

Competitive Neutrality
Policy



Competitive Neutrality **Policy**



Department of
Treasury and Finance

Competitive Neutrality Policy Victoria 2000

Prepared by: The Department of Treasury and Finance

Foreword from the Treasurer

In April 1995, the Commonwealth and all State and Territory governments signed three interrelated agreements which collectively underpin National Competition Policy.



The Victorian Government is committed to the ongoing implementation of National Competition Policy in a considered and responsible manner. This means that public interest considerations should be taken into account explicitly in any Government decisions on the implementation of National Competition Policy.

Under the *Competition Principles Agreement*, Victoria is obliged to apply competitive neutrality policy and principles to all significant business activities undertaken by government agencies and local governments. The Victorian Government will fulfil this obligation and also meet its wider responsibility to the community by requiring competitive neutrality be applied only where it is in the public interest to do so.

Competitive Neutrality Policy Victoria 2000 sets out the new Victorian approach to competitive neutrality which reflects and reinforces the four key priorities of Government.

■ **Restoring democracy**

A key focus of the new policy framework is the responsibility of government agencies and local governments to be transparent in their decision making processes in respect of their business undertakings. This will lead to more open and accountable government in Victoria.

■ **Improving services to all Victorians**

Government plays an important role in delivering quality services to the community. The Victorian competitive neutrality policy provides a framework for improving the delivery of services by significant business activities.

■ **Growing the whole of Victoria**

The new policy establishes and sustains a framework to allow all capable and competent private businesses to compete or form partnerships with government and local government businesses on a fair and equitable basis. This will encourage diversity in sources of supply, contribute to greater consumer choice and enhance job growth and employment opportunities in local communities.

■ **Responsible financial management**

The Victorian competitive neutrality policy framework encourages consideration of alternative approaches to delivering quality services to the community. This will help inform the choice of efficient and effective means of service delivery, thereby ensuring that scarce public resources are deployed in a financially responsible manner.

foreword

Foreword from the Treasurer cont...

A simple but robust *public interest* test has been embedded in the new Victorian approach to competitive neutrality. This test is designed to assist government agencies and local governments to balance competitive neutrality with the key priorities and public policy objectives of Government through a public and consultative process. In line with the Government's priorities for open and consultative processes, consultation with relevant community groups is a key requirement of the test. An equally important requirement is that the test is presented and made available to the public. This will help ensure that deliberations on the application of competitive neutrality to significant government businesses are transparent, understandable and accessible to Victorians.

Importantly, the Government recognises that competitive neutrality costing and pricing do not - and should not - override the public policy objectives of government agencies and local government bodies.

However, *Competitive Neutrality Policy Victoria* does require the relevant government agencies and local government bodies to at least consider competitive neutrality costing and pricing as one way of achieving their public policy objectives.

The Bracks Government has taken a responsible approach to ensure that the application of competitive neutrality is consistent with the achievement of wider Government objectives. The renewed *Competitive Neutrality Policy Victoria* will provide many opportunities for government businesses, non-government businesses and local communities to work together to achieve more efficient and effective delivery of important government services.



John Brumby
Treasurer

1. Background to Victoria's

competitive neutrality policy

background

The Government of Victoria is a party to the inter-governmental *Competition Principles Agreement* (CPA) which is one of the three agreements that underpin National Competition Policy (NCP). Under the CPA, each State and Territory is obliged to introduce and apply competitive neutrality policy and principles to local government and to all government agencies.

The Government has exercised the discretion granted by the CPA to revise its competitive neutrality policy framework to take into account the new priorities of Government without contravening either the letter or spirit of NCP. While the Government is committed to the ongoing implementation of NCP, it also notes that NCP does not require:

- asset sales and privatisation;
- compulsory competitive tendering;
- contracting out;
- financial market deregulation;
- industrial relations reforms;
- reductions in the size of the public sector;
- local government amalgamations;
- reductions in welfare and social services; or
- removal of community service obligations (CSOs)¹.

