recreational swimming facilities** is a business activity. While the revenue derived from this activity does not cover its cost, it is provided in a business context and has a business character. It involves the provision of services for remuneration (regardless of whether that is commercially adequate) with a high degree of system and regularity. Recreational swimming is available year-round in some centres and from Spring to Autumn for outdoor pools. The council has discretion as to whether to provide the activity and in setting the price. While facilities in the area that provide only recreational swimming tend to be operated by other councils, there are private traders that offer recreational swimming at facilities with gym and other leisure activities. As such, the council considers the activity to be of a nature which a private trader might provide.

^a A market-based assessment involves considering the product or service category in which competition does, or could, exist. For example, what substitutable products or services would consumers switch to if the price of the good or service increased?

^b Different conclusions may be reached for each activity depending on the circumstances.

- The **water play park** at the local park is not a business activity. The council had decided to install the facilities on the basis that they would be freely available to anyone who visits the park. The water play park consists of a series of small fountains and operates in the same way as the children's playground next to it. The water play park is managed by council staff separately to the aquatic centres and is maintained as part of the park. Although there are water parks that are commercially operated, the nature of the services at those parks (such as slides and large pools) are quite different in character from what is on offer at the council's water play park. The council concludes that the water play park is not an activity carried on in a business context and lacks the commercial character for a private citizen or trader to undertake it.
- The supply of **gym access, spa, sauna, and steam rooms, swimming lessons, rental of shops and cafes, and function spaces** are business activities. They all involve the supply of goods and services that a private citizen or trader might undertake, and they are undertaken with system and regularity. For instance, the council is aware that there are private spa/sauna/steam rooms that operate in its local government area. The council has discretion as to the provision of these services and price it sets.

B.1.4 Significance test

A government business activity does not pass the significance test if:

1. The annual forecast turnover from the business activity is less than \$3.7 million, which is to be indexed in the policy.^c
2. The government entity undertaking the business activity has assessed it as having a low market impact (evidenced by market share of less than 10%).
3. The Minister has not declared the activity significant.

Table B.3 Summary of council's application of the significance test

	Recreational swimming	Spa/sauna /steam room	Gym access	Swimming Lessons	Café/retail swim store	Function space
Revenue (actual prices)	Over \$3.7 million	Under \$3.7 million	Over \$3.7 million	Over \$3.7 million	Under \$3.7 million	Under \$3.7 million
Revenue (market prices)	Over \$3.7 million	Under \$3.7 million	Over \$3.7 million	Over \$3.7 million	Under \$3.7 million	Under \$3.7 million
Market share ^d	Not tested ^e	Not tested	Over 10%	Over 10%	Not tested	Not tested
Ministerial declaration	N	N	N	N	N	N
Significant?	Y	N	Y	Y	N	N

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

^d Where revenues are greater than \$3.7 million, government businesses do not need to do the market test unless they wish to establish that the activity is insignificant.

^e The council does not intend to establish that this activity is insignificant based on market share.

To determine the significance, the council looked at each business activity on an individual basis rather than looking at each centre. Because the activities are highly consistent across the different centres, the council considered the significance of each activity in total across the 4 aquatic centres.

Another option could be to choose to apply competitive neutrality principles to all the business activities provided by the aquatic centres. This is not required by the competitive neutrality policy but removes the need to undertake a significance test for each business activity. In this case, the council decides to assess the significance of each business activity.

The council determined that **recreational swimming, gym access, and swimming lessons** represent significant business activities, as they have revenues above the \$3.7 million threshold, and the council considers that they would be significant under the market test.

The Council's assessment of significance for each activity is summarised below.

Revenue threshold limb of significance test

The revenue threshold calculation used by the council is as follows:

1. Based on the current pricing model, the total annual revenue generated from **the bundled membership** is \$15 million. The revenue ratio for **recreational swimming, gym access, and spa/sauna/steam rooms** is 50:40:10 (based on council data on the usage for these activities), respectively. Therefore, 50% of the revenue from the bundled membership will be allocated to recreational swimming as a business activity (\$7.5 million), another 40% of the membership bundle's revenue (\$6 million) will be allocated to gym access as a business activity, and the remaining 10% to spa/sauna/steam rooms as a business activity (\$1.5 million).
 - a. This means both **recreational swimming access and gym access** would pass the significance threshold of \$3.7 million even without the addition of the revenue from casual pool and gym entry.^f
 - b. The total revenue generated from **spa/sauna/steam rooms**, including **the bundled membership**, amounts to \$2.5 million which is below the significance threshold.
 - i. However, the test requires the council to consider whether it would pass the threshold if it was priced in line with the market price of non-government providers in the same or a similar area. Where non-government competitors are not available for comparison, the government business is required to seek out the most comparable government competitors in determining the market price.
 - ii. Council notes that there are similar services offered by other councils in surrounding local government areas, which charge similar prices to its own.
 - iii. It also knows that there are private spas that charge significantly more for spa/sauna/steam room access.
 - iv. On balance, the council considers that the services it provides at the aquatic centre are quite different from those provided by private spas. For example, the spa area is within the larger indoor pool area so does not provide a tranquil, private space for relaxation in the same way as the private facilities do.

