

# Competitive neutrality & local government

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.

The aim of this information paper is to help local government and its businesses understand and provide feedback on our review of NSW's competitive neutrality policies and processes.

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.

This short information paper explains what competitive neutrality is, gives a summary of NSW competitive neutrality policies as they apply to local government and explains why we are reviewing them. It also provides 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 and why is it important?

Competitive neutrality policies (see Box 1) aim to ensure that government businesses do not have a competitive advantage over other businesses simply because they are owned by the government. This promotes 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](#).<sup>a</sup> 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 NSW competitive neutrality policies and processes that apply specifically to local government businesses:

- [Policy Statement on the Application of National Competition Policy to Local Government, June 1996](#)
- [Pricing and Costing for Council Businesses – a Guide to Competitive Neutrality, July 1997](#)
- [Department of Local Government - Guidelines on the Management of Competitive Neutrality Complaints, 1997.](#)

The other policies relating to competitive neutrality that we will consider as part of our review are:

- [NSW Government Policy Statement on the Application of Competitive Neutrality \(TPPO2-1\), January 2002](#)
- [Guidelines for pricing of user charges \(TPP01-2\), June 2001](#)
- Part 4C of the *Independent Pricing and Regulatory Tribunal Act 1992*
- Section 173 of the *Public Works and Procurement Act 1912* and Part 3 of the *Public Works and Procurement Regulation 2019*.

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 in 1995.

Competitive neutrality requires government businesses to assess their advantages and disadvantages from being government-owned and offset any net competitive advantages. 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 local government ownership may be:

- 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 local government ownership may be:

- restrictions on importing capital or inputs (e.g. buying Australian only),
- restrictions on borrowing locally and overseas
- stricter employment and industrial relations obligations
- paying the costs of meeting community service obligations.

Competitive neutrality policies provide competing businesses with confidence that they can operate on a level playing field with government businesses. In doing so, these policies allow dynamic non-government businesses to enter and innovate in the same markets as government businesses, promoting competition and efficiency in those marketplaces.

As small and local businesses are often the competitors of council businesses, competitive neutrality contributes to strong local businesses and growing local economies. This in turn encourages cost-reflective prices, better quality services and greater service choice for local consumers. In this way, competitive neutrality policies are important to achieving a prosperous economy in NSW that meets the demands of the future.

There are also benefits for local councils. Being clear about the costs of undertaking different activities and the value of any subsidies that are being provided helps direct limited funds to the areas of greatest community need. Having efficient private operators in the market may allow councils to save money by stepping away from direct provision in some circumstances. For activities that are not subsidised, local councils can benefit directly from prices that are set to recover notional costs that are not borne by their businesses but would be faced by their private competitors (such as, return on investment and any taxes or charges where local government is exempt). Where councils themselves incur disadvantages from government ownership, this can help offset some of these costs. A recent finding of the Essential Services Commission of South Australia (ESCOSA) highlights this issue (see Box 2)

### Box 2 Case study – bundling of business and non-business activities in South Australia

Two councils in South Australia jointly owned a corporatised entity – the Fleurieu Regional Aquatic Centre Authority (FRACA). FRACA's sole purpose was to run a regional aquatic centre with 3 swimming pools, a gym/fitness centre and a shop.

A competitive neutrality complaint was made against FRACA for bundling gym services with recreational pool access, which the complainant claimed was at non commercial terms. The bundled membership packages were priced lower than what private sector gym operators could offer for gym-only memberships.

FRACA responded to the complaint by stating it had determined that "it is not of net public benefit to apply cost-reflective prices for Fleurieu Aquatic Centre at this point in time." Additionally, it argued that recreational pool access was a core community service obligation (CSO) activity and was not provided for a commercial objective, therefore it should not be subjected to competitive neutrality principles.

### Box 2 Case study – bundling of business and non-business activities in South Australia

The complaint was brought to the Essential Services Commission of South Australia (ESCOSA), which found it was arguable FRACA had infringed the competitive neutrality principles.

