

Review of competitive neutrality in NSW

28 June 2022

We are reviewing NSW's competitive neutrality policies and processes. Our review will identify issues and concerns with current competitive neutrality policies and analyse opportunities to expand their scope. We will consider how the policies compare to best practice and recommend potential improvements.

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

Government businesses might compete across a range of industries, including in manufacturing, laundry services, construction (including roads), waste disposal, gyms and fitness, tourism services, printing, childcare and aged care. Some of the businesses across Australia over which competitive neutrality concerns have been raised include aquatic centres, nuclear medicine and land valuation and plumbing services

This short information paper is written to help you understand and provide feedback on the competitive neutrality policies and processes in NSW. It explains what competitive neutrality is, gives a summary of current NSW competitive neutrality policies and explains why we are reviewing them. It also provides further information on how you can get involved and provide your feedback. It can be read alone or with the material listed at the end of this paper.

1 What is competitive neutrality?

Competitive neutrality policies (see Box 1 NSW's current competitive neutrality policies) aim to ensure that government businesses do not have a competitive advantage over other businesses simply because they are owned by the government. In doing so, these policies promote competition, innovation and efficiency in the marketplace, which encourages cost-reflective prices, better quality goods and services and greater choice for customers.

Box 1 NSW's current competitive neutrality policies

Australia's national competitive neutrality principles are established in clause 3 of the [Competition Principles Agreement](#).^a The Competition Principles Agreement gives each government discretion on how to implement the principles, resulting in different competitive neutrality regimes across the Commonwealth, States and Territories.

We are reviewing the following current NSW competitive neutrality policies and processes:

1. [NSW Government Policy Statement on the Application of Competitive Neutrality \(TPPO2-1\), January 2002](#)
2. [Guidelines for pricing of user charges \(TPP01-2\), June 2001](#)
3. Part 4C of the *Independent Pricing and Regulatory Tribunal Act 1992*
4. Section 173 of the *Public Works and Procurement Act 1912* and Part 3 of the *Public Works and Procurement Regulation 2019*
5. [Pricing and Costing for Council Businesses – a Guide to Competitive Neutrality, July 1997](#)
6. [Policy Statement on the Application of National Competition Policy to Local Government, June 1996](#)
7. [Department of Local Government - Guidelines on the Management of Competitive Neutrality Complaints, 1997.](#)

a. The Competition Principles Agreement is one of three intergovernmental agreements that form Australia's National Competition Policy. The others are the [Conduct Code Agreement](#) and the [Agreement to Implement the National Competition Policy and Related Reforms](#). All three agreements were entered into in 1995.

Competitive neutrality policies require government businesses to assess their advantages and disadvantages from being government-owned and offset any net competitive advantage. One way that government businesses are currently required to do this is by pricing their goods and services to reflect all costs that an equivalent private business would have to pay in the same market.

Some advantages of government ownership that a government business may benefit from are:

- not having to pay the same set of taxes as other businesses
- not needing to earn a profit
- being able to access cheaper finance or infrastructure than other businesses
- non-cost advantages such as exemptions from regulatory constraints.

Some disadvantages of government ownership that a government business may experience are:

- restrictions on importing capital or outputs (e.g. buying Australian only)
- restrictions on borrowing locally and overseas

- stricter employment and industrial relations obligations, and
- paying the costs of meeting community service obligations.

1.1 Why are we reviewing NSW competitive neutrality policies?

While Australia's competitive neutrality policies are well regarded worldwide,¹ NSW's current policies have not been reviewed in over 2 decades and NSW's economy has changed significantly since they were put in place. For instance:

- Many large government businesses have been sold or corporatised, subjecting them to the same set of costs and taxes as private businesses.
- Local governments have outsourced or divested a range of business activities.
- Many services provided by Commonwealth, state and local governments have been expanded to allow the private and not-for-profit sectors to operate alongside government providers.

Given these significant changes, this review is an important step in ensuring NSW competitive neutrality policies remain fit-for-purpose. The NSW Government has asked us to conduct this review. This delivers on its commitment to revise the NSW competitive neutrality framework in response to the recommendations of a review of Australia's competition policy completed in 2015².

