

OECD Corporate Governance Working Papers No. 4

Competitive Neutrality and State-Owned Enterprises in Australia: Review of Practices and their Relevance for Other Countries

Matthew Rennie,

Fiona Lindsay

https://dx.doi.org/10.1787/5kg54cxkmx36-en

OECD

OECD CORPORATE GOVERNANCE WORKING PAPERS

OECD Corporate Governance Working Papers provide timely analysis and information on national and international corporate governance issues and developments, including state ownership and privatisation policies. The working paper series is designed to make select studies by the OECD Corporate Governance Committee, OECD staff members and outside consultants available to a broad audience.

The papers are generally available only in their original language English or French with a summary in the other if available.

The opinions expressed in these papers are the sole responsibility of the author(s) and do not necessarily reflect those of the OECD or the governments of its member countries, unless otherwise noted.

Comment on the series is welcome, and should be sent to either corporate.affairs@oecd.org or the Corporate Affairs Division, OECD, 2, rue André Pascal, 75775 PARIS CEDEX 16, France.

OECD CORPORATE GOVERNANCE WORKING PAPERS
are published on www.oecd.org/daf/corporateaffairs/wp

© OECD 2011
Applications for permission to reproduce or translate all or part of this material should be made to: OECD Publishing, rights@oecd.org or by fax 33 1 45 24 99 30.

Abstract

COMPETITIVE NEUTRALITY AND STATE-OWNED ENTERPRISES IN AUSTRALIA: REVIEW OF PRACTICES AND THEIR RELEVANCE FOR OTHER COUNTRIES

By Matthew Rennie & Fiona Lindsay[1]

This working paper provides a comprehensive overview of the competitive neutrality framework of the Australian Commonwealth as well as individual States. It reviews the history behind the framework and provides examples of cases brought before the respective complaints handling offices. Finally, the paper draws conclusions regarding the successes and failures of the Australian framework and its applicability to other jurisdictions.

The working paper argues that Australia's competitive neutrality framework can be viewed as highly successful overall. However, the success can probably only be copied by other countries if these are willing to undertake similarly profound reforms as were engendered as part of the Australian competition reforms in the 1990s with the active participation of the Productivity Commission.

The factors behind Australia's apparent success include: a reform program that applied both to SOEs and to specific industries; the flexibility to apply the framework differently in different geographic contexts; anchoring the commitment to competitive neutrality in strong administrative processes; regular reviews and reporting by individual jurisdictions on the progress of their reforms; clarity in communication to enhance a nationwide understanding of the goals and mechanisms to achieve those goals; transparent public benefit tests to establish the boundaries between commercial and non-commercial public activities; and transparent and politically independent review processes.

JEL classification: G30, G34, L4
Keywords: competitive neutrality, state-owned enterprises, corporate governance, competition policy, competitive advantage, sectoral reforms.

[1] Acting as consultants to the Corporate Affairs Division of the OECD Directorate of Financial and Enterprise Affairs. The paper was contracted from the Australian consulting firm Energy Advisory Services which was subsequently acquired by Ernst & Young.

TABLE OF CONTENTS

COMPETITIVE NEUTRALITY AND STATE-OWNED ENTERPRISES IN AUSTRALIA: REVIEW OF PRACTICES AND THEIR RELEVANCE FOR OTHER COUNTRIES 5

1. History of competition reforms in Australia 5

2. The structure and goals of the national competition policy 10

3. Implementing competitive neutrality reforms 20

4. The competitive neutrality complaints mechanisms 24

5. Consideration of Australia's approach and applicability to other sectors 37

GLOSSARY 45

ANNEX A – SPECIFIC UTILITIES REFORMS 47

OVERVIEW OF THE AUSTRALIAN UTILITIES SECTOR 47

THE ELECTRICITY INDUSTRY REFORM PROCESS 48

THE WATER INDUSTRY REFORM PROCESS 50

ANNEX B - FLOW CHART FOR DETERMINING APPLICATION OF COMPETITIVE NEUTRALITY 52

COMPETITIVE NEUTRALITY AND STATE-OWNED ENTERPRISES IN AUSTRALIA: REVIEW OF PRACTICES AND THEIR RELEVANCE FOR OTHER COUNTRIES

1. History of competition reforms in Australia

This section provides some general information on the federal structure of the Australian Governments, which is useful to understand the practicalities necessary to implement reforms in such an environment, and then provides a historical overview of the development of competitive neutrality awareness and reforms in Australia over the last twenty years.

1.1 Overview of the Australian governmental structure

Australia became a federation in 1901, when the then six self-governing colonies of Queensland, New South Wales (NSW), Victoria, Tasmania, South Australia (SA) and Western Australia (WA) became States (retaining the majority of their governmental systems), with a separate Commonwealth Government superimposed over these individual Governments. Under Australia's Constitution, certain powers were specifically granted to the Commonwealth Government by each of the States. The States retained the remaining unspecified powers. A neutral territory (the Australian Capital Territory, or ACT) was established to be the site of the federal capital. Following a number of modifications, the Northern Territory became a part of the Australian federation.

The federated nature of Australia's government had implications for the implementation of its competitive neutrality reforms. In particular, as discussed later in this paper, each of the States and Territories carried out competitive neutrality reforms on an individual basis, albeit subject to an overarching agreement.

1.2 Developing an Australian policy on competition reforms

The current Australian structure of competition law, which is based on specifying certain conduct as prohibited, was first developed through the enactment of the Trade Practices Act 1974 (Cth).[2] Note that although the Trade Practices Act has recently (1 January 2011) been renamed the Competition and Consumer Act 2010 (Cth), we have referred to it in this Paper as the Trade Practices Act, as that was its title during the relevant period. However, it was subsequently recognised that more extensive competition reforms were required (particularly in relation to the design of market structures) in light of:

[2] "Australia's National Competition Policy: Its Evolution and Operation", by Kain, J., Kuruppu, I. and Biling, R., published as an e-brief through the Parliamentary Library of the Parliament of Australia in June 2001 and updated 3 June 2003, available at http://www.aph.gov.au/library/intguide/econ/ncp_ebrief.htm

- the increasing level of inter-State and Territory economic activity (given existing ad hoc competition arrangements[3]);

- the desire to ultimately benefit consumers by allowing more efficient businesses to supplant less efficient businesses;[4]

- the presence of significant inefficiencies in the economy that were actively restricting productivity growth;[5] and

- the ownership of a majority of public utilities by SOEs.[6]

It is important to note that the driver for the competition reforms was not to introduce competition for its own sake, or to meet unspecified higher ideals. The purpose was to create an environment where commercial and non-commercial functions could be clearly outlined and there would be increased levels of competition (particularly in areas traditionally dominated by the public sector), thus incentivising businesses to reduce prices and provide greater customer choice. In this environment SOEs would be incentivised to improve performance to more efficient levels (thereby optimising available resources), with the ultimate goal being the expansion of the Australian economy and the creation of jobs.[7][8]

This need to introduce competition reforms was highlighted by the then Australian Prime Minister, Bob Hawke, in the following policy statements:

- "Towards a Closer Partnership",[9] where he discussed the need for greater co-operation towards microeconomic reform; and

- "Building a Competitive Australia",[10] where he outlined that the competition laws provided, at best, inconsistent coverage and that the scope of the Trade Practices Act should be expanded to include the explicit promotion of competition in monopoly industries.