^f Because the allocated amount is above the significance threshold, it is not necessary to calculate revenues generated from casual visits.

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- v The council decides to do the market price check using the prices in other councils' aquatic centres. It finds that the activity is not significant as it does not pass the turnover threshold.
 2. Regarding the **swimming lessons**, the total annual revenue generated from this activity across the 4 aquatic centres is \$3.9 million, which is above the significance threshold of \$3.7 million. Therefore, this business activity would pass the significance test.
 3. The other business activities of the aquatic centres including **retail rental and function space** each have a turnover of less than \$3.7 million, even when using a market price. As a result, the council determined that these business activities do not pass the significance test.

Market test limb of significance test

The council considers that there are a lot of private providers for gym access and swimming lessons that it competes with and is unsure whether those activities would be considered significant when looked at in the context of the market. Therefore, the council considers it appropriate to undertake market-based assessments to gain more insight.

The market test for assessing significance is whether the business activity has a market share greater than 10% in the relevant market. The council has reviewed gym and swimming lesson providers in adjacent local government areas and determined that there are none close enough to compete with their aquatic centres. The council has therefore determined that the geographic market for applying this test is gyms and swimming lesson providers in its local government area.

The market review concluded that:

- The **gym access** has a significant impact on the market. The combined market share of the council gym is greater than 10%. The council gym holds approximately 15% of the market share (\$7 million out of \$44 million⁹ annual revenue each year).
- The **council swimming lessons** have a significant impact on the market. The combined market share of the council swimming lessons is greater than 10%. The council swimming lessons hold approximately 36% of the market share (130,000 out of 360,000 lessons each year).

B.1.5 Conclusions

The council concludes that the following activities in this scenario will be subject to competitive neutrality as they are significant government business activities:

- recreational swimming access
- gym access
- swimming lessons

⁹ Council research indicates that there are 22 private gyms in the local government area, with an average annual turnover of \$2 million.

For each of these activities, the council will have to establish the competitively neutral price by identifying the costs of undertaking the activity (based on either the fully distributed cost or incremental cost approach, to be determined by the council after considering the guidance in the competitive neutrality policy) and identifying and adjusting for any net advantages that arise from government ownership.

In this example, the council wants to charge less than the competitively neutral price for recreational swimming. The council will need to undertake a qualitative public interest test applying the guidance in the competitive neutrality policy to ensure that they have considered all relevant factors.

B.2 Case study of competitive neutrality tests and obligations – provision of secure parking services

A business owned by a council in NSW offers secure parking in a multi-storey carpark in its CBD and is currently reviewing its prices. presents the key information about the service.

Figure B.1 Key information about council-run parking building



The council is concerned that construction in the CBD is causing people to go elsewhere for leisure. The average occupancy of carparks in the council building is down and local businesses have noticed a drop in customers. Because of this, the council is reviewing its carpark prices.

The council advertises its secure parking service through posters hung in main streets of the CBD. It is planning to use this advertisement to encourage people to visit the CBD.

B.2.1 Does competitive neutrality apply?

Competitive neutrality applies to significant government business activities, as defined by our 3 proposed tests.



The secure parking service passes the government ownership test

The activity is run by a business owned by the council, which is a general government sector entity.



The secure parking service passes the business activity test

The activity involves the supply of services (secure parking) with system and regularity (at all times). Management has a degree of independence over the supply of the service and the price at which it is provided and the council advertises the services. It therefore has a commercial character.



The secure parking service passes the significance test

The activity is significant as neither of the significance test exemptions (based on turnover or market impact) apply. Each of these elements is explored further below.

Turnover

A government activity is not significant if the annual turnover from the business activity is less than \$3.7 million (to be indexed in the policy). To be exempt based on low turnover, the business needs to ensure that its turnover would be under the threshold if its products/services are priced in line with non-government providers in the same or similar area.

The projected turnover based on the current price of \$3 an hour would be less than \$3.7 million. However, if the average market price for secure parking in the CBD of \$4 per hour was used to calculate turnover instead of the current council fee,^h the turnover would exceed the \$3.7 million threshold for the significance test (see Table B.4).