ESCOSA did not challenge FRACA's ability to subsidise the costs of its pool services as a CSO activity and considered that if an activity is undertaken by government owned businesses for the sole purposes of a CSO then competitive neutrality principles do not apply to it.

However, in this case there were other issues which ESCOSA considered relevant. Specifically, if FRACA's pool services were (even partially) used to compete with private sector operators it should not be treated as a CSO.

FRACA had bundled a CSO activity (recreational pool access) with a significant business activity (gym services) for commercial reasons. Additionally, the price for bundled membership was below a reasonable private sector-equivalent price.

Source: 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.

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.

## 2 How does competitive neutrality currently apply to local councils?

The NSW competitive neutrality policies and processes explicitly acknowledge the role of local councils as elected bodies and do not attempt to limit either the types of goods and services councils can provide their constituents or their ability to subsidise their price.

The focus of the local government competitive neutrality framework is internal transparency. The policies and processes currently require local councils to account for the full costs of running any significant<sup>a</sup> businesses they have and make an explicit decision in relation to any subsidy.

The competitive neutrality policies and processes for local government currently set out:

- what a local council's obligations are in relation to competitive neutrality, including record keeping and costing advice
- which local government activities are subject to competitive neutrality obligations

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<sup>a</sup> 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.

- what happens if a competitor (such as a private business) feels it has been disadvantaged by a local government business.<sup>1</sup>

A pricing guideline also applies to local government businesses and sets out how local governments are required to implement competitive neutrality principles. The pricing guideline currently requires councils to:

- separately identify, report on and account for the costs of significant local government businesses including full cost attribution (including tax equivalent payments, debt guarantee fees and return on capital)
- take a case by case approach to adopting competitive neutrality to other council businesses
- make subsidies to business activities an explicit transaction
- establish a complaint handling mechanism for competitive neutrality issues.<sup>2</sup>



Where goods and services are significant and it is in the public interest to do so, councils must follow the guidelines. Where goods and services are not significant, businesses may choose to instead price at a level similar to those of commercial providers in the market as a proxy for applying the guidelines in full.

We are seeking your views on how competitive neutrality applies to councils and if any improvements can be made.

### 3 How does competitive neutrality apply to council subsidies?

The guidelines are clear that "Council has full discretion to subsidise prices, in consultation with the community".<sup>3</sup> Councils may subsidise their businesses for any purpose. When they do, the value of those subsidies must be fully disclosed (at least internally) as an explicit transaction.<sup>4</sup> They do not need to disclose subsidies for non-business activities. Subsidies may fall into one of the following categories:

- **Community service obligation (CSO) subsidies** – including pensioner rebates, subsidised childcare places for low income families, discounted charges for charity or non-profit users of a council's business assets
- **Other subsidies** – including a wide range of costs borne by council instead of the business activity, such as 'free' use of equipment or central services.<sup>5</sup>

In some cases, councils provide services that they consider to be important for their community because the market conditions impede the private sector providing these on a commercial basis. Examples are aged care services and childcare services in rural areas. The 'thin' markets in these areas mean that councils end up as providers of last resort even where they would prefer not to be involved. Councils may be unable to charge competitively neutral prices as this would mean the service is unaffordable for residents. The competitive neutrality framework can help identify the cost of providing these services and quantify the subsidy.

## 4 Which council activities are currently subject to competitive neutrality?

Competitive neutrality obligations apply to significant local government business activities where it is in the public interest. They do not apply to non-business, non-profit activities.

### I What is currently a business activity?

Operating water supply, sewerage, gas production and reticulation and abattoirs are business activities. Other activities are determined by the council based on their circumstances. An activity is likely to be a business activity if it is operated for profit, is subject to competition, is significant to the people who are supplied by it, or has an impact on the local, regional or broader economy.<sup>6</sup>

Businesses with sales turnover of \$2 million or more per year are currently considered significant (category 1 businesses) and therefore, subject to competitive neutrality.<sup>7</sup> Councils currently need to assess the significance of businesses with a lower sales turnover (category 2 businesses) on a case by case basis. Councils are to apply competitive neutrality principles to as many of these business as is practicable.<sup>8</sup> The closer in size to a category 1 business, the stronger the argument to fully apply the competitive neutrality principles.