Following these policy statements, at a Special Premiers' Conference,[11] the Premiers of each State agreed to consider the implementation of a broader, nationally consistent policy

---

[3] "Parliamentary Research Service: Research Paper Number 1 1994 – National Competition Policy: Overview and Assessment" by Kain, J., 21 February 1994, pp ii and 6

[4] "The Economic Impact of Competition", address by Bill Scales to The Australian Financial Review Conference on National Competition Policy, Sydney, 26 October 1993

[5] "Review of National Competition Policy Reforms: Productivity Commission Inquiry Report" No. 33, by Banks, G., Weickhardt, P. and Fitzgerald, R., 28 February 2005, p xiii

[6] See p 3 of "Corporatisation in Practice – A Victorian Experience", Fearon, P., 1-3 December 2004, presented to Asia Pacific Infrastructure Forum, p 404 of the PC Paper

[7] See pp 6, 8 of the Queensland Statement, p 8 of the Victorian Statement

[8] "Review of National Competition Policy Reforms: Productivity Commission Inquiry Report" No. 33, by Banks, G., Weickhardt, P. and Fitzgerald, R., 28 February 2005, p xvi

[9] "Towards a Closer Partnership", address by Prime Minister Bob Hawke at the National Press Club, Canberra, 19 July 1990

[10] "Building a Competitive Australia", Ministerial Statement by Prime Minister Bob Hawke, 12 March 1991

[11] Special Premiers' Conference, Sydney, 30-31 July 1991

framework, referred to as the National Competition Policy (NCP). An independent Committee of Inquiry into a National Competition Policy for Australia was established on 4 October 1992 by the then-Prime Minister Paul Keating, to investigate areas outside the jurisdiction of the Trade Practices Act.[12] The Committee's report[13] (now known as the Hilmer Review, after the chair of the Committee, Professor Frederick G. Hilmer) was handed down on 25 August 1993.

The Hilmer Review was instrumental in the Australian Government being able to clearly articulate the variety of barriers to competition that were seen to be affecting various industries in the early 1990s. One of the six priority areas recommended by the Hilmer Review was the introduction of competitive neutrality so that government businesses do not enjoy unfair advantages when competing with private businesses, that is, to adopt policies to establish "level playing field" conditions in situations where SOEs competed against private firms.[14] The remaining five priority areas can be summarised as the need to address:[15] (i) anti-competitive conduct of firms; (ii) regulatory restrictions on competition; (iii) public monopoly structures which restrict competition; (iv) restrictions on access to monopoly infrastructure; and (v) monopoly pricing. The present Paper only considers the competitive neutrality aspect.

A strong theme throughout the Hilmer Review was that market-based mechanisms should be implemented to address the priority policy recommendations, rather than using regulatory solutions.[16] However, in practice, it was recognised that certain changes to legislation would need to be implemented, particularly in the competitive neutrality area, to establish the desired outcome of a "level playing field".

1.3 The National Competition Policy and the Productivity Commission

1.3.1 The National Competition Policy

As a first stage, individual Governments considered the impacts of competition reform (in particular for this Paper, competitive neutrality reforms) on the relevant SOEs. Relevant factors for consideration included:

- the extent to which competitive neutrality reforms would ultimately impact on payments to stakeholders in the SOE;
- whether privatisation would be a more effective process, including balancing the one-off revenues from privatisation against the long-term benefits from competition reforms;
- the extent to which exposure of SOEs to competition could adversely impact on cross-subsidisation of CSO costs; and

[12] "Parliamentary Research Service: Research Paper Number 1 1994 – National Competition Policy: Overview and Assessment" by Kain, J., 21 February 1994, p 7

[13] "National Competition Policy", by Hilmer, F.G., Rayner, M. and Taperell, G, 25 August 1993

[14] "Parliamentary Research Service: Research Paper Number 1 1994 – National Competition Policy: Overview and Assessment" by Kain, J., 21 February 1994

[15] "Parliamentary Research Service: Research Paper Number 1 1994 – National Competition Policy: Overview and Assessment" by Kain, J., 21 February 1994, pp 10-11

[16] "Parliamentary Research Service: Research Paper Number 1 1994 – National Competition Policy: Overview and Assessment" by Kain, J., 21 February 1994, p. iv

- the internal costs of setting up appropriate accounting and reporting methodologies to accurately price the relevant goods and services.

Notwithstanding these issues, jurisdictional agreement on the NCP was reached on 11 April 1995[17] through the Council of Australian Governments (CoAG). The relevant NCP reforms covered the period 1995-2005 and were documented in the following agreements: (i) the Competition Principles Agreement; (ii) the Conduct Code Agreement; and (iii) the Agreement to Implement the National Competition Policy and Related Reforms (Implementation Agreement).

The Commonwealth, States and Territories, through the then-Trade Practices Act,[18] established an independent expert advisory body known as the National Competition Council (NCC). The NCC's functions were very broad, but it was primarily designed with two purposes. First, it should provide independent and expert advice on the development and future elaboration of the competitive neutrality principles (including on any matters referred by the Commonwealth Minister). Secondly, it should assist Governments in the implementation, elaboration and refinement of the competitive neutrality policy principles.[19] It was responsible for overseeing the progress of the competition reforms over the period 1995-2005.[20] Its current function relates to the regulation of third party access to services provided by monopoly infrastructure. [21]

In a practical sense, the NCP involved a set of undertakings by each of the State and Territory Governments to take action to address competition issues (in particular in relation to the commercial delivery of goods and services), in exchange for the receipt of certain financial incentives – referred to as "competition payments" – to be made by the Commonwealth Government to the State and Territory Governments. The purpose of the payments was twofold:

- to enable sharing of any resultant efficiency benefits manifesting in economic growth, and any increased consequential taxation revenues received by the Commonwealth;[22] and

- to incentivise the State and Territory Governments to implement the desired reforms within the specified timetable.

These payments were closely linked to each State or Territory meeting its prescribed timeline for introducing competitive reforms. By 2005, the payments made to all States and Territories were around $800 million per year.[23] The NCP also encompassed specific reforms in the electricity, gas, water and road transport industries,[24] being areas which have historically

[17] "Compendium of National Competition Policy Agreements", Second Edition, published by the National Competition Council in June 1998

[18] Section 29A of the *Trade Practices Act 1974* (Cth)

[19] See pp 308, 323 of the Hilmer Review

[20] See the NCP website at http://ncp.ncc.gov.au/

[21] See the NCC website at http://www.ncc.gov.au/index.php/about/about_us

[22] See p 29 of the PC Paper

[23] See p 36 of NCC Submission to PC

[24] "Compendium of National Competition Policy Agreements", Second Edition, published by the National Competition Council in June 1998, p 3

been dominated by public monopolies and in relation to which reforms were viewed as essential to improving Australia's economic performance. [25]

1.3.2 The Productivity Commission

In 1998, the Commonwealth Government combined three existing bodies (the Industry Commission, Economic Planning Advisory Commission and Bureau of Industry Economics) into a new entity, the Productivity Commission under the Productivity Commission Act 1998 (Cth). [26] The Productivity Commission was designed to be the Commonwealth Government's independent research and advisory board on a range of issues.

The functions of the Productivity Commission relevant to competitive neutrality include: [27]

- to receive and investigate competitive neutrality complaints about Commonwealth SOEs and business activities – this aspect was allocated to the Australian Government Competitive Neutrality Complaints Office (AGCNCO), an autonomous office within the Productivity Commission; [28]

- to report to, and advise, the relevant Minister on industry and productivity issues referred to it by the Minister (including any competitive neutrality complaints and implementation of competitive neutrality); and

- to research matters relating to industry, industry development and productivity, including competitive neutrality issues.

In addition, the Productivity Commission has the power to do everything necessary or convenient in connection with performing the above functions. [29] In addition, the Productivity Commission is allowed to carry out its functions using flexible and informal mechanisms,[30] which allows it to obtain information in a less legalistic and more efficient manner. Importantly, the Productivity Commission is independent from the Commonwealth Government, is transparent and has a community focus, seeking to advance the interests of the entire community. [31]

1.4 Moving forward after the National Competition Policy reforms

In 2005, the Productivity Commission conducted a comprehensive assessment of the outcomes of Australia's National Competition Policy and noted[32] that the policy had resulted in outstanding economic performance amongst OECD countries and benefited the wider Australian

[25] See p 404 of the PC Paper

[26] See the *Productivity Commission Act 1998*

[27] See section 6(1) of the *Productivity Commission Act 1998* (Cth), p 105 of "From Industry Assistance to Productivity: 30 Years of 'The Commission'", Productivity Commission, Canberra, 2003

[28] See p 121 of "From Industry Assistance to Productivity: 30 Years of 'The Commission'", Productivity Commission, Canberra, 2003

[29] See section 7 of the *Productivity Commission Act 1998* (Cth)

[30] See section 9 of the *Productivity Commission Act 1998* (Cth)

[31] See p 1 of "From Industry Assistance to Productivity: 30 Years of 'The Commission'", Productivity Commission, Canberra, 2003

[32] See p xvi of the PC Paper

community.[33] The following comment sums up the Productivity Commission's views: [34] "NCP has been a highly innovative exercise in national economic reform. Several factors have underpinned its success: (i) recognition by all governments of the need for reform; (ii) broad agreement on the priority problem areas; (iii) a solid conceptual framework and information base to guide policy prescriptions; and (iv) some highly effective procedural and institutional mechanisms to implement reform".