The revised competitive neutrality policy framework, as set out in this Policy Statement, reflects the core intent of NCP while reinforcing the four key priorities of Government - restoring democracy, improving services to all Victorians, growing the whole of Victoria, and responsible financial management.

¹ Productivity Commission, *Impact of Competition Policy Reforms on Rural and Regional Australia*, Inquiry Report, 8 September 1999, p.316

2. Competitive neutrality policy and principles

principles

the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities. Section 3(1) of the CPA as

“ the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities: Government business 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.”

It is common for private businesses (including 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. The inequalities of concern arise from differences in tax treatment, differences in the need to provide a return on investment, and related cost advantages or disadvantages which might impact on the prices that are set by government businesses.

The aim of competitive neutrality policy is to account for these factors in such a way that where governments undertake significant business activities in markets, they do so on a fair and equitable basis. Competitive neutrality policy measures are designed to achieve a fair market environment without interfering with the innate differences in size, assets, skills and organisational culture which are inherent in the economy. Differences in workforce skills, equipment and managerial competence, which contribute to differing efficiency across organisations, are not the concern of competitive neutrality policy.

Competitive neutrality can benefit all Victorians by enhancing the confidence of business to make decisions on investments in the State and private decisions as to what to buy and sell.

In general terms, the **competitive advantages** of public ownership arise from additional costs (or other factors affecting the supply of goods or services) which would be faced by a government business if it were a private firm. For example, a government business which is exempt from paying land tax will enjoy a cost advantage that is not available to a private business operating in the same market. *Government agencies should review all of their circumstances and the markets they supply to identify any advantages peculiar to their own circumstances.*

Similarly, the **competitive disadvantages** of public ownership are the additional costs (or other factors affecting the supply of goods or services) which would not be incurred by a government business if it were a private sector business. For example, a government business may have additional accountability and reporting requirements which are not faced by a private business supplying the same goods or services. *The key factor in assessing whether a disadvantage constitutes a competitive neutrality issue is that the constraint (on the conduct of the public business) is externally imposed on the agency and it exceeds that likely to be faced by a private sector business supplying the same goods or services.*

See Appendix 1 for further details on the types of differences that will potentially generate cost advantages or disadvantages which may be faced by a public business.

3. The application of

competitive neutrality in Victoria

In line with the CPA, the Policy applies only to the *significant business activities* of publicly owned entities, and not to the non-business non-profit activities of those entities.

The CPA does not provide a definition of “significant business activities.” The Government believes that such determinations must therefore be made on a case-by-case basis. In making a determination, relevant considerations may include the size of the relevant business activity in relation to the size of the relevant market, its influence or competitive impact in the relevant market, the resources it commands and the effect of poor performance. *An activity should not be regarded as significant or insignificant solely because of its size relative to the overall size of the public or local government business.*

In Victoria, it is the responsibility of government agencies and local governments to determine if their business activities fall within the scope of the Policy.

Agencies and local governments should consult the Competitive Neutrality Complaints Unit, located in the Department of Treasury and Finance, if they require assistance in this regard.

An agency or local government should document its determination as to whether a business activity is, or is not, within the scope of the Policy. This documentation should be defensible and will be subject to scrutiny in the event that an investigation is triggered by a complaint.

4. Policy implementation

Competitive neutrality measures will be required where the expected benefits of introducing such measures outweigh the costs, and where there are net benefits from implementing such measures having regard to public policy objectives other than competitive neutrality.

There is a range of possible measures that may be adopted to achieve competitive neutrality. These include corporatisation, commercialisation and full cost-reflective pricing.

implementation

organisations, or through the creation of a separate legal business entity to provide the relevant goods and services. Such an entity is characterised by:

- clear and non-conflicting objectives;
- managerial responsibility, authority and autonomy;
- independent and objective performance monitoring; and
- performance-based rewards and sanctions.