The use of monetary thresholds for defining significance differs from the approach applied to other government businesses in NSW, which is done by applying a market-based assessment to each business. This assessment considers the business' size and influence on the market, resources commanded and effect of poor performance.<sup>9</sup>

While monetary thresholds based on revenue or turnover have the benefit of being much simpler to administer, they may have the unintended consequence of encouraging council businesses to price well below the competitively neutral price in order to remain underneath the significance threshold. Using alternative estimates such as the size of the asset base may reduce this incentive but has its own issues regarding measurement.

The current \$2 million threshold was set in 2002 – if it had been escalated by the change in the Consumer Price Index, it would be \$3.3 million in 2022.<sup>b</sup> This means that there are likely to be businesses not initially subject to competitive neutrality principles that now would be. Failing to update the thresholds may have either added to the costs of the competitive neutrality framework by capturing more businesses than intended or led to inadvertent non-compliance from local councils. Which of these outcomes is occurring in practice is likely to depend on how often local councils are reviewing their business operations against the significance test.

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<sup>b</sup> Using CPI Sydney March 2022/March 2002.

Other Australian states and territories have developed their own approaches to assessing significance. These includes both guidance on how to assess market impact and monetary thresholds. Tasmania sets prescriptive guidance for the significance test for campgrounds.<sup>c</sup> Queensland explicitly excludes some activities, including activities described as building certifying, roads, or related to library services.<sup>10</sup>

If a business meets the threshold for significance but a council considers that it is not in the public interest to apply competitive neutrality principles, then the onus is on the council (or its business) to undertake a cost-benefit analysis to demonstrate this. The cost-benefit analysis must consider the economic and social benefits to the community as well as the cost impact on the government business. The NSW policy for local government requires the cost-benefit analysis to be "independently carried out, rigorous and public".<sup>11</sup>

There is currently a presumption that the benefits of applying competitive neutrality to significant business activities outweigh the costs, unless shown otherwise. Competitive neutrality principles may apply regardless of a decision to subsidise prices. This is because the competitively neutral price can still be identified, with a clear and explicit subsidy being applied to that price.

There is no published information on how many local government businesses have undertaken a cost-benefit analysis or how they have done this assessment. There is limited guidance on how to undertake the cost-benefit analysis provided by the policies.

We are seeking your views on the council activities that are subject to competitive neutrality and whether any improvements can be made.

## 5 How do local councils currently show they are meeting their obligations?

Comparisons of prices between privately and publicly supplied goods and services are not a good indication of whether competitive neutrality principles have been followed. Obligations requiring the publication or provision of information in response to a complaint are therefore an important component of competitive neutrality policy.

There are many reasons why prices may diverge from costs, either temporarily or permanently. Some of these reasons would be a breach of competitive neutrality policy, but this is not always the case.

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<sup>c</sup> This includes consideration of the number of un-powered sites provided by the business compared to the number of un-powered sites provided within a 60km driving radius. A local government business with greater than 10% of the sites would be considered significant. See Department of Treasury and Finance, *National Competition Policy: Applying Competitive Neutrality Principles to public camping in Tasmania*, January 2019.

Council businesses are currently required to document the basis of their costing and pricing and be prepared to respond to issues raised by complainants and to provide information to the relevant complaints review body if requested to do so.

For significant (category 1) businesses, councils are currently required to include a statement of expenses incurred, revenue raised, assets acquired, and assets held in their annual reports. Their annual reports must also include, among other things, a summary of complaints received regarding competitive neutrality and the results of those complaints.

