COMPETITIVE NEUTRALITY IN THE ACT

ACT DEPARTMENT OF TREASURY

October 2010
Final V.2

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Approval

Name	Title	Department	Date
M Smithies	**Under-Treasurer**	**Department of Treasury**	**October 2010**

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PREFACE

In keeping with its commitment to the National Competition Policy and as a requirement of the Competition Principles Agreement the ACT Government is required to publish a policy statement on competitive neutrality.

The absence of direct market competition of many government business and activities raises the potential for productive inefficiencies to emerge in the form of over staffing, poor investment decisions, inefficient work practices, inadequate pricing policies, lack of innovation and poor service delivery.

In this regard the main thrust of the Competition Principles Agreement is to make government business activities more commercial as a means of improving efficiency and to increase competition for government funded services. The Agreement outlines a set of reform principles which are directed towards:

- reducing anti-competitive practices;
- reducing monopolist practices;
- opening public sector business to competition; and
- ensuring that public sector businesses do not have an unfair advantage in the market place.

Competitive neutrality is an integral part of this policy framework. It requires actual or potential competition to be conducted fairly between public and private sector providers. Fair competition entails removing the main advantages and disadvantages of government ownership to create a level playing field.

As a result of removing competitive advantages, government business activities or functions increasingly will be subjected to private sector costing and pricing principles, taxation and dividend requirements, and regulations.

The ACT has already adopted a range of reform measures based on the principles of competitive neutrality including full cost attribution, corporatisation, commercialisation and competitive tendering.

The Competition Principles Agreement provides a strategic framework with which to apply these principles more broadly.

These principles, however, will take some time to be fully implemented. The application of competitive neutrality requires a case by case assessment of each government business to determine an appropriate business and management structure. This may require extensive consultation with the various stakeholders including the community.

In future the ACT will produce an annual report recording progress in implementing the principles of competitive neutrality and any associated reform measures. This report will include details of any complaints received about the application of these principles and the findings of any subsequent investigations.

INTRODUCTION

This policy statement aims to explain the role of competitive neutrality in the ongoing reform of the ACT Public service.

The structure of the paper is outlined as follows:

Section 1

Contains a brief overview of the National Competition Policy and each of the underlying intergovernmental agreements.

Section 2

What is competitive neutrality? Defines and describes the concept of competitive neutrality. Competitive neutrality will:

i) ensure the cost of providing government funded services are transparent and consistent with the cost of activities provided by the private sector;
ii) reduce competitive inequities between the public and private sectors in providing goods and services; and
iii) remove bias that may discourage government agencies from obtaining services from the most cost efficient source.

Section 3

Application of competitive neutrality in the ACT. The ACT will adopt two approaches to competitive neutrality, matched with associated structural and financial reforms such as corporatisation, commercialisation and competitive tendering:

i) full application of the principles of competitive neutrality to significant business enterprise and activities; and
ii) full cost attribution for the general government sector.

Section 4

Associated reform measures. This section outlines a range of structural and financial reforms that will ensure government businesses compete on even terms with the private sector.

i) Corporatisation, where the business is established as an incorporated company under corporations law and subject to the *Territory Owned Corporations Act 1990*. Corporatisation subjects government businesses to similar disciplines, incentives and sanctions as private business enterprises.
ii) Commercialisation may be adopted as either a step toward, or alternative to, corporatisation. The main difference is commercialisation does not involve incorporation under corporations law and in some instances there may not be a separate board. This model would most likely apply to activities where there is a lack of a market, there are substantial community services obligations relative to their overall operations or there is limited experience in operating in a commercial environment.
iii) Full cost attribution. This opens the way to market test many ancillary government business activities or community services through competitive tendering.

Section 5

The Cost Benefit and Public Interest Tests. Competitive neutrality need only apply if the benefits outweigh the costs. The public interest clause in the Competition Principles Agreement also requires an assessment of a broad range of community issues.

Section 6

How will the principles be applied? A government task force will review all business functions and activities to apply the appropriate principles of competitive neutrality. The objective is to achieve more efficient, competitive businesses with the emphasis on markets, customers, planning and efficiency.

Section 7

Complaints Mechanism. The ACT is moving to adopt legislation that will provide for alleged breaches of the principles to be investigated.