Indications were that the economic performance was largely attributable to microeconomic reforms such as the NCP, and resultant resilience in competing entities. However, the Productivity Commission noted that there was still scope to improve upon the progress completed up to that time (in particular in relation to competitive neutrality)[35], and that this should be pursued. [36] Based upon this, CoAG then resolved to pursue an extension of the competition reforms, known as the National Reform Agenda.

The National Reform Agenda was structured to cover not just ongoing competition reforms but also regulatory reforms and reforms in relation to "human capital" in such areas as health, education, training and work incentives, [37] where the implementation of competitive neutrality reforms would have to be modified to account for the differing drivers (other than purely commercial outcomes). The competition reforms were also intended to cover the energy, transport, infrastructure, planning and climate change areas. [38]

Due to the success of the competitive neutrality reforms over the period 1995-2005, the issue of competitive neutrality ceased to be debated in reform discussions in Australia beyond 2005. Notwithstanding this, the National Reform Agenda did accept the Productivity Commission's recommendations to continue competitive neutrality reforms, and the relevant provisions of the Competition Principles Agreement continue to apply, augmented by enhanced principles in the Competition and Infrastructure Regulation Agreement. [39]

2. The structure and goals of the national competition policy

This section clarifies what is meant by competitive neutrality in the context of more general competition reforms and examines the key competitive neutrality reforms promulgated by the National Competition Policy. In particular, this section explains how the relevant competitive neutrality reforms were structured, particularly their target of significant business activities and their focus on resolving known competitive distortions.

---

[33] See also the NCP website at http://ncp.ncc.gov.au/

[34] See p xxiii of the PC Paper

[35] See pp 271, 290, 293 of the PC Paper

[36] "Review of National Competition Policy Reforms: Productivity Commission Inquiry Report" No. 33, by Banks, G., Weickhardt, P. and Fitzgerald, R., 28 February 2005, p xii

[37] See p v of "Potential Benefits of the National Reform Agenda – Report to the Council of Australian Governments", Productivity Commission, Canberra, 2006, p 1 of "History of the National Reform Agenda", Victorian Government, 2006

[38] See "Potential Benefits of the National Reform Agenda – Report to the Council of Australian Governments", Productivity Commission, Canberra, 2006

[39] See section 6.1 of the Competition and Infrastructure Regulation Agreement

2.1 The concept of competitive neutrality and intent of the relevant reforms

2.1.1 The concept of competitive neutrality

The concept of competitive neutrality relates to a drive to ensure that, in situations where public enterprise and private enterprise compete (or could potentially compete) in relation to the provision of goods and services in a market, that both the public entities and the private entities are essentially subject to the same external environment, where this is in the public interest. [40]

Although there are inherent differences between entities (including between private entities), the fact of Government ownership of SOEs resulted in those SOEs being systematically subject [41] to different external conditions (e.g. regulatory, financial, reporting) than applied to the private entities. This resulted in distortions in the way that these entities could compete with one another within that market (competitive distortions). Generally, the SOEs were seen as having a variety of competitive advantages over private enterprise (and, also, some competitive disadvantages[42]) which were generally viewed as inequitable by the private sector[43] – these are detailed in the section below on the advantages and disadvantages of competitive neutrality distortions.

The intent of the competitive neutrality reforms was to modify the relevant external environment and the interrelationship between the relevant entity with its stakeholders so that, broadly, each of the entities would operate in a similar environment, with similar responsibilities and goals. This enabled services to be priced at competitive rates, thus reducing inefficiencies, which in turn allowed the relevant market to operate according to competitive market principles in a level playing field, with the aim of producing economic and employment benefits.

2.1.2 Guiding principles for establishing competitive neutrality reforms

The Hilmer Review enunciated a set of principles[44] intended to guide the development of policy to achieve competitive neutrality in relevant industry sectors, without introducing unnecessary impediments to the operation of enterprises within these sectors. These principles, which have been adopted by the relevant Governments and are still used today, are that:

- Government businesses should not enjoy any net competitive advantage by virtue of their ownership when competing with other businesses;
- Government businesses competing against other firms within their traditional markets should be subject to measures that effectively neutralise any net competitive advantage flowing from their ownership. Unless exceptional circumstances exist, those advantages should be neutralised within one year of the introduction of competition:
    - where the government business has traditionally provided services directly to the public, there should be a presumption that this be achieved through corporatisation; and

[40] See also p 129 of the PC Paper

[41] See p 293 of the Hilmer Review

[42] See p 6 of the Commonwealth Statement

[43] See p 5 of the Commonwealth Statement

[44] See pp 305-307 of the Hilmer Review

- where the government business has traditionally provided services only to other government entities, this may be achieved through corporatisation or the application of effective pricing directions; and

- Government businesses should not compete against other businesses outside their traditional markets without being subject to measures that effectively neutralise any net competitive advantage flowing from their ownership. No transition period should be permitted in this setting:

  - where the government business has traditionally provided services directly to the public, there should be a presumption that this be achieved through corporatisation; and

  - where the government business has traditionally provided services only to other government agencies, this may be achieved through corporatisation or the application of effective pricing directions.

The Competition Principles Agreement further clarified that the objective of competitive neutrality policy was: [45]

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

2.1.3 The competitive neutrality distortions – advantages and disadvantages

The main distortions relevant to SOEs, which were widely viewed by competing private enterprise as inequitable, included a number of perceived advantages: [46]

- The fact that SOEs were exempt from existing competitive conduct rules;

- SOEs being either immune from the obligation to pay various taxes and charges, or the beneficiaries of certain tax-related concessions, which generally arose from either:[47]

  - specific enabling legislation; or

  - exemptions included in the general taxation legislation;

- Differences in the application of various regulatory requirements between the public and private sectors due to exemptions held by SOEs (the "shield of Crown ownership" or "Crown immunity). Particular areas included:[48]

[45] Clause 3(1) of the Competition Principles Agreement

[46] See pp 296-297 of the Hilmer Review, pp 9-10, 40 of the Queensland Statement, p 21 of the NSW Statement, 39-40 of the Guidelines for Managers

[47] See p 16 of the Guidelines for Managers

[48] See pp 27-28 of the Guidelines for Managers

- the then Trade Practices Act;
- planning and environmental regulation; and
- different licencing and reporting requirements.

- The ability to procure debt at a significantly reduced cost, as compared with the private sector (i.e. borrowing rates either non-existent or reflecting the credit risk of the relevant owning Government rather than the specific SOE).[49] This principally encompassed:
  - the ability of SOEs to obtain specific government guarantees, thus reducing risk taken on by providers of financial support (and, consequently, reducing costs payable by the SOE, which is linked to the level of risk adopted);
  - the perception by providers of financial support that SOEs benefit from implicit government support, also reducing the risk assumed by the providers (manifesting as concessional interest rates); and
  - the ability of SOEs to borrow from the Budget;
- not being required to achieve a commercial rate of return on assets commensurate with private enterprise (the absence of rate of return neutrality);
- exemptions from freedom of information obligations;
- effective immunity from bankruptcy;
- the ability to cross-subsidise services subject to competition with private enterprise by drawing on funds received by the SOE from providing monopoly services; and
- the ability of SOEs to obtain lower insurance premiums, again due to the perception of the insurance providers.