Many councils include a reference to their pricing approach in their published list of fees and charges. Disclosing the pricing approach helps stakeholders understand where councils are choosing to subsidise services and where they are charging a competitively neutral, or market-based price.

We are seeking your views on how councils currently show they are meeting their competitive neutrality obligations and whether any improvements can be made.

## 6 What currently happens if a complaint is made?

A competitor<sup>d</sup> may make a complaint if they consider they are being disadvantaged because of a local government business' net competitive advantage. A complaint can be that either the council has not met its competitive neutrality requirements or has not abided by the spirit of competitive neutrality in the conduct of a business activity.<sup>12</sup>

In the first instance, complaints must currently be lodged with the council for review. Councils must have a complaints handling process in place to deal with competitive neutrality complaints.



An effective complaints mechanism in each council is an important part of the application of national competition policy and should not be underestimated

If a complaint is unable to be resolved between the complainant and the council, it can be escalated to the Office of Local Government.<sup>13</sup>

If the Office of Local Government investigates a complaint and finds that a council business has not followed competitive neutrality principles, it is currently unclear whether the council is currently required to respond to the finding.<sup>e</sup> If not, this may undermine the efficacy of competitive neutrality policies.

<sup>d</sup> This can include potential competitors.

<sup>e</sup> If an investigation was carried out by the Office of Local Government under section 430 of the *Local Government Act 1993*, the council would be required to respond to a report of an investigation into a complaint. However, no competitive neutrality investigations have been carried out under section 430. The Department of Local Government's Guidelines on the Management of Competitive Neutrality Complaints do not require the council to respond to the findings of an investigation.

We have been contacted several times by businesses with complaints that include competitive neutrality issues against local government. However, we are not the correct investigative body for these complaints. We do not have visibility into the volume of competitive neutrality complaints that are raised with local governments or escalated to the Office of Local Government.

We are seeking your views on how the local government competitive neutrality complaints process is working and whether any improvements can be made.

## 7 Further information

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

- review issues paper
- review of competitive neutrality in NSW information paper
- complaints handling processes information paper.

## 8 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 range 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 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 for council business activities in NSW



If you run a business that competes with a Council business activity 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 Council business activity 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.

<sup>1</sup> New South Wales Government, *NSW Government Policy Statement on the Application of National Competition Policy to Local Government*, June 1996.

<sup>2</sup> Department of Local Government, *Pricing and costing for council businesses - a guide to competitive neutrality*, July 1997

<sup>3</sup> Department of Local Government, *Pricing and costing for council businesses - a guide to competitive neutrality*, July 1997, p 43.

<sup>4</sup> New South Wales Government, *NSW Government Policy Statement on the Application of National Competition Policy to Local Government*, June 1996, p 14; Department of Local Government, *Pricing and costing for council businesses - a guide to competitive neutrality*, July 1997, p 28.

<sup>5</sup> Department of Local Government, *Pricing and costing for council businesses - a guide to competitive neutrality*, July 1997, pp 28-29.

<sup>6</sup> New South Wales Government, *NSW Government Policy Statement on the Application of National Competition Policy to Local Government*, June 1996, p 12.

<sup>7</sup> New South Wales Government, *NSW Government Policy Statement on the Application of National Competition Policy to Local Government*, June 1996, pp 13-14.

<sup>8</sup> Department of Local Government, *Pricing and costing for council businesses - a guide to competitive neutrality*, July 1997, pp 8-9.

<sup>9</sup> New South Wales Treasury, *Policy statement on the application of competitive neutrality*, January 2002, p 6.

<sup>10</sup> *Local Government Act 2009* (Qld), section 43(5).

<sup>11</sup> Department of Local Government, *Pricing and costing for council businesses - a guide to competitive neutrality*, July 1997, p 3.

<sup>12</sup> Department of Local Government, *Guidelines on the management of competitive neutrality complaints*, p 3.

<sup>13</sup> Department of Local Government, *Guidelines on the management of competitive neutrality complaints*, pp 1-2.