Section 8

Implementation Timetable. Identifies the range of business activities to be reviewed during 1996 and 1997.

1. NATIONAL COMPETITION POLICY – AN OVERVIEW

The Commonwealth and all State and Territory governments have agreed to a national competition policy to generate broad based community benefits and improve Australia's competitiveness in international markets.

The National Competition Policy evolved from recognition that ultimately the ability of the Australian economy to continue growing, provide sustainable employment and an improved standard of living depends on how well the productive potential of the economy is utilised.

The National Competition Policy comprises three agreements signed by all heads of government at the Council of Australia Governments meeting of 11 April 1995. The agreements are:

- Conduct Code Agreement;
- Competition Principles Agreement; and
- Agreement to Implement the National Competition Policy and Related Reforms.

These Agreements provide the legislative and policy framework for promoting competition and restricting anti-competitive activities, by establishing the conditions for fair trade regardless of individual bargaining power.

The policy framework specifically provides for the reforms to be considered against broader government and community policy objectives, providing for decisions that would continue to restrict competition where that is assessed as being in the community interest.

Conduct Code Agreement

This agreement provides a legislative framework for a Competition Code to achieve and maintain consistent, uniform and complementary national competition laws and policies applying to all businesses regardless of whether they are publicly or privately owned.

The Competition Code is contained in the conduct rules of Part IV of the *Trade Practices Act 1974* (TPA). It applies to both persons and private and public business activity, excluding government regulatory activities such as the imposition or collection of taxes, levies and fees, non-commercial functions of government and the acquisition of primary products by government.

The Competition Policy Reform Act 1996 applies the Competition Code in the ACT.

Competition Principles Agreement

This Agreement seeks to create a level playing field on which private and public sector organisations may compete fairly to produce benefits for the community. Competitive neutrality is to be achieved by removing market distortions resulting from public ownership, removing anti-competitive legislation and restraining monopolistic and exclusive activity.

The policy focuses on removing the barriers to competition that have primarily existed in the public sector whereas the Competition Code applies the anti-competitive conduct rules to business when competition is in place.

The additional Policy elements include:

- legislation and regulation review;
- prices oversight of public monopolies;
- competitive neutrality policy and principles;
- structural reform of public monopolies; and
- access to services provided by means of significant infrastructure facilities.

Agreement to Implement the National Competition Policy and related reforms

This Agreement defines the terms on which the States/Territories receive competition payments in return for their support in implementing reforms on time and in the manner intended. It sets out the conditions which the States/Territories must satisfy to qualify for Commonwealth financial assistance payments. The National Competition Council (NCC) is responsible for determining whether the States and Territories have met the conditions to which they have agreed.

The Agreement Provides for payments to be made to the States and Territories commencing in 1997-98.

2. WHAT IS COMPETITIVE NEUTRALITY?

The Competition Principles Agreement defines the aim of competitive neutrality policy as:

"*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 ownership. These principles only apply to the business activities of publicly owned entities, not to the non-business, non-profit activities of these entities*". (Competition Principles Agreement subclause 3.(1))

According to the Competition Principles Agreement, each Government will seek to improve efficiency in the public sector by introducing market disciplines and increasing the level of competition for provision of government services. This reform will provide the stimulus to restrain costs, promote efficiency and raise service standards as government business operators strive to at least match the performance of their private sector counterparts.

The aim of these reforms is largely to achieve improved allocations of resources by ensuring that services are delivered by the most efficient provider. The principles of competitive neutrality intend that government businesses should not be able to underprice more efficient private businesses as a result of advantages stemming from government ownership.

Competitive neutrality will result in government business activities or functions assuming similar costing and pricing principles, taxation and financing requirements and regulations as the private sector. The removal of any advantages of government ownership will provide the incentive for government businesses to become more efficient and effective.

In removing any specific advantage it may be necessary to discount any prevailing disadvantages to enable government businesses to compete fairly. For instance there may be a requirement to separately identify and directly fund community service obligations through the budget rather than have these costs absorbed directly by the relevant government business. These cross subsidies are disadvantages because they are not costs which the business would normally incur in pursuit of its commercial objectives.