Commercialisation involves organising an activity along commercial lines without creating a separate legal business entity. This is typically achieved by introducing and applying a set of “commercial practices” to the business functions of the government agency. The relevant commercial practices, not all of which are needed to achieve competitive neutrality, include:

- clear delineation of commercial and non-commercial activities, typically through a business plan;
- clearly defined commercial performance targets and financial reporting requirements;
- separate accounting for, and funding of, non-commercial activities;
- separation of regulatory functions from commercial activities;
- an appropriate financial return on the assets used in the commercial activity;
- application of a tax equivalent regime;
- application of debt guarantee fees; and
- appropriate financial arrangements for the allocation of profits from the commercial activity.

Corporatisation or commercialisation may be unsuitable in circumstances where the scale of the government business activity is small relative to the non-commercial or regulatory functions of the agency. This is likely to be the case for local government business activities which are performed as part of a broader local government function (eg. commercial cleaning by a local government’s cleaning service). In such cases, full cost-reflective pricing will be an appropriate means of achieving competitive neutrality.

When setting the price for a good or service into account:

- all of the costs that can be attributed to the provision of the good or service;
- the cost advantages of public or local government ownership (see Appendix 1 for some guidance); and
- the cost disadvantages of public or local government ownership (see Appendix 1 for some guidance).

The intention of full cost-reflective pricing is to *offset* any net competitive advantages a government business may enjoy, thereby ensuring that resource allocation decisions are made on the basis of comprehensive and accurate costing.

In setting the price for the good or service in question, the government agency may have regard to a number of economic factors which include, but are not limited to:

- the level of demand for the good or service;
- the level of competition between service providers; and
- short term pricing strategies involving the use of “loss leaders” or cross-subsidisation, subject to the prohibitions of certain pricing behaviour under the *Trade Practices Act 1974*.

For the purpose of the Policy, the key requirement of full cost-reflective pricing is that government agencies and local governments should aim to recover the full costs of their whole of business activity over the medium to long term.

Costing for competitive neutrality and the steps in achieving full cost reflective pricing are explained further in *A Guide to Implementing Competitive Neutrality*.

5. Assessment of costs and benefits

The decision to implement any specific competitive neutrality measure depends, in the first instance, on the expected benefits outweighing the expected costs.

The CPA only requires governments to implement competitive neutrality measures "to the extent that the benefits to be realised from implementation outweigh the costs."

Benefits of applying competitive neutrality measures

For the purpose of the Policy, an assessment of the potential benefits of applying competitive neutrality measures should include, but is not limited to, the matters outlined below:

- increased market contestability which enables competition in the markets which have been traditionally dominated by public sector businesses. Such contestability produces incentives for businesses to lower prices and provide greater choice for consumers;
- improved performance of government businesses in comparison with competitors. Competitive neutrality increases the incentives for the business to operate efficiently thereby encouraging better use of the community's scarce resources; and
- owner governments can better clarify non-commercial objectives, and thereby determine whether the business is effectively meeting these objectives.

In evaluating the beneficial impact of competitive neutrality measures, it is important to remember that the benefits from greater competition will generally arise year after year so that there is a stream of benefits which must be considered. For this reason benefits may be more difficult to establish than costs.

Costs of applying competitive neutrality measures

For the purpose of the Policy, an assessment of the potential costs of applying competitive neutrality measures should include, but is not limited to:

- legislative and regulatory amendment;
- obtaining information and undertaking analysis to assess appropriate levels for tax equivalents, debt guarantee fees or pricing principles; and
- administration of tax equivalent and debt guarantee frameworks.

These are mainly what might be generically termed "transaction costs" and arise directly from, or are associated with, the process of implementing competitive neutrality measures.

A government agency will need to undertake a public interest test if it considers that another policy objective or objectives of Government would be compromised by the implementation of a competitive neutrality measure. This is discussed further in Section 6.

Weighing up costs and benefits of competitive neutrality measures

Competitive neutrality measures need not be applied in situations where costs exceed benefits, that is, when the stream of competitive costs incurred over time is greater than the corresponding stream of benefits accrued over the same period.