At the same time, a number of possible disadvantages to the public sector providers were identified:

- Limitations on the market in which they operate and the ability to diversify into other business areas;
- Obligations in relation to the provision of superannuation to employees and Government employment and industrial relation policies;
- Obligations to provide community service obligations (**CSOs**) (that is, being directed to deliver services at a price where, if market conditions prevailed, the services would not be delivered at that price [or at all]);
- Restrictions on managerial freedom due to the need to report to, and comply with, Ministerial requirements;

[49] See p 21 of the Guidelines for Managers, p 17 of the Commonwealth Statement

- Obligations to comply with Budget directions in carrying out expenditures;
- Restricted powers to source funds from alternative services providers, and to invest;
- Greater transparency and accountability requirements due to their publicly owned nature; and
- Greater costs incurred as a result of increased reporting requirements.

2.1.4 The scope of competitive neutrality reforms

It is important to note that the competitive neutrality reforms were intended to specifically address those distortions arising purely as a result of Government ownership. This meant that the competitive neutrality reforms were not intended to: [50]

- put all businesses (both public and private) on a completely equal footing (as various businesses will have various inherent size, expertise, efficiency, managerial competence or other advantages);
- require sales of assets and privatisation of all SOEs and reduce the size of the public sector;
- require Governments to open the in-house provision of goods and services to competition and contract out the delivery of these goods and services;
- remove CSO obligations from the business or restructure the delivery of social programs into competitive market-based mechanisms (e.g. compulsory competitive tendering); or
- imply that SOEs cannot be successful when operating in competitive markets by relying on their own merits (rather than on unfair advantages); or
- carry out loosely related reforms such as financial market deregulation or industrial relations reforms.

Instead, the competitive neutrality reforms were intended to establish a fair market environment in situations where Governments elected to provide services through market-based mechanisms, without changing the innate differences inherent as part of the organisation. [51]

2.2 Competitive neutrality undertakings in the National Competition Policy

2.2.1 Undertakings by the State and Territory Governments

The main competitive neutrality undertakings made by the Australian State and Territory Governments in the Competition Principles Agreement were that: [52]

[50] See p 10 of the Queensland Statement, p 4 of the Guidelines for Managers, p 5 of the Commonwealth Statement, p 3 of the Victorian Statement

[51] See p 4 of the Victorian Statement, p 5 of the Commonwealth Statement

[52] See p 405 of the PC Paper

- States and Territories were to determine their own agenda for implementing competitive neutrality principles, and were required to publish a policy statement on competitive neutrality; [53]

- where benefits outweigh the costs, States and Territories were to adopt a corporatisation model for SOEs undertaking significant business activities, and ensure that SOEs were subject to the normal tax and regulatory regime, and were required to pay debt guarantee fees to offset the competitive advantages of government guarantees; [54]

- where benefits outweigh the costs, the parties were to adopt the principles described immediately above to agencies that undertake significant business activities as part of their functions, and were also required to ensure that prices for goods and services reflect full cost attribution; [55] and

- each State and Territory was required to publish a policy statement on competitive neutrality by June 1996, and thereafter publish an annual report on the implementation of competitive neutrality principles. [56]

In addition, the State and Territory Governments undertook to facilitate the adoption of competitive neutrality reforms by local governments.

2.2.2 The competition payments to the States and Territories

The Implementation Agreement contained the mechanism by which the Commonwealth would encourage States and Territories to commit to, and pursue, the competitive neutrality reforms. This was a procedure whereby the Commonwealth would make competition payments to the States and Territories in three tranches. The Implementation Agreement outlined the conditions of such financial assistance. The provision of financial assistance by the Commonwealth is conditional on the States making satisfactory progress with the implementation of NCP and related reforms. "Satisfactory progress" was specified in the Implementation Agreement to include factors such as: [57]

- the State or Territory giving effect to the above agreements and meeting the deadlines specified in those agreements – specifically, the imposition of the competitive neutrality arrangements described earlier in this section;

- implementation, and continued observance, of all CoAG agreements on electricity arrangements, including the establishment of a competitive national electricity market;

- implementation, and continued observance, of all CoAG agreements on the national gas framework;

[53] Sections 3(2) and 3(8) of the Competition Principles Agreement

[54] Section 3(4) of the Competition Principles Agreement

[55] Section 3(5) of the Competition Principles Agreement

[56] Section 3(10) of the Competition Principles Agreement

[57] See p 3 of the Implementation Agreement

- observance of road transport reforms; and

- implementation and maintenance of the framework for the reform of the water industry.

Specific penalties that could be imposed for a failure to comply with the above included permanent reductions in levels of competition payments; temporary suspensions of competition payments; and "group" suspensions of competition payments, which apply in relation to cumulative non-significant compliance failures[58]. In 2003-2004, close to 24% of the aggregate of the allocated competition payments were withheld as a penalty, principally due to a failure by various Governments to implement all of the relevant legislative amendments within the scheduled 1995-2005 time period. [59] This withholding triggered rapid re-uptake of the reforms, with the result that nearly all the withheld payments were released in the months following the 2004 assessment.

2.3 The targets of the competitive neutrality reforms

2.3.1 Competitive neutrality reforms focused on "significant business activities"

The core targets for the competitive neutrality reforms were the "significant business activities" carried out by the public sector, whether these were carried out by Government authorities, departments or agencies. The nature of a significant business activity was clarified in the 1996 Policy Statements, [60] in particular, the Queensland Statement, which contained a useful flowchart for determining whether a business is a significant business (reproduced in the Annex to this Paper). [61]

It is important to note that the competitive neutrality reforms were to be applied to the specific business activity, regardless of the specific legal characterisation of the entity, asset ownership arrangements or level of importance of the function to the entity.[62] Moreover, the business activities targeted for compulsory competitive neutrality reforms were only those business activities within the control of the Government's Executive branch (although other business activities are encouraged to voluntarily adopt these reforms).

2.3.2 Definition of "business activity"

Essentially, a "business activity" involves all of the following:

- commerciality, evidenced by trading goods or services in exchange for end-user charges and any commercial focus (regardless of whether the user is public or private or whether full or partial costs are recovered);

[58] See p 31 of the PC Paper

[59] See p 31 of the PC Paper, p viii of the NCC Submission

[60] See pp 7-8 of the Commonwealth Statement, pp 25-26 of the Queensland Statement, pp 3-6 of the NSW Statement

[61] See p 29 of the Queensland Statement

[62] See p 9 of the Commonwealth Statement

- a non-regulatory and non-policy nature, evidenced by the presence, or potential presence, of a competitor (whether public or private) (as opposed to situations where legislation prohibits alternative sources of supply); and

- a business structure, evidenced by a degree of self-sufficiency in the management of the production or supply of the good or service.

This concept excludes non-profit, non-business activities such as: (i) government programs constituting direct budget funding (however, these will still be expected to make greater use of competitive tendering structures); (ii) organisations where the goods and services produced are used within that organisation; and (iii) organisations whose primary role is to implement some form of social policy (such as health, education, public research, police and emergency services, among other things), provided that they do not undertake ancillary activities that compete with the private sector. It should be noted that the above reference to "non-profit" refers not to businesses that are not profitable but to businesses that are prohibited (either by legislation or by government direction) from making a profit. [63]

2.3.3 Definition of "significant" in relation to a "business activity"

"Significant" was defined as referring to those organisations which are structured to operate in a commercial fashion, being large-scale operations such as:

- organisations which primarily sell goods and services in a market to earn a commercial return and have an independent legal existence from Government and the Executive[64]);

- other share-limited trading companies (designed to operate commercial businesses in competitive markets);

- designated business units, where that business unit's function is to trade goods and services to earn a competitive return; and

- potentially, other business activities having commercial receipts in excess of $10 million per year.

The rationale for restricting the competitive neutrality reforms to large-scale operations is due to the significant costs that will be incurred in complying with these reforms – both initial establishment costs and ongoing administrative costs – and ensuring that targeting these business activities would not incur more costs than benefits.