Certain government businesses may be subject to more restrictive employment practices and additional regulatory requirements than their private sector counterparts. These factors will be assessed, not only to determine the relative efficiency of the particular business activity but also to determine whether these constraints should remain.

As a result of these reforms, not only will private enterprise be able to compete for government business on a fairer basis, but there will be general economic and social benefits resulting from an improved allocation of community resources.

Although the reforms may introduce an element of competitiveness by allowing the private sector access to previously denied markets, there will be less incentive for government funded services to be privatised or contracted out if performance is maintained at satisfactory levels.

3. APPLICATION OF COMPETITIVE NEUTRALITY IN THE ACT

Each Government is free to determine its own agenda for the implementation of the competitive neutrality principles. (Competition Principles Agreement subclause 3(2))

While the Competition Principles Agreement addresses significant business activities, the Territory will apply the principles of competitive neutrality wherever it is considered to be in the public interest. This will encourage improved efficiency and allocation of resources on a broader scale.

All government business activities will be required to fully attribute costs on the same basis as private firms. Subject to the cost/benefit test, significant business enterprises and activities will also be required to:

- pay all Commonwealth and Territory tax or tax equivalent payments;
- pay debt guarantee fees if in receipt of concessional interest rates that reflect their government ownership rather than their commercial status; and
- comply with the same regulations that apply to their private sector counterparts.

4. ASSOCIATED REFORM MEASURES

In each case the relative advantages and disadvantages of providing services through government agencies will need to be identified and integrated with an appropriate measure of reform according to the scale and nature of their business activities.

These reforms include:

- adopting commercial accounting practices;
- separately identifying the cost and quality of government activities;
- extending competitive tendering practices and contractual arrangements; and
- commercialisation or corporatisation of separate government businesses.

Which government businesses are affected?

"Government Trading Enterprises are organisational units within the public sector that produce goods and services which are, or could be sold or tendered in the market place without compromising government's economic or social objectives. The Government Trading Enterprise concept includes units within government departments that are engaged in trading activities and may include social services, the provision of which could be undertaken by such units on the basis of an arm's length contract with government." (Steering Committee in Government Trading Enterprises, 1988)

All Government business operations will be reviewed to ensure that their structure, operational requirements and financial incentives promote efficient practices. This applies to all government organisational units that produce goods and services that could be sold or tendered in the market place. These trading activities extend to the provision of goods and services to other parts of the public sector. These business activities will range from the specialist activities located within government departments, and may include community service obligations that could be provided under contract by private organisations, to separate legal entities such as statutory authorities or Territory Owned Corporations.

According to the Competition Principles Agreement, competitive neutrality need not apply to non-business and non-profit activities. Whilst this may exempt some core government functions such as environmental protection, education, health and safety, justice, law and order, these agencies may contain certain business activities or services that will need to become more competitive by removing any tied business arrangements.

It may be that such business activities will continue to operate as semi-autonomous business units within the parent agency, under a more contestable regime, or be converted into separate commercial entities such as a statutory authority or a territory owned corporation. In any case they will be required to fully attribute the costs of the goods and services they provide. Moreover the goods and services will be provided in a contestable market characterised by competitive tendering and contracting.

Having regard to the objectives of the Competition Principles Agreement, the use of the term 'non-profitable' does not exclude from the application of the principles of competitive neutrality those commercial or business activities that operate at a loss.

These businesses will still be subject to competitive neutrality even though they may not be suitable for corporatisation. Until they are subject to competitive neutrality principles, the real costs and efficiency of their operation will remain obscured and there will be less motivation to improve performance.

For significant Government business enterprises which are classified as 'Public Trading Enterprises' and 'Public Financial Enterprises' under the Government Financial Statistic Classification:

(a) each government will, where appropriate, adopt a corporatisation model for these Government business enterprises; and

(b) impose on the Government business enterprise:

(i) full Commonwealth, State and Territory taxes or tax equivalent systems;

(ii) debt guarantee fees directed towards offsetting the competitive advantages provided by government guarantees; and

(iii) those regulations to which private sector businesses are normally subject, such as those relating to the protection of the environment and planning and approval processes, on an equivalent basis to private sector competitors.