In general, the costs of implementing competitive neutrality measures are more immediate, faced by the public business itself and more measurable. The benefits, which tend to accrue over the medium to longer term and diffuse across the community as a whole, are less easily quantified.

It is important that any comparison of costs and benefits is undertaken on the same basis. This can be done by amortising costs over the period for which the benefits are expected to accrue, or converting both the cost and benefit streams to their current values so that they can be compared properly. In this regard, the costs of implementation in most cases are likely to be small relative to overall expenditures relating to the significant business activity.

The cost-benefit assessment should be documented and made available in the event that an investigation is triggered by a complaint.

6. A public interest test

When a department or local government considers that the implementation of a competitive neutrality measure would compromise other public policy objectives

Once a government agency or local government has determined that the activity in question is subject to the Policy and the expected benefits of introducing the relevant competitive neutrality measure outweigh the costs, it would then need to consider whether implementation of the measure is in the public interest.

Government agencies and local governments have responsibility for achieving an array of social, environmental, economic and regional objectives. It is the Government's intention for the Policy to be implemented responsibly and sensitively by incorporating a recognition of these other potential objectives.

The CPA provides some guidance on the matters which should be taken into account in assessing the application of competitive neutrality measures, but it does not address the weighting which governments should apply to such matters. These include:

- 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;
- economic and regional development, including employment and investment growth;
- the interests of consumers generally or a class of consumers;
- the competitiveness of Australian business; and
- the efficient allocation of resources.

It is important to note that this is an open-ended list so that other relevant matters can be considered as appropriate. These may include:

- local policies relating to economic and business development, local employment, quality of goods and services, including timeliness of supply;
- impact on the local community; and
- impact on the State and national economies, if any.

Where a department, agency or local government considers that the implementation of a competitive neutrality measure would compromise other public policy objectives, it will need to conduct a public interest test in order to demonstrate the case for not implementing the measure in question. To satisfy the formal requirements of the Policy, the test should, at a minimum:

1. clearly identify the policy objective(s) that is to be achieved and ensure that the policy objective(s) has official endorsement (for example, stated by a Minister, a local government body or in an official policy document);
2. demonstrate that the achievement of the stated policy objective(s) would be jeopardised if the 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.

The public interest test should be undertaken in consultation with the community through an open and transparent process. At the conclusion of the process, the conduct and outcomes of the public interest test should be documented and made publicly available. Information that is commercial-in-confidence may be excluded, provided this is noted in the public documentation.

7. Government business enterprises and competitive neutrality policy

The *Competition Principles Agreement* imposes specific competitive neutrality requirements for Government Business Enterprises (GBEs)². The Agreement requires that governments adopt a corporatisation model for GBEs when the benefits of this approach are expected to outweigh the costs. In Victoria this requirement has been met.

For those GBEs - where it is determined that corporatisation would not deliver a net benefit to the community - the CPA requires that they are subject to taxation, financial and regulatory requirements equivalent to the private sector. This parity is achieved by subjecting the non-corporatised GBEs to:

- Commonwealth, State and Territory taxes or tax equivalent systems;
- debt guarantee fees to offset the advantages of government guarantees; and
- equivalent regulatory requirements as private sector businesses, for example environment and planning regulations.

Further details on the application of this 'equivalence' requirement to GBEs in Victoria are provided in Appendix 2.

² Government Business Enterprises include Public Financial Enterprises and Public Trading Enterprises as defined by the Government Financial Statistics Classification

8. Compliance

and the complaints mechanism

It is the responsibility of individual departments, agencies and local governments to:

- identify the activities to which the Policy applies;
- take the necessary actions to comply with the Policy; and
- document the decisions they have taken and make the material available to the public on request.

Departments, agencies and local governments should refer to the flow diagram in Appendix 3 and the implementation checklists in Appendix 4 for further guidance.