2.3.4 Identification of particular significant business activities

Each of the 1996 Policy Statements clarified that the identification of significant business activities was one that needed to be made on a case-by-case basis. The 1996 Policy Statements included a list of the relevant Governmental organisations identified as conducting significant business activities. These organisations were often public financial enterprises and public trading enterprises, and included providers of the following services:

---

[63] See p 3 of the Guidelines for Managers

[64] "Research Paper 18 1999-2000 Government Business Enterprises and Public Accountability through Parliament", Bottomley, S., 11 April 2000

- equipment, accommodation and other services for the defence sector;
- technological and scientific research organisations and laboratories;
- air services and airports;
- rail services and railways
- postal, telecommunications, television and publishing services;
- car fleet services;
- ports;
- energy and water services;
- forestry services;
- financial services (such as the Federal Reserve Bank);
- university teaching and consultancy services;
- lotteries;
- insurances such as housing loan insurance and private health insurance;
- sales organisations (such as for coordinating the sales of wheat and wool); and
- security services.

2.4 Identifying the distortions and assessing the impacts of reform on the SOE

2.4.1 Mechanism for identifying competitive distortions

Once an SOE has been identified as carrying out a significant business activity, the next step is to identify the particular competitive neutrality distortions that exist in relation to that SOE. Ideally, it would be possible to identify these distortions by assessing the SOE's operations against those of a notional private sector competitor. However, there are a number of practical difficulties that mitigate against this being a useful approach. Principally, details of cost information for private sector entities are not usually available, and any such data is usually subject to aggregation, which can result in individual data characteristics being unreliable or unable to be clearly determined. In its 1996 Policy Statement, the Commonwealth recognised that this method of assessment was not generally feasible. [65] In the Commonwealth Statement[66], the Commonwealth took the approach (which was subsequently followed throughout the country):

[65] See p 6 of the Commonwealth Statement

[66] See p 6 of the Commonwealth Statement

- the success or otherwise of competitive neutrality reforms should be determined through competitive mechanisms, rather than by comparing outcomes against notional accounting data; and

- any disadvantage that is caused to an SOE should be identified by that SOE and subject to specific consideration by the relevant Government.

2.4.2 Assessing the impacts of reform

Once the competitive advantages and disadvantages are identified for an SOE that is potentially or actually operating in competition with the private sector, the next step is assessing whether the benefits of implementing the relevant reforms exceeds the costs associated with doing so. These costs are not restricted to the direct costs of implementation, but also include the costs associated with the following impacts: [67]

- impact on the management autonomy and commercial flexibility of the business activity;

- impact on employees of the business activity;

- impact on the market (including on prices, suppliers and resources);

- impact on the finances of the specific business activity (including profits, returns on investment, taxation, revenue costs and CSOs);

- impact on the relevant Governmental budget;

- impact on consumers (range and quality of goods and services, prices and access to goods and services);

- impact on social welfare and equity; and

- impact on the environment, sustainable management of natural resources and regional development.

As part of making a cost-benefit analysis, it was also necessary to consider whether there was a valid reason for the SOE to retain any existing competitive neutrality advantages – the "public interest" test. Although the components of public interest were not specifically defined, the Competition Principles Agreement[68] did provide that any benefits assessment should have regard to, among other things:

- government legislation and policies relating to ecologically sustainable development;

- social welfare and equity considerations, including CSOs;

- government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity;

[67] See p 36 of the Queensland Statement

[68] See section 1(3) of the Competition Principles Agreement

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

The inclusion of both economic and non-economic factors in the overall impact analysis of implementing competitive neutrality reforms was intended to ensure that all relevant factors were assessed and that the value of economic reforms did not override other valid benefits to the community.

3. Implementing competitive neutrality reforms

This section identifies the particular competitive neutrality distortions that were present in the 1990s and outlines the mechanism by which these distortions were to be specifically addressed. In practice, the reforms were often implemented as part of a broader move on the part of the SOE towards commerciality.

3.1 The practicalities of implementing competitive neutrality reforms

As flagged in section 2.1.3 of this Paper, there are a number of specific distortions that were targeted as priorities in the competitive neutrality reforms. Of these distortions, the ones which were considered to be most important (and were most heavily discussed), included transparency and accountability; taxation neutrality; debt neutrality; rate of return neutrality; and regulatory neutrality. The mechanism for correcting these distortions could be broken down into the following action items:

- to require SOEs carrying out significant business activities to implement the reforms, which generally involved a push towards commerciality and often corporatisation;
- to review the progress of other SOEs and other business activities subsequently and decide whether to implement reforms; and
- to implement a competitive neutrality complaints mechanism.

3.2 The approaches to eliminating the key distortions

3.2.1 Transparency and accountability

A core plank of competitive neutrality reforms in Australia was the implementation of transparency and accountability requirements in line with commercial private sector enterprises.[69] Specific processes to achieve the desired levels of transparency and accountability included:

- setting out the objectives of, and main activities to be undertaken by, the SOE in a clear and centralised document;
- establishing boards with a commercial focus;

[69] See p 16, 18 of the Queensland Statement, p 7 of the NSW Statement

- introducing performance benchmarks and performance targets for both the short- and medium-terms (which may cover both financial and non-financial aspects of performance) – often these are included in a "Statement of Corporate Intent" or similar document;

- regularly monitoring the performance of the organisation (including financial performance monitoring by Government Treasuries); and

- setting appropriate financial requirements (such as debt-to-equity ratios).

3.2.2 Taxation neutrality

The approach adopted by the Australian Governments in their 1996 Policy Statements and still applied in the present day is that a neutral environment (from the point of view of taxation) can be achieved by either:

- where this can be achieved in a cost-effective and administratively simple manner – removing taxation exemptions from identified organisations to render them liable for Commonwealth and State/Territory taxes such as income tax, stamp duty, land tax, payroll tax and sales tax; or

- if the above cannot be achieved – retaining taxation exemptions and establishing "taxation equivalent regimes" (again, providing that it is cost-effective to do so). [70]

Considerations for timing implementation included any restructuring of the business; and the existence of appropriate accounting and financial management systems.

3.2.3 Debt neutrality

The ability of SOEs to obtain financing at significantly lower rates than would have applied to a private entity was to be compensated by applying fees to the relevant SOE so that the SOE would, in aggregate, pay a total cost that was in line with what a private entity with the SOE's credit rating would have had to pay. Specifically, this would be achieved by modifying relevant legislation to either: [71]

- apply a borrowing levy or guarantee fee to relevant SOEs to take account of any cost benefits received due to the perceived drop by the financial provider in risk of lending to a Government-supported organisation; or

- require those organisations which borrow from the Budget to pay a rate of interest equivalent to that in the market without the government advantages.

The additional amounts are paid into the Official Public Account, being the State and Territory Government's central bank account. [72]

[70] See p 18 of the Queensland Statement

[71] See p 17 of the Commonwealth Statement, pp 16, 24 of the Queensland Statement

[72] See p 23 of the Guidelines for Managers

3.2.4 Rate of return neutrality

The Australian Governments agreed that rate of return neutrality would be achieved by requiring all relevant SOEs to: [73]

- earn commercial levels of returns on the provision of goods and services (i.e. sufficient returns to more than fully cover costs, equivalent to that required to achieve long-term commercial viability of the business); and

- pay dividends to the relevant Government's Budget in line with the average commercial returns for their industry (and in lieu of the value of capital appreciation).

The Guidelines for Managers[74] provides significant detail about how appropriate rates of return may be set, such as: (i) the weighted average cost of capital (WACC); (ii) where a WACC process is not feasible, a broad-banding estimation; (iii) applying a uniform rate of return upon its assets; or (iv) where the business is service-based and has a minimal asset base, profitability margins.

3.2.5 Regulatory neutrality

Regulatory discrimination between the public and private sector was to be remedied by first identifying the areas where regulatory discrimination applied (such as through specific task force reviews), and then: [75]

- modifying relevant regulatory regimes to remove the discrimination – which involved not only extending the scope of application of the relevant legislation to the public as well as the private sector, but also removing the application of specific public sector-specific legislation to that SOE; and;

- implementing appropriate responses to competitive neutrality complaints.