Table B.4 Turnover assessment for significance test

	Current price	Market price
Total projected turnover	\$3,285,000	\$4,380,000

Note: projected turnover is based on an occupancy of 6 hour per carpark per day, observed from data collected in the previous year.

Market review

The council has conducted a recent market review that concluded the activity has a significant impact on the market. The council holds around 34.5% of the market share (500 out of 1450 parking spaces in the CBD), which exceeds the 10% threshold for significance.

^h The market price was established by assessing the price for 3 hours of parking at the non-government secure parking buildings in the CBD. These averaged out to \$12 for 3 hours.



As the secure parking service passes all three tests, it is a significant government business activity and competitive neutrality principles apply.

B.2.2 Estimating the competitively neutral price

As the council has assessed that competitive neutrality principles apply, it is required to estimate the competitively neutral price. Firstly, the council would undertake a cost assessment as set out in Figure B.2.

Figure B.2 Steps to cost assessment

- 01** **Select costing approach and assess cost base**
The council should use fully distributed costs as the cost approach because the secure parking service is operated by a stand-alone business that does not share costs with another entity.
- 02** **Account for cost-based advantages and disadvantages**
 - Advantage: The building that the secure parking service operates from is owned by the council and is leased to the carpark business at below-market rates.
 - Advantage: The parking service has access to the council insurance scheme, which gives it access to lower insurance rates compared to non-government competitors.
 - Council did not find any notable competitive disadvantages.
- 03** **Account for non-cost advantages and disadvantages**
No non-cost advantages or disadvantages identified.

Table B.5 below shows the actual calculated costs and the resulting estimated competitively neutral price.

Table B.5 Cost assessment for council secure parking service

Cost	Amount
Direct costs (equipment, staff, land lease, advertisement, maintenance, and ticketing system)	\$3,400,000
Adjustments (lower lease, lower insurance rates)	\$145,000
Total	\$3,545,000
Resulting competitively neutral price (per hour based on expected 6 hours of occupancy per day, rounded to the nearest 5 cents)	\$3.25

B.2.3 Public interest test

A public interest assessment is required to charge below the competitively neutral price. As the council is currently investigating its fee options, it can apply the public interest test to help it determine which approach to take. The public interest test for the subsidy could be carried out as shown in .

Figure B.3 Summary of public interest test findings

01	Define what is being proposed Subsidised prices for parking in secure council parking building, to encourage people to visit the CBD during ongoing construction. Prices to remain at \$3 per hour or be further discounted to stimulate demand.
02	Assess benefits of proposed option The council expects cheaper parking to attract more people to the CBD, which means a higher number of customers for local businesses.
03	Assess costs of proposed option The council undertook a brief modelling exercise to estimate the cost of the subsidy if parking fees remain at \$3 an hour, concluding that it would cost around \$270,000 to administer for a year. Provision of subsidies to users of the council-run parking building discriminates against other providers, which may impact competition for secure parking services in the area. In the longer term this could impact the choice and quality of services for consumers.
04	Do the benefits outweigh the costs? The council considers it highly important to support local businesses, to ensure that the CBD continues to meet the needs of the community. However, a price increase of \$0.25 per hour in line with the competitively neutral price is considered to have a minor impact on customers, who on average would pay an additional 75 cents, especially considering this price is still lower than competitors. The council also noted a subsidy that only applies to some parking in the CBD may not be effective enough compared to a subsidy also applied to non-government parking buildings (which would be a costlier subsidy). The council has concluded that the benefit will not outweigh the impact on the private business' services, consumers and the cost of the subsidy.
05	Are there less costly means of achieving the objective? An alternative is not applying a subsidy at all, which is less costly and still results in a relatively affordable price. Another option is to introduce a free parking period that would reduce parking costs for people who spend money at local businesses while they are parked. Customers who spend money at a local business could validate their ticket with the business to receive their first half hour of parking free. At the same time, the council could raise hourly parking rates for customers who do not validate their ticket. There is strong support for this option amongst local retailers. Initial studies suggest this would be more costly to implement but the council is investigating further.
06	Conclusion The council has concluded the subsidy is not in the public interest.

As the council has concluded the subsidy is not in the public interest, it has decided to raise its fee to \$3.25 per hour.

B.3 Complaints process case studies

The tables in this section of the Appendix provide further detail on the complaints process case studies outlined in Chapter 7.