Compliance by government agencies and local governments

The actions taken by agencies to comply with the Policy will need to reflect the circumstances of the particular significant business activity and the responsible area of government.

Government departments and agencies, including local governments, are required to be able to *demonstrate full observance of the requirements of the Policy*. Chief Executives (in the case of internal department activities, Department Secretaries) are required to affirm compliance with the Policy for all significant business activities. Acknowledgment will also be required in the annual report of the relevant public body.

In the event that a competitive neutrality complaint is received, this information will be requested by the independent Competitive Neutrality Complaints Unit which is established in accordance with the Government's obligations under CPA.

8. Compliance and the complaints mechanism cont...

The complaints mechanism

Under the inter-governmental CPA, the Government is obliged to introduce and apply the principle of competitive neutrality to all significant business activities in the public sector. This means that all government bodies in Victoria are required to undertake their significant business activities in accordance with the Policy. The Complaints Unit will therefore operate on the assumption of compliance rather than non-compliance.

It is the role of the Complaints Unit to determine the extent to which an agency's actions comply or do not comply with competitive neutrality policy. The Complaints Unit also provides private businesses with an independent avenue to verify the compliance of a particular government business with the Policy.

There are a number of important procedural and administrative features of the complaints mechanism. The Complaints Unit:

- accepts complaints from a directly affected person or business, as well as from industry or community groups. Complaints are assessed in accordance with this Policy. When a complaint is received, the first response of the Complaints Unit is to seek verification from the subject agency or local government as to its compliance with the Policy;
- cannot initiate an investigation;
- will abide by principles of procedural fairness and will investigate all complaints fairly, independently and rigorously and will come to a finding on the basis of the best available information. Where the Complaints Unit recommends a course of action which a government agency or local government should take to comply with the Policy, it will request further information to follow-up on how compliance with the Policy has been achieved;
- will consult with, and seek comments from, all parties involved before finalising its investigation. Finalised investigation reports - excluding any commercial-in-confidence information - are provided directly to the parties and published on the Complaints Unit web site;
- has no enforcement powers; and
- does not recommend any compensation or termination of contractual arrangements.

The Complaints Unit does not assess anti-competitive behaviour that is already covered by the *Trade Practices Act 1974* or the *Competition Policy Reform (Victoria) Act 1995*, nor does it deal with probity issues arising from tendering processes of government agencies or local governments.

The protocols for the conduct of a competitive neutrality investigation are fully documented on the competitive neutrality web site at www.vic.gov.au/ncp/default.html

The contact details for the Competitive Neutrality Complaints Unit are as follows:

*Director
Competitive Neutrality Complaints Unit
Department of Treasury and Finance
1 Treasury Place
Melbourne 3002*

Tel: 9651 2148

Fax: 9651 5575

Email: cncu@dtf.vic.gov.au

In line with the Treasurer's role as the Minister responsible for NCP, the Department of Treasury and Finance has the broader responsibility for ensuring overall compliance with the Policy.

Appendix 1

Some potential cost advantages faced by government departments, agencies and local governments

Advantages through exemption from:	Description
<i>Payroll tax</i>	Levied on firms whose annual payroll is over \$515,000.
<i>Land tax</i>	Annual tax based on total unimproved value of Victorian land owned by taxpayer.
<i>Financial Institutions Duty (FID)</i>	A financial institution that receives money is liable to pay FID in respect of each receipt of money except where it is for the credit of an exempt account.
<i>Debits tax</i>	Debits tax is levied on all debits of not less than \$1 to taxable accounts.
<i>Stamp duty</i>	Duties are charged on a number of tradeable instruments.
<i>Accident compensation levy</i>	Levied on employers to cover WorkCover expenses.
<i>Local rates and charges</i>	Imposed on land.
<i>Wholesale sales tax</i>	Tax levied on the wholesale cost of certain goods. This tax was abolished when the Goods and Services Tax (GST) was introduced on 1 July 2000.
<i>Capital cost</i>	Requirement to earn a rate of return on funds which could otherwise be used elsewhere.
<i>Corporate overheads</i>	Access to various corporate overheads free of charge, including office accommodation, payroll services, human resource services, marketing and IT services.
<i>Capital financing</i>	Cheaper financing due to no risk premium where the agency is backed by an explicit or implicit government guarantee.