2 What are the principles of competitive neutrality?

Current competitive neutrality policies impose 3 main sets of principles, or obligations, on government businesses:

- The first set focuses on the corporatisation and commercialisation of state government businesses that operate as self-contained organisational units and are principally engaged in trading activities, ensuring that the taxes, debt guarantee fees and regulations they face are the same as those affecting private sector competitors.
- The second set outlines pricing guidelines that apply to government businesses that operate, or potentially operate, in competition with private businesses. The guidelines require those businesses to price goods and services:
 - transparently, taking into account the costs they incur in conducting the business and ensuring that prices charged at least cover the avoidable costs.
 - in a way that is consistent with the approaches followed by private sector companies and reflects the costs that they would have to pay in the same market (including a profit margin or return on capital and taxes). Adjustment may be made for material disadvantages of government ownership where such policies cannot be revised to remove them.

- Being explicit around any subsidies made for policy reasons – government businesses are not required to charge full cost recovery but must be explicit about the quantum of subsidy being provided to fulfil policy aims.

We are reviewing these obligations and Chapter 3 of our [issues paper](#) discusses them in more detail.

3 When do competitive neutrality obligations currently apply?

The current competitive neutrality policies and process in NSW apply to government entities that are principally engaged in trading activities, where these activities are significant and applying competitive neutrality principles is in the public interest.

Examples of these businesses include state owned corporations^a, public trading enterprises^b, public financial corporations^c and general government businesses^d, including those that provide goods and services to other parts of the public sector.

Assessing whether a government business is significant currently depends on the ownership of the business:

- For businesses that are not local government owned, a case-by-case basis assessment is currently made, considering such factors as the business' size, influence on the market, resources commanded and the effect of poor performance.
- Local government businesses are currently significant if they have a \$2 million or more annual turnover. Businesses below this threshold may also be significant and require a case by case assessment.

We are seeking your feedback on how NSW competitive neutrality policies assess government businesses as significant and whether this could be improved.

A recent finding of the Essential Services Commission of South Australia (ESCOSA) illustrates the concept of significance (see Box 2).

^a State owned corporations are government businesses 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.

^b These include both state owned corporations 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.

^c 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 state owned corporations.

^d 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.

Box 2 Market based significance test for penguin tours in South Australia

National Parks and Wildlife SA (NP&WSA) was operating nightly guided 'Discovering Penguins' tours from a hotel in Kingscote. A private penguin tour operator who also conducted their penguin tours in Kingscote complained to the South Australian Department of Premier and Cabinet that NP&WSA may be running its tours at a loss because it was not required to recover full capital costs and overheads. The Premier of South Australia referred the complaint to ESCOSA for investigation and report.

The private tour operator initially complained to the South Australian Department of Environment and Heritage (DEH), NP&WSA's parent department. The DEH did not consider the tours to be a business activity, rather an activity included in its broad-ranging responsibility for South Australia's wildlife. Additionally, it was not a significant activity due to its small turnover that "basically" covered the direct costs of the tour operation.

NP&WSA tour prices were lower than the private operator's. DEH estimated that NP&WSA received about 60% of the Kingscote penguin tour business. ESCOSA's onsite observation confirmed that NP&WSA's tour attracts more visitors than the private tour.

Following its investigation, ESCOSA found that such a market share of Kingscote penguin tours gave NP&WSA the ability to exert a substantial influence on the market. It concluded that NP&WSA's penguin tours should be considered as a significant business activity due to its significant market influence. Therefore, NP&WSA needed to apply competitive neutrality principles to the operations of its penguin tours.

- a. Source: South Australia, Competitive Neutrality complaint against National parks and Wildlife SA, December 2002.
b. 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 framework.

Competitive neutrality policies do not apply where the costs of implementing them outweigh the benefits of doing so. Where a government business considers this to be the case, they must undertake a cost-benefit analysis in support of this and document their findings.