Where appropriate, these provisions will also apply to significant business activities. At a minimum, reforms should ensure that the prices charged for goods and services will take account of the items listed in paragraph 3(4)(b), and reflect full cost attribution for these activities. (Competition Principles Agreement subclauses3 (4) and 3(5))

Corporatisation

In line with government commitments under the Competition Principles Agreement, the Territory will consider corporatising significant business enterprises and activities subject to the provisions of the *Territory Owned Corporations Act 1990*.

Corporatisation exposes government businesses to tax, regulation and costs of finance similar to those in the private sector.

A significant business enterprise is likely to have the following characteristics:

- it is a separate legal entity;
- its predominant activity is trading goods and/or services or is able to earn a substantial part of its operating revenue from user charges;
- it has predominantly commercial or profit making focus;
- it has or could have a significant impact on the relevant market; and
- the impact of poor performance is substantial.

Corporatised entities will be subject to the following principles of competitive neutrality as appropriate:

Setting commercial target rates of return, capital structures and dividend payments;

Corporatisation seeks to subject Government Business Enterprises to disciplines, incentives and sanctions which are effectively the same as those applying to private business enterprises.

The principal objective is based on their commercial performance including target of return.

Dividend payments are determined by considering the need for working capital and the government's revenue requirements. The general minimum dividend pay-out ratio is 50% of after-tax profits.

The capital structure and dividend policy of each entity is assessed to determine whether they are comparable with similar private firms.

Where the business is not subject to full market competition, performance targets are set with control of overall price levels to ensure targets are met by real productivity improvements and not simply by taking advantage of monopoly pricing.

Full Payment of Territory taxes and Commonwealth income and sales tax equivalents;

All Territory owned corporations will be liable to pay all taxes and charges that their competitors area required to pay.

In addition to paying Commonwealth taxes or tax equivalents, Territory owned corporations will be subject to the same Territory taxes and charges that apply to the private sector. These taxes include payroll tax, financial institutions duty, land tax, stamp duties and any rates and charges not already collected.

Loan guarantee fees;

Territory owned corporations may be subject to a borrowing levy that reflects the value of any concessional borrowing rate by virtue of an implied government guarantee. The levy will increase the cost of debt to the level that the business would be required to pay if it was privately owned having regard to its financial position and risk portfolio.

The level of the fee will take into account any new borrowing or capital injections as well as an estimate of the cost that would apply to past borrowings, based on the level of assets held.

Subject to business regulation;

The rules and regulations under which businesses operate influence their efficiency. Regulations can have a major bearing on the cost of inputs, market behaviour and other constraints such as the requirement to meet environmental or occupational health and safety standards.

All government business activity to which competitive neutrality principles are applied will be subjected to at least the same regulatory regime as private enterprises. In some cases the regulatory requirements of public enterprises are more onerous than for private businesses.

Business enterprises will not be responsible for regulatory activities. Regulatory activities will be performed by a separate authority. Government businesses should not determine their own regulatory standards because they may conflict with the business' commercial objectives.

Explicit funding for community service obligations;

The government may require a business to provide services to the community that it would not undertake as part of its normal commercial activity, except at a higher price. These community service obligations will be indentified and directly funded by government. Previously they have often been hidden services and indirectly funded from cross subsidies. Clearly identifying and costing these services will enable business to focus on commercial targets and respond to market based price signals and incentives. The government will be able to determine which services can be effectively and efficiently provided by the public sector.

Community service obligations should provide an identified community benefit and be subject to agreed standards of performance and delivery.

Independent performance monitoring.

It is widely recognised that quality performance will not be sustained unless performance is subject to continuous improvement.

A major incentive for efficient management in the private sector is the regular scrutiny of a company by the equity and debt markets. Such incentives do not apply to public sector businesses, such as territory owned corporations. An alternative set of performance standards are needed that are appropriate to the public sector.

Territory owned corporations will be subject to independent performance monitoring to replicate the external monitoring of private companies. Performance assessment will use performance targets agreed annually between the government and corporate boards. The performance agreement targets will be supplemented by monthly financial statements and non financial benchmarks to ensure service quality.

Corporate entities should be self financing. They must be able to generate sufficient cash flows to be profitable and to raise adequate capital investment funds. They will be required to male returns on capital comparable to private business benchmarks.