Some potential cost disadvantages faced by government departments, agencies and local governments

Disadvantages due to government ownership:	Description
<i>Employment remuneration and awards</i>	The public sector has different employment and industrial relations requirements. For example, a public sector agency may, in comparison to private sector counterparts, incur a disadvantage due to the higher statutory rates of superannuation contributions in the public sector.
<i>Accountability costs</i>	Greater accountability costs due to public sector reporting and regulatory requirements, where these are greater than the requirements under <i>Corporations Law</i> .
<i>Corporate overheads</i>	Limited flexibility in reducing or restructuring corporate overheads.
<i>Government agency specific legislation, regulation or directives</i>	Compliance with various Commonwealth and State legislation, eg. FICA and restrictions on investment powers.

Appendix 2

Status of significant government business enterprises - April 2000

<i>Current Status</i>					
Entity	Corporatised ^(a)	Commonwealth Tax Equivalent Regime (TER)	Financial Accommodation Levy ^(c)	State Taxes and Charges	Relevant Regulations
<i>Public Trading Enterprises (PTEs)</i>					
City West Water Ltd	✓	✓	✓	✓	✓
Melbourne Water Corporation	✓	✓	✓	✓	✓
Melbourne Ports Corporation	✓	✓	✓		
Overseas Project Corporation of Victoria Ltd	✓	✓		✓	
South East Water Ltd	✓	✓	✓	✓	✓
Urban Land Corporation	✓	✓		✓	
Victorian Channels Authority	✓	✓		✓	
Victorian Rail Track Corporation	✓	✓ ^(b)		✓	
Yarra Valley Water Ltd	✓	✓	✓	✓	✓
<i>Public Financial Enterprises (PFEs)</i>					
Victorian Funds Management Corporation	✓	✓ ^(b)		✓	
Transport Accident Commission	✓	✓		✓	
State Trustees Ltd	✓	✓		✓	
Rural Finance Corporation	✓	✓ ^(b)		✓	
Victorian Workcover Authority	✓	✓ ^(b)		✓	

- (a) Clause 3(4) of the CPA states, in part, "... for significant Government business enterprises which are classified as "Public Trading Enterprises" and "Public Financial Enterprises" under the Government Financial Statistics Classification: (a) the Parties will, where appropriate, adopt a corporatisation model for these Government business enterprises". This column indicates where a corporatisation model has been implemented.
- (b) Subject to income tax equivalent payments only.
- (c) Applicable to all PTEs/PFEs with borrowings in excess of \$5 million.

Appendix 3

Competitive Neutrality Policy Implementation Flow Diagram



Appendix 4

Competitive Neutrality Policy Implementation Checklists

Checklist A - Determine whether the activity in question is subject to CN Policy

- Identify the context within which the relevant output from the activity (ie. goods and/or services) is produced and provided to the community.
- Assess the significance of the business activity in terms of its size relative to the size of the relevant market.
- Assess the significance of the business activity in terms of its actual and/or potential impact in the relevant market.
- Document the determination as to whether the business activity is, or is not, within the scope of the Policy.

Checklist B - Public interest test: Balance CN measures with public policy objectives

- Identify the policy objective(s) that is to be achieved and provide supporting documentation, eg. statement by a Minister or local government body, or official policy documents.
- Demonstrate that the achievement of the stated policy objective(s) would be jeopardised if the particular competitive neutrality measure under consideration was adopted.
- Determine the best available means of achieving the overall policy objectives, including an assessment of alternative approaches.
- Document the conduct and outcomes of the “public interest test” and make the documentation available to the public. Information that is commercial-in-confidence may be excluded, provided this is noted in the public documentation.