Labour costs in these case studies are based on the default hourly rate for a manager (\$66) derived by NSW Department of Premier and Cabinet, adjusted using the Wage Price Index for NSW.ⁱ

Table B.6 Details of Company A's complaint experience

Stage	Current process	Proposed process
Identifying the issue	<ul style="list-style-type: none"> The manager of the private business (Company A) notices that the council business is charging significantly less. The manager suspects the council business may not be adequately applying competitive neutrality principles. 	<ul style="list-style-type: none"> The manager of the private business (Company A) notices that the council business is charging significantly less. The manager suspects the council business may not be adequately applying competitive neutrality principles.
Investigating the problem	<ul style="list-style-type: none"> The manager conducts research on competitive neutrality. This includes identifying whether it applies to the council business and how to make a complaint. The manager finds information on competitive neutrality in NSW is difficult to find, as it is spread across different sources. The manager has no way of identifying whether the council business has applied competitive neutrality principles. 	<ul style="list-style-type: none"> The manager conducts research on competitive neutrality. This includes identifying whether it applies to the council business and how to make a complaint. All general information on competitive neutrality in NSW and how to make a complaint can be found on IPART's website. The manager can refer to the council business' annual report (on its website) to see whether and how it has applied competitive neutrality principles. While the council business has fulfilled its reporting obligations, the manager thinks the council business may not be fulfilling all pricing obligations.
Estimated cost	16 hours of labour \$1536	5 hours of labour \$480
Considering solutions	<p>Company A has several options:</p> <ul style="list-style-type: none"> no action: continue pricing to cover its costs and risk losing market share adjust prices to compete with the council business and make losses exit the market commence pursuing a formal competitive neutrality complaint by contacting the council business take action to address the perceived breach of competitive neutrality (while avoiding directly contacting the council, which goes against the policy requirement of approaching the government business first). 	<p>Company A has several options:</p> <ul style="list-style-type: none"> no action: continue pricing to cover its costs and risk losing market share adjust prices to compete with the council business and make losses exit the market contact the council about the perceived breach of competitive neutrality contact IPART about the perceived breach of competitive neutrality.

ⁱ See Department of Premier and Cabinet, [Measuring the Costs of Regulation](#), June 2008, p. 5; Australian Bureau of Statistics, [Wage Price Index, Australia, Table 3b](#), February 2023.

Stage	Current process	Proposed process
Estimated cost	1 hour of labour \$96	1 hour of labour \$96
Taking action	<ul style="list-style-type: none"> The manager wants to pursue a complaint but does not want to approach the council directly given the council also regulates the private business. The current policy does not provide guidance on this situation (it provides for all complaints to be directed to council in the first instance) so the manager writes to the NSW Ombudsman. As part of this correspondence, the manager collects information on the prices of the council business and why these appear to not be competitively neutral. The NSW Ombudsman informs the manager that it does not handle complaints of this nature and refers the manager to IPART. IPART provides information on the process and refers complainant to the Minister to request that the matter is referred to IPART. The manager is aware that IPART cannot receive complaints unless the complainant has approached the government business first but attempts to get around this by explaining position to Minister's office and requesting the complaint to be directly referred to IPART. The Minister's office responds that the complainant must have the matter referred to IPART, but that he must contact the government business first. Change of Ministerial portfolios results in the Minister referring the matter to a different Minister. In total, the manager makes 6 separate attempts to contact Ministers and government agencies to have their complaint heard. The manager receives no further follow up and gives up. 	<ul style="list-style-type: none"> The manager wants to pursue a complaint but does not want to approach the council directly given the council also regulates the private business. Information on IPART's website about the process is clear. They contact IPART to discuss their concerns. IPART suggests the manager fills out the form to submit a competitive neutrality complaint. The manager submits their complaint, referring to evidence such as the council business' reporting on competitive neutrality.
Estimated cost	16 hours of labour \$1536	4 hours of labour \$384
Outcome	The manager gives up on pursuing a complaint.	The manager receives a response from IPART indicating whether the complaint will be investigated or resolved in another way.
Total estimated cost	\$3168	\$960
Total duration	18 months	1 month

Table B.7 Details of Company B's complaint experience

Stage	Current process	Proposed process
Identifying the issue	<ul style="list-style-type: none"> The manager of the private business (Company B) is concerned that the state-owned business is charging significantly less. The manager suspects the state-owned business may not be adequately applying competitive neutrality principles. 	<ul style="list-style-type: none"> The manager of the private business (Company B) is concerned that the state-owned business is charging significantly less. The manager suspects the state-owned business may not be adequately applying competitive neutrality principles.