3.3 Mechanisms used to deliver the competitive neutrality reforms

3.3.1 Overview

The mechanism chosen to deliver the reforms was generally revising the overall business structure to more closely resemble the structure of a commercial entity (i.e. the process of transforming a Government business unit into a corporate business entity) – this process was generally loosely referred to as corporatisation. These structural and mechanistic changes ranged from

- attribution of full cost pricing;

- other commercialisation reforms, including clarifying the SOE's objectives; giving the SOE's management a level of autonomy; implementing performance targets and monitoring; and providing effective rewards and sanctions;

[73] See the 1996 Policy Statements, p 29 of the Guidelines for Managers

[74] See p 31 of the Guidelines for Managers

[75] See the 1996 Policy Statements, esp 6, 9 and 13 of the Commonwealth Statement

- structural corporatisation (involving a change to the legal structure of the SOE);

- potentially, extending as far as privatisation.

It is important to note that structural corporatisation on its own is not sufficient to achieve the required competitive neutrality reforms. Instead, it forms part of a suite of mechanisms that can be used. In addition to the above changes, a competitive neutrality complaints mechanism is an essential part of any competitive neutrality reforms.

3.3.2 Full cost pricing and rate of return

The initial stages of delivery are to implement cost-reflective pricing, which is a system whereby the amounts received by an SOE over the medium- to long-term in exchange for the goods and services provided would represent an amount that offsets any competitive advantages in the sense that they: [76]

- would reflect the full costs incurred by the SOE in carrying out the relevant business activities to provide that good or service; and

- incorporate a profit margin in line with a commercial rate of return.

This would involve an overhaul of relevant accounting and management systems to correctly assess individual operating costs and allocate them to the provision of a specific good or service. In addition, the interaction between commercial and non-commercial goals (such as CSOs and Parliamentary accountability requirements) would need to be clarified to ensure that costs were appropriately allocated and revenues dealt with. The methods selected to implement this arrangement are:

- the fully distributed cost method – which covers all costs exclusive to the business and calculates a proportion of costs shared with other business units on a pro-rata basis;

- the avoidable cost method – which focuses only on those costs that would have been avoided had the relevant business not operated (i.e. the "but for" test); and

- where the relevant SOE held monopoly power, imposing a prices oversight mechanism to ensure that SOEs could use their monopolistic nature and lack of competition to recover an excessively elevated profit margin.

Compliance with this policy aspect would be assessed by reviewing the SOE's overall financial performance, rather than reviewing individual prices. This approach was selected as being in line with private commercial activities, as private entities sometimes reduce prices below cost for a limited period to secure a revenue stream.

3.3.3 Other commercialisation reforms

Other associated reform mechanisms include:[77]

[76] See pp 4, 37 of the Guidelines for Managers, p 19 of the Commonwealth Statement, pp 13, 19 of the Queensland Statement, p 7 of the NSW Statement

[77] See the 1996 Policy Statements

- removing any regulatory or other non-commercial functions from the SOE to enable the SOE to establish clear, non-conflicting objectives (including ring-fencing mechanisms);

- separating contestable and monopoly functions (for example, separation of monopoly electricity network services from potentially contestable retail and generation services);

- where non-commercial functions are to be retained, clearly delineating between accounting and funding for the commercial and non-commercial activities (also referred to as ring-fencing);

- independent prudential supervision;

- transparency in relation to any retained public duties (such as the provision of CSOs); and

- implementation of service contracts to and from the SOE, where goods and services provided by the SOE are governed by the other competitive neutrality principles mentioned in this section.

3.3.4 Structural corporatisation

Structural corporatisation was viewed as a useful structure to enable SOEs to become properly accountable for their performance, involving the establishment of appropriate boards and the imposition of performance requirements.[78] In some cases, decisions were made not to follow through with structural corporatisation, but merely to rely on implementation of commercialisation reforms without changing the legal structure. Such decisions were generally based on: (i) structural corporatisation not being viewed as appropriate at that point in time; (ii) the relevant goods or services were provided within Government or were designed to meet particular policy objectives or market shortcomings; or (iii) the relevant business unit was sufficiently small that the costs of corporatisation were greater than the expected benefits. [79]

3.3.5 Privatisation

Although by no means a vital component of competition reforms, it was acknowledged that in some cases, seeking improved outcomes may result in the divestment of SOEs to private enterprise.[80] This completely eliminates any barrier to competitive neutrality, but must be balanced against the potential loss of services and competition to each of the public and to the Government itself.

4. The competitive neutrality complaints mechanisms

This section of the Paper sets out the current Australian architecture relevant to competitive neutrality – primarily, the powers and functions of the individual regulators and complaints offices – and reviews a number of competitive neutrality complaints which are relevant to understanding how competitive neutrality requirements were treated in practice.

[78] See p 16 of the Queensland Statement

[79] See pp 17-18 of the Queensland Statement, p 7 of the NSW Statement

[80] See p 13 of the Queensland Statement

4.1 Background

During the height of the reforms from 1995-2005, additional entities were necessarily involved in the implementation of the reforms. Chief among these was the NCC, which was the primary regulatory body over this period. In addition, there were various specific regimes set up by each State, Territory and the Commonwealth to handle complaints in relation to competitive neutrality.

However, now that the framework of the reforms has been completed (for example, the changes to the regulatory and tax regime), the focus is now on continuing to maintain competitively neutral markets, which is enabled by the formalisation of a series of competitive neutrality complaints offices in each State and Territory and also in the Commonwealth. [81] Complaints can be made to these offices when there is a suspicion that an SOE is not complying with various aspects of the competitive neutrality principles.

4.2 Structure of competitive neutrality complaints process

The structure implemented for the operation of each of the competitive neutrality complaints offices is broadly similar, and involves a methodical and logical approach to competitive neutrality complaints. For a complainant or potential complainant, the first stage is to liaise directly with the specific SOE to resolve the issue. If this liaison is not successful, the complainant can then approach the relevant competitive neutrality complaints office.

The level of standing required by complainants varies between jurisdictions. The Commonwealth complaints office permits [82] any entity (including individuals, private businesses and other interested parties) to make a complaint (although note that the Productivity Commission Act 1998 (Cth) permits the AGCNCO to reject complaints where the complainant does not have sufficient interest in the matter), whilst the State and Territory complaints offices generally require the entity to be a "competitor", being an entity directly and adversely affected by the alleged breach of competitive neutrality principles (that is, was a participant or potential participant in the relevant market). The ACT has adopted a slightly different approach and allows any person to make a complaint, provided that they pay the costs of the investigation.

The complaints office then follows a structured process, essentially involving: [83]

- clarification of the nature of the complaint and specification of the particular limbs of competitive neutrality which are allegedly distorted;
- confirmation that the complaints office is the appropriate venue to handle the complaint (in particular, that the complaint relates to an SOE owned by the relevant Government) and that the complaint:[84]
    - is about a substantive and non-trivial issue, and not frivolous or vexatious;

[81] See p 6 of the Commonwealth Statement, pp 41-42 of the Queensland Statement

[82] See p 20 of the Commonwealth Statement

[83] See p 20 of the Commonwealth Statement

[84] See p 3 of the "Competitive Neutrality Investigation into Provision of Counter Terrorist First Response Services by the Australian Protective Service", AGCNCO, December 1998, s 22(1)(a) of the *Productivity Commission Act 1998* (Cth)

- relates to a competitive neutrality issue; and
- is not in relation to a competitive neutrality issue that is currently being reviewed by the Government;

- confirmation that the SOE carries on a significant business activity, where "business" is summarised as an operation:
  - which charges users for goods and services;
  - in an environment where there is an actual or potential competitor (whether public or private); and
  - where the managers have a degree of independence in producing or supplying the good or services and the price of supply.
- confirmation that the complaint relates to the presence of a competitive advantage as a result of its public ownership (i.e. competitive neutrality), and not as a result of other factors, specifically:
  - a failure on the part of the SOE to implement the competitive neutrality principles;
  - the SOE incorrectly applying the competitive neutrality principles and the application is not effective to remove the relevant competitive advantages; or
  - that the relevant Government activities have not been exposed to competitive neutrality reforms and should be.
- systematic analysis of whether there is a particular breach of any aspect of the competitive neutrality principles (and whether the benefits of implementing competitive neutrality principles outweigh the relevant costs).