For a corporation to achieve maximum operating efficiency, the role of the government as owner should be to define core activities, and determine the financial distribution policy, including the target rates of return and the broad limits on the capital structure.

Commercialisation

Not all government business enterprises should be corporatised. Corporatisation requires organisations to be commercially sound. It is unlikely that businesses reliant on government funding to meet their operating and investment requirements would be considered for incorporation. Such business activities may benefit, however, from increased exposure to commercial practices and market disciplines.

Even if a business is commercially sound it may not be corporatised. It may be more advantageous to introduce competitive tendering for some services and allow all tenderers to bid for access to associated government owned assets.

Commercialised entities may operate as statutory authorities with their own enabling legislation or as semi-autonomous business units within a parent agency. However, while they are not fully subject to market forces, commercialised activities will be subject to the same costing and pricing principles, taxation and debt guarantee requirements and appropriate regulations as fully corporatised businesses.

The essential policy is to ensure that government businesses are efficient, determined by their ability to effectively compete with their private sector counterparts. To achieve that goal it is important to provide incentives for sensible administration thereby benefiting from more commercially competitive service provision. Removing ownership advantages and disadvantages will ensure that the resources are allocated efficiently and allow clear judgements to be made about commercial performance.

Full Cost Attribution

It has not always been possible to compare the performance of government agencies with one another or their private sector counterparts because of different financial controls and management practices.

There have been instances where government agencies either do not know the full costs of their operations or have not fully accounted for these costs. In such circumstances there is no capacity for effective performance management. Making meaningful comparisons with private sector benchmarks is therefore difficult.

Consistent with the principles of competitive neutrality and in order to promote greater accountability and efficiency in the allocation of resources the ACT Government has introduced various financial management reforms which are contained in the *Financial Management Act 1996* and are being applied on a whole of government basis.

These reforms include accrual accounting, separating the purchaser and provider roles within government agencies, improved reporting and monitoring of performance, and the full costing of services to enable more accurate comparisons with external suppliers.

Overall these reforms will enable government agencies to better identify opportunities for services to be delivered in competition with the private sector as the relative advantages and disadvantages of internal and external providers become more apparent.

In particular all government agencies will adopt full cost attribution to encourage rational use of resources and disclosure of the real cost to the community of providing services. That discipline will reduce excess demand for services, stimulate demand for improved services quality and encourage government businesses to charge competitive prices. Where government services are uncompetitive they risk losing their business to more efficient suppliers.

5. THE COST BENEFIT AND PUBLIC BENEFIT TESTS

In pursuit of efficiency and its national competition policy undertakings, the government may decide to corporatise businesses, restructure them along commercial lines or expose them to a more contestable market arrangement. Alternatively the government may decide it is better for some functions to be contracted out or sold. In making those decisions the government is obliged to consider whether their public benefit exceed their costs.

Clause 1(3) of the Competition Principles Agreement states that the following matters should be taken into account in when considering public benefits:

- government legislation and policies relating to ecologically sustainable development;
- social welfare and equity considerations, including community service obligations;
- government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity;
- economics and regional development including employment and investment growth;
- the interest of consumers generally or of a class of consumers;
- the competitiveness of Australian businesses; and
- the efficient allocation of resources.

Furthermore, according to Clause 3(6) of the Agreement, the government is only required to apply the principles of competitive neutrality to the extent that the benefits outweigh costs, which may include:

- the transaction and legal costs associated with structural reform such as corporatisation; and
- the increased regulatory costs associated with tax equivalents, debt guarantees, pricing oversight and compliance monitoring.

The benefits will be derived from:

- greater cost awareness and improved cost management;
- better client focus arising from increased competition and financial incentives;
- improved decision making and allocation of resources;
- improved program orientation and policy objectives; and
- improved accountability and performance measurement.

6. HOW WILL THE PRINCIPLES BE APPLIED?

The complete implementation of these reforms will need to be phased in depending on the existing form and state of the particular business activity. It is important that this be undertaken in a coordinated manner and that the reform program is maintained.