Stage	Current process	Proposed process
Investigating the problem	<ul style="list-style-type: none"> The manager conducts research on competitive neutrality and finds that there is not much information on how it applies to the pricing of goods and services by state-owned businesses. The manager also generally finds information on competitive neutrality in NSW is difficult to find, as it is spread across different sources. The private business seeks the services of an external lawyer to advise on whether competitive neutrality applies and whether there are grounds for a complaint. The manager has no way of identifying whether the state-owned business has considered competitive neutrality principles. Having looked into the complaints process, the manager is concerned about the fact that the minister overseeing the state-owned business is more senior than the minister receiving the complaint (who therefore has discretion to refer the complaint to IPART). They are concerned that politics may override the validity of their complaint. 	<ul style="list-style-type: none"> The manager conducts research on competitive neutrality. This includes identifying whether it applies to the state-owned business and how to make a complaint. All general information on competitive neutrality in NSW can be found on IPART's website. The manager can refer to the state-owned business' annual report (on its website) to see whether and how it has applied competitive neutrality principles. While the state-owned business has fulfilled its reporting obligations, the manager thinks the state-owned business may not be fulfilling pricing obligations.
Estimated cost	12 hours of internal labour \$10,000 for legal advice Total \$11,152	5 hours of labour \$480
Considering solutions	<p>Company B has several options:</p> <ul style="list-style-type: none"> no action: continue pricing to cover its costs and risk losing market share adjust prices to compete with the state-owned business and make losses exit the market commence pursuing a formal competitive neutrality complaint by contacting the state-owned business in the first instance. 	<p>Company B has several options:</p> <ul style="list-style-type: none"> no action: continue pricing to cover its costs and risk losing market share adjust prices to compete with the state-owned business and make losses exit the market contact the state-owned business about the perceived breach of competitive neutrality directly contact IPART about the perceived breach of competitive neutrality.
Estimated cost	1 hour of labour \$96	1 hour of labour \$96
Taking action	<ul style="list-style-type: none"> Company B wants to pursue a complaint but is concerned about the costs involved in making a complaint given they are uncertain whether the complaint would be upheld. Instead, Company B writes directly to the state-owned business explaining their concerns. The state-owned business responds after 4 weeks, asking for in-depth evidence to support the allegations. The private business seeks out further legal advice and responds to the SOC with further evidence. The state-owned business responds after a further 4 weeks, dismissing the complaint with a justification it has received ministerial direction to set its prices. 	<ul style="list-style-type: none"> The manager contacts IPART to discuss making a complaint. IPART encourages the private business to contact the state-owned business directly first. The private business writes directly to the state-owned business explaining their case. The state-owned business responds after 4 weeks, asking for in-depth evidence to support the allegations. Concerned with the resources required to adequately respond to the state-owned business, the private business goes back to IPART to commence a formal complaint. This involves filling out the form to submit a competitive neutrality complaint. The manager submits their complaint, referring to evidence such as the council business' reporting on competitive neutrality.

Stage	Current process	Proposed process
Estimated cost	16 hours of internal labour \$7,000 for legal advice Total \$8536	5 hours of labour \$480
Outcome	The manager gives up on pursuing a complaint.	The manager receives a response from IPART indicating whether it will investigate the complaint or resolve it in another way.
Total estimated cost	\$19,784	\$1056
Total duration	6 months	3 months

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 - ⁹ NSW Department of Premier and Cabinet submission to IPART Issues Paper, August 2022, p 1.
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 - ¹¹ Hunter Water submission to IPART Draft Report, February 2023; Bega Valley Shire Council submission to IPART Draft Report, February 2023; Albury City Council submission to IPART Draft Report, February 2023, pp 1-6.
 - ¹² Local Government NSW submission to IPART Draft Report, February 2023, pp 7-8.
 - ¹³ Caravan & Camping Industry Association of NSW submission to IPART Draft Report, February 2023 pp 3-4; Australian Diagnostic Imaging Association submission to IPART Draft Report, February 2023 p 8.
 - ¹⁴ LG Professionals Australia NSW submission to IPART Draft Report, February 2023 p 2.
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 - ¹⁶ Local Government NSW submission to IPART Draft Report, February 2023 p 9.
 - ¹⁷ *Competition Principles Agreement 1995* (Cth) cl 3(1).
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 - ²⁰ IPART, *What we heard – competitive neutrality workshops*, August 2022, p. 14.
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 - ²² Local Government NSW submission to IPART Draft Report, February 2023, p 8.
 - ²³ *Competition Principles Agreement 1995* (Cth) cl 7(1).
 - ²⁴ *Competition Principles Agreement 1995* (Cth) cl 7(2).
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