The economic benefits of applying competitive neutrality policies to a significant government business may include increased competition, innovation and efficiency in the business's marketplace. The costs may relate to restructuring and corporatising the business with a new board management system, changes to accounting or costing systems or processes, or any legislative, regulatory or administrative changes required to ensure the business is competitively neutral. Costs will also include the broader costs of administering the regime, including handling and resolving complaints.

This means that competitive neutrality policies may not apply where, for example, they work against government social welfare policies and as a result, the total costs of applying them exceed the benefits. The principles of competitive neutrality may be applied irrespective of a decision to subsidise an activity, with a clear and explicit subsidy being applied to determine the price to users once the competitively neutral cost is identified.

We are seeking your feedback on how the cost-benefit test applies in NSW and whether it could be improved.

3.1 Should the scope be expanded to other government activities?

There are now many government activities outside of business ownership that may impact competition, such as:

- directly supplying social services or programs (e.g. public education and hospitals services)
- contracting out service provision to a private operator (e.g. bus, ferry and light rail)
- taking a minority ownership stake in a business (e.g. by selling a majority stake in a previous government business)
- providing grants, concessional loans, tax advantages or equity stakes to particular private businesses to achieve policy outcomes (such as employment or innovation)
- obligations that differ between public and private sector businesses (e.g. licences granted under the *Sydney Water Act 1994* and the *Water Industry Competition Act 2006*)

NSW competitive neutrality policies currently do not apply to these government activities. However, 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. We are seeking your views on this issue.

One option for broadening the scope of competitive neutrality policies is to apply it where there are different arrangements for government and other providers operating in the same market and the differential treatment is not justified on net public benefit grounds.³ Another option is a new principle that competitive neutrality policies apply to government activities that significantly impact competition between government and other businesses.

Traditional competitive neutrality obligations include pricing and other costing principles which are not appropriate for non-business activities. If competitive neutrality obligations were expanded beyond their traditional scope, a different set of principles may need to be applied to any newly in-scope activities. For example, a new principle could be that government non-business activities should not restrict competition unless the benefits of doing so outweigh the costs and the government's policy objectives can only be achieved by doing so.

4 Further information

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

- review issues paper

- competitive neutrality & local government information paper
- complaints handling processes information paper

5 We want to hear from you

We want to hear about your experiences with the NSW competitive neutrality framework. Hearing the views of a wide group of stakeholders on how the current policies and processes are working is very important to us. We are also interested in identifying any gaps in the current framework and your suggestions on improvements that could be made. The areas where you may have influence in this review are:

- what government activities are captured by the competitive neutrality policies and processes
- application of the significance test
- application of the public interest test
- what obligations apply to activities that are covered
- what the complaints and investigation process should look like
- how and when we consult (over and above what is required by the terms of reference).

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

Improving the competitive neutrality framework in NSW



If you run a business that competes with a government business tell us:

- What are your concerns about competing with government businesses?
- What activities should competitive neutrality principles apply to?
- What information should government businesses be required to publish?



If you run a government owned business tell us:

- What is your experience applying the competitive neutrality policies and guidance material?
- What challenges do you face when applying the current policies?
- Is it necessary to maintain separate policy and guidance for state and local government businesses?
- How can we improve transparency about competitive neutrality decisions and what information should remain confidential?

 Have your say

Your input is critical to our review process.

[Submit feedback »](#)

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

[Contact the review team »](#)

We are accepting written submissions on our information papers and issues paper until 15 August 2022. You can express your interest in attending upcoming workshops on our website. Later in the year, we will also hold a public hearing to hear more from stakeholders. If you have any questions regarding the review, are interested in meeting with us or would like to speak to the review team, please contact one of the staff members listed at the beginning of the issues paper.

¹ See e.g., Antonio Capobianco and Hans Christiansen, OECD Corporate Governance Working Papers No. 1, *Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options*, 2011, p 16; Matthew Rennie and Fiona Lindsay, OECD Corporate Governance Working Papers No. 4, *Competitive Neutrality and State-Owned Enterprises in Australia: Review of Practices and their Relevance for Other Countries*, 2011, p 3.

² Harper, I, McCluskey, S and O'Bryan, M, *Competition Policy Review Final Report*, March 2015.

³ *Ibid.*, p 267.