A government task force will assist in implementing the principles of competitive neutrality. The task force will review all significant business enterprises and activities on a case by case basis and consider the need to restructure particular business activities. Specific tasks will be indentified to resolve any implementation issues relating to each business function or activity. Situations will arise where special transitional arrangements may need to be adopted because of associated conversion costs or legislative requirements.

The task force will report to government on the scope and timing of reforms including strategies for consultation with the various stakeholders including customers, suppliers, employees, the business community and the general public.

The government will also establish a consultative committee to provide ongoing monitoring and advice on the implementation of competition policy. This committee will include representatives of community, environmental, consumer, union, business and academic organisations.

The terms of reference will enable the consultative committee to monitor:

- the structural reform of government business enterprises;
- the regulatory review process;
- the development of community service obligations;
- competitive tendering and outsourcing; and
- any other matter related to the Competition Principles Agreement or the Competition Code.

7. COMPLAINTS MECHANISM

Each government will publish a policy statement that includes an implementation timetable and a complaints mechanism. (Competition Principles Agreement subclause 3.(8))

All entities to which the policy applies will be subject to a complaints mechanism. Claims will be received from parties alleging direct and material disadvantages as a result of unfair competition from government businesses. The complaints mechanism forms part of a set of mechanisms intended to ensure that the competitive neutrality framework is effective. Other mechanisms include provision for appeals concerning assessments of tax under the tax equivalent regime and prices oversight.

Specific legislation proposing to establish an independent office holder to consider complaints dealing with competitive neutrality will be considered during 1996.

The basic principles to be considered in dealing with complaints include:

- independence;
- ease of access;
- expeditious consideration and resolution of complaints;
- public process; and
- publication of decisions and availability of relevant information.

For more information

Further information can be obtained from Economics Branch, Investment and Economics Division, ACT Department of Treasury, 02 6207 0337.

Competitive Neutrality Complaints in the ACT are now handled by the Independent Competition and Regulatory Commission (ICRC).
Location: Level 2, 12 Moore St, Canberra ACT 2601
Address: GPO Box 296, Canberra City, ACT 2601
Phone: (02) 6205 0799 Fax (02) 6207 5887
Email: icrc@act.gov.au Website: www.icrc.act.gov.au

8. IMPLEMENTATION TIMETABLE

Consistent with the provisions of the Competition Principles Agreement those enterprises classified in the Government Finance Statistics as Public Trading Enterprises and Public Financial Enterprises will be reviewed in 1996-97. The enterprises included in those classes are:

ACT Milk Authority	To be reviewed in 1996-97
ACTEW	Corporatised on 1 July 1995
ACT Forest	Under Review
ACTTAB	Corporatised 1 July 1996
Home Purchase Trust Account	Under Review
Canberra Retail Markets Trust	No longer exists
Canberra Theatre Trust	Under Review
Totalcare	Corporatised on 1 January 1992
Canberra Commercial Development Board	No longer exists
ACTION	Under Review

Subject to the cost benefit and public benefit test the reviews will consider the need to establish:

i) new operational and financial structures including Territory Owned Corporations; and
ii) to ensure the principles of competitive neutrality are being applied including Commonwealth and Territory taxes and tax equivalents, debt guarantee fees and any regulatory requirements.

Other significant business activities currently being reviewed or that will be reviewed during 1996-7 include:

ACT Housing Trust	Under Review
ACT Borrowing and Investments Trust	Under Review
Australian International Hotel School	Under Review
Exhibition Park in Canberra	To be reviewed in 1996-97
ACT Fleet	Under Review
Yarralumla Nursery	To be reviewed in 1996-97
Gungahlin Development Authority	Under Review
Information Technology Services	Under Review
Urban Services – all commercial and public works services	Under Review

The review of housing services will take into account any associated intergovernmental agreements undertaken in the Commonwealth State Housing Agreement.

Eventually all government agencies will be reviewed in order to identify those business functions and activities to which the principles of competitive neutrality should be applied. Each business will be assessed to determine the scope for improving the basis of their operations whilst retaining government ownership and identifying any associated reforms required to achieve this objective.

All government agencies are being surveyed in 1996 to identify the opportunities for additional competitive tendering and contracting of their services and business activities. As part of this process they will be required to market test these programs during 1996-97 and identify any potential savings. It may also be appropriate in some instances to commercialise or corporatise these business activities.