Generally, the competitive neutrality complaints offices are given great flexibility in carrying out their investigation and acquiring relevant information – for example, by way of public hearings, data gathering, retention of consultants and so forth. [85]

4.3 The Commonwealth complaints office – the AGCNCO

The Productivity Commission is responsible for receiving and investigating complaints about the implementation of competitive neutrality arrangements in relation to Commonwealth Government businesses. [86] It does this through a dedicated body, the Australian Government Competitive Neutrality Complaints Office (AGCNCO). As well as investigating complaints, the AGCNCO provides advice and assistance to SOEs to assist them in implementing competitive neutrality reforms.[87] The Productivity Commission consists of a chairperson and between 4 to 11

[85] See p 4 of the "Guidelines on making a competitive neutrality complaint in the ACT", ICRC, December 2010

[86] See section 6(c) of the *Productivity Commission Act 1998* (Cth)

[87] See p 121 of "From Industry Assistance to Productivity: 30 Years of 'The Commission'", Productivity Commission, Canberra, 2003

commissioners, who are appointed by the Governor-General. [88] Of the commissioners, at least one must have extensive skills and experience acquired in working in Australian industry, and at least one must have extensive skills and experience in dealing with the social effects of economic adjustment and social welfare service delivery.

The Commonwealth Minister may also appoint associate Commissioners to the Productivity Commission. The chairperson is responsible for managing the affairs of the Productivity Commission and convening meetings,[89] and may also engage suitably qualified persons as consultants to the Productivity Commission. [90] The AGCNCO: [91]

- receives and investigates complaints on the application of competitive neutrality to significant businesses carried on by Commonwealth SOEs (including that the SOE should be subject to competitive neutrality requirements and is not);
- is entitled to require persons who it believes are capable of providing information to an inquiry in relation to a competitive neutrality complaint to provide such information; [92]
- reports on the outcomes of its investigation to the Commonwealth Treasurer;
- makes appropriate recommendations for future action;
- reports on the number of complaints made and outcomes of these complaints; and
- releases various guidelines to assist SOEs in applying competitive neutrality principles, such as rate of return issues [93] and cost allocation and pricing[94]. These useful guidelines provide further detail on how the AGCNCO assesses whether an SOE is complying with the relevant competitive neutrality principles.

Even though the AGCNCO uses the methodical approach set out in section 4.2 above, it is clear from a review of the various complaints investigations that in practice the AGCNCO gives SOEs a certain amount of flexibility where the relevant failure to comply with the competitive neutrality requirement is not due to an active policy decision by the SOE, but to external events over which the SOE itself has little or no control. The Productivity Commission is essentially an advisory body, and it is the role of the Commonwealth Government to implement any recommendations which it accepts.

4.4 The State and Territory complaints offices

A brief outline of the relevant State and Territory complaints offices and a high-level summary of their functions are set out in this section:

---

[88] See sections 23(1), 24 of the *Productivity Commission Act 1998* (Cth)

[89] See ss 38, 39 of the *Productivity Commission Act 1998* (Cth)

[90] See s 45 of the *Productivity Commission Act 1998* (Cth)

[91] See p 5 of the Guidelines for Managers, p 121 of "From Industry Assistance to Productivity: 30 Years of 'The Commission'", Productivity Commission, Canberra, 2003

[92] See s 48(1) of the *Productivity Commission Act 1998* (Cth)

[93] See "Rate of Return Issues – CCNCO Research Paper", AGCNCO, December 1998

[94] See "Cost Allocation and Pricing – CCNCO Research Paper", AGCNCO, October 1998

- *Queensland.* There are two relevant bodies in Queensland, being:

  - the Queensland Competition Authority (QCA), which accepts and investigates appropriate complaints in relation to State SOEs and local government business activities, and accredits State and local government business activities as compliant from a competitive neutrality standpoint for up to 2 years; and

  - the Queensland Treasury, which accepts competitive neutrality complaints outside the QCA's jurisdiction.

- *New South Wales.* In NSW, the State Contracts Control Board (SCCB) investigates competitive neutrality complains relating to tender bids made by SOEs, and the Independent Pricing and Regulatory Tribunal (IPART) investigates all other competitive neutrality complaints. The SCCB/IPART (depending on the situation) investigate and notify the complainant, the SOE, the SOE's portfolio Minister and the Treasurer of the investigation and the outcomes of the investigation.

- *Australian Capital Territory*. Due to the smaller size of the ACT Government, the ACT applies competitive neutrality principles to all of its SOEs where it considers that this is in the public interest, regardless of relevant thresholds. [95] The ACT's competition regulator is the Independent Competition and Regulatory Commission (ICRC), an independent body, which is responsible for investigating and reporting on competitive neutrality complaints made by any person (provided that that person bears the costs of the inquiry). Where a formal investigation has been carried out, the ICRC will publish its findings and may make recommendations to the Government concerning actions to be taken.

- *Victoria.* In Victoria, the Competitive Neutrality Unit (CNU) of the Victorian Competition and Efficiency Commission (VCEC) is the relevant complaints office and investigates and reports to the relevant SOE departmental secretary and the obligations of the SOE to comply with the competitive neutrality policy. The CNU then follows up the SOE within three months of the investigation being finalised.

- *Tasmania.* In Tasmania,[96] the process involves initial contact with the relevant SOE. If the complainant is not satisfied with the outcome, they may apply to the Office of the Tasmanian Economic Regulator (OTTER) (this aspect was previously carried out by the Government Prices Oversight Commission or GPOC). OTTER will then report to the complainant, the SOE, the Treasurer and the relevant portfolio Minister.

- *South Australia*. In South Australia, the Competitive Neutrality Complaints Secretariat, within the Department of the Premier and Cabinet, receives complaints and refers them to the SOE for initial investigation and resolution. If the issue is not resolved, then the Secretariat may refer it to the Competition Commissioner, who carries out the investigation and reports on its findings.

[95] See p 2 of the "Guidelines on making a competitive neutrality complaint in the ACT", ICRC, December 2010

[96] See "Competitive Neutrality Complaints Mechanism Guideline", OTTER, October 2010

- *Western Australia*. In WA,[97] complaints that are not resolved through direct liaison with the SOE are then directed to the Competitive Neutrality Complaints Secretariat within Treasury, which screens the complaint and then investigates complaints deemed to be of substance. The Competitive Neutrality Complaints Secretariat then reports to the Expenditure Review Committee within Cabinet. If there is a finding that competitive neutrality has been breached, the Expenditure Review Committee will decide what action needs to be taken. Of the eight complaints received to date, only one was found to relate to competitive neutrality.

- *Northern Territory*. In the Northern Territory, the Treasury receives and deals with competitive neutrality complaints itself.

4.5 The Australian Competition and Consumer Commission

The Australian Competition and Consumer Commission (ACCC) is established as a body corporate under the Competition and Consumer Act. [98] It consists of a chairperson and members appointed by the Governor-General, and has a broad responsibility for ensuring that individuals and businesses comply with the Commonwealth's competition laws. [99]

As the individual State and Territory Governments are responsible for implementing the competitive neutrality reforms, the role of the ACCC in relation to competitive neutrality reforms is primarily limited to reporting to the Commonwealth Government and the NCC on non-compliance with these reforms. [100]

4.6 Contents of complaints made to date

To date, there have been limited numbers of complaints to the various competitive neutrality complaints offices. As could be expected, these complaints primarily relate to different aspects of the competitive neutrality reforms, such as taxation neutrality and rate of return neutrality, as described below.

4.6.1 Rate of return neutrality

Several cases involve situations where there are allegations that the charges levied for the provision of goods or services do not cover the costs incurred by the SOE in providing those goods or services. Assessing this requires the AGCNCO to review business costs and charges to confirm that charges levied on users, in general, cover the costs experienced by the business in providing those goods or services.[101] Importantly, the AGCNCO permits individual charges or tenders to undercut the costs of production, provided that the overall revenues exceed costs by a level consistent with a market rate of return.

---

[97] See Department of Treasury and Finance, Western Australia

[98] Section 6A of the *Competition and Consumer Act 2010* (Cth)

[99] See the ACCC website at http://www.accc.gov.au/content/index.phtml/itemId/54137

[100] See p 331 of the Hilmer Review, the ACCC website at http://www.accc.gov.au/content/index.phtml/itemId/54137

[101] See "Australian Institute of Sport Swim School – Investigation No. 2", AGCNCO, 1999, "ABC Production Facilities – Investigation No. 4", AGCNCO, 2000

In calculating the relevant costs incurred, the AGCNCO has made it clear that where an SOE procures equipment and/or facilities for its public purposes, and later uses these for commercial endeavours, the relevant costs are the costs additional to that required for the public purpose, that is, the "avoidable costs" (and, similarly, the relevant rate of return has to be calculated based on the relevant proportion of the asset base). Examples of relevant cases include:

- The investigation of the National Rail Corporation,[102] where the AGCNCO found that an appropriate rate of return had not been obtained, but excused the National Rail Corporation on the basis of delays in the restructuring of the SOE, and did not pursue this further.

- The case of ARRB Transport Research Limited,[103] where the AGCNCO excused the SOE from covering costs in the provision of services on the basis that Government members of ARRB imposed low rates but required the work to be done. The AGCNCO permitted this apparent breach as there was no apparent cross-subsidy of contestable work by non-contestable work.

4.6.2 Taxation neutrality

Where there is an allegation that an SOE is exempt from various taxes,[104] the AGCNCO must conduct investigations into the SOE's accounting processes to confirm either that such taxes apply or that a suitable tax equivalent regime is in place.

4.6.3 Regulatory neutrality

Relevant cases involve allegations that an SOE is given special consideration under legislation. The first case ever submitted to the AGCNCO involved provision of counter-terrorism services,[105] where relevant regulations required the provider of such services to have the power of arrest – effectively limiting the providers to Federal and State police forces. The AGCNCO held that this was a legitimate requirement, and that competition still existed between the relevant police forces.

In contrast, in a case involving Australia Post [106] there a legislative discrepancy between customs procedures for Australia Post compared to private parcel carriers (specifically, differing value thresholds), which meant that more of a private sector enterprise's parcels were subject to formal screening by the Australian Customs Service than was the case for Australia Post. This was held to be unjustified and required rectification. The legislation was amended shortly thereafter to remove this distortion.

---

[102] See "National Rail Corporation Ltd – Investigation No. 3", AGCNCO, 2000

[103] See "ARRB Transport Research Limited – Investigation No. 6", AGCNCO, 2001

[104] See "Competitive Neutrality Investigation into provision of Counter Terrorist First Response Services by the Australian Protective Service – Report No. 1", AGCNCO, Dec 1998

[105] See "Competitive Neutrality Investigation into provision of Counter Terrorist First Response Services by the Australian Protective Service – Report No. 1", AGCNCO, Dec 1998

[106] See "Customs Treatment of Australia Post – Investigation No. 5", AGCNCO, 2000

4.6.4 Competition

In one case,[107] the complainant submitted that SOEs should not engage in business activities in competition with existing private enterprise. The AGCNCO was unsympathetic to this view, given that the thrust of the NCP was to permit neutrality in competition, not to eliminate competition by SOEs. [108]

4.7 Competitive neutrality complaints cases

This section provides a summary of a selection of competitive neutrality complaints cases from several jurisdictions, to illustrate both the breadth of issues raised and the approach taken by the various competitive neutrality complaints offices to these issues.

4.7.1 State Flora[109] - assessing whether an activity is a significant business activity

This complaint was brought in the State of South Australia in relation to the activities of the State Flora nursery business conducted by the Department for Primary Industries and Resources (PIRSA). This case devoted some time to the question of whether State Flora was carrying on a "significant business activity", given that it had not been identified in the relevant 1996 State Policy as one of the particular businesses to be targeted. Briefly, State Flora operated two nurseries, one catering for both wholesale and retail sales and the other purely for retail sales, the latter being located within the Belair National Park. The first question was, was State Flora carrying on a business?

The Competition Commissioner noted that:

- State Flora was likely to be seen as carrying on a business, as it:
    - produces goods and services for sale in a market, through the propagation of revegetation and forestry plants, as well as selling associated ornamental garden equipment and numerous other plant species;
    - charges users for its services with the intention of recovering at least most of its operating costs; and
    - operates in a business-like manner; and
- State Flora operates in competition with private businesses supplying comparable products, as evidenced by the existence of the complainant, which was a commercial nursery and seedling propagation business, and other private sector nursery operators which operated in the same market and which were directly affected by State Flora's operations and market share.

[107] See "Australian Institute of Sport Swim School – Investigation No. 2", AGCNCO, 1999

[108] See also p 4 of the "Guidelines on making a competitive neutrality complaint in the ACT", ICRC, December 2010

[109] See "Competitive Neutrality Complaint against State Flora under the Government Business Enterprises (Competition) Act 1996 – Report Summary", South Australian Competition Commissioner, June 2002

Accordingly, the Competition Commissioner held that State Flora was carrying on a business. The second question was, was State Flora carrying on a significant business? In considering whether State Flora was carrying on a significant business, the Competition Commissioner referred to, and agreed with, a comment by the NCC that there was a danger in using arbitrary size or revenue limits to determine whether a business was significant, and that regard should instead be had to the significance of the business in the particular market in which it operated. The Competition Commissioner then noted that defining the relevant market was the first stage in this assessment. This is a typically complex assessment that must have regard to various characteristics of the market, namely: [110]

- product – what goods and services are provided by existing and potential businesses;
- function – what stage in the supply chain does the business operate;
- geography – what are the area(s) over which the competing businesses operate; and
- time – are there likely to be future changes in the market which will restrict the exercise of any market power?

In this case, the Competition Commissioner noted that State Flora operated in the following two markets:

- propagation and sale of high volume revegetation and forestry seedlings, which is also the market in which the complainant operated; and
- retail nursery activities within the National Park, which the complainant essentially did not operate in.

The Competition Commissioner reviewed the markets and concluded that:

- all of the dominant characteristics of the first market in respect of State Flora also applied equally to the complainant. The Competition Commission then concluded that the large volume wholesale and tender activities carried out by State Flora, in conjunction with the limited number of customers operating in this particular market, meant State Flora had substantial market power in this market. The Competition Commissioner also noted that State Flora priced its goods and services in the upper end of the spectrum (and with specific regard for competitors' prices), and noted that this pricing behaviour had a substantial effect on what competitors could achieve; and
- the retail nursery was not a significant business activity as it did not have substantial market power in this market (due to its size and limited influence on the retail nursery market).

The Competition Commissioner concluded that State Flora was carrying out a significant business activity in the revegetation and forestry seedling market, and presented "formidable competition" to private sector operators of similar businesses.

[110] See p ix of the "Competitive Neutrality Complaint against State Flora under the Government Business Enterprises (Competition) Act 1996 – Report Summary", South Australian Competition Commissioner, June 2002

The Competition Commissioner also made the following points in relation to the activities of State Flora in this market:

- although State Flora came close to covering its out of pocket costs, no allowance was made for profit, costs of capital and indirect costs; and

- many of PIRSA's officers and other personnel directed enquiries preferentially to State Flora over private sector businesses.

The Competition Commissioner held that the propagation aspect of State Flora should be classified as a significant business activity and appropriate competitive neutrality principles (in particular, full cost attribution pricing) should be applied.

4.7.2 National Rail Corporation Ltd – the responsibility for failure to meet a competitive neutrality principle

The National Rail Corporation (NRC) was established in 1991 through a Shareholders Agreement and was owned by the Commonwealth, NSW and Victorian Governments, who had committed to transferring all of their individual rail freight businesses to the NRC. NRC was identified as a significant SOE in each of the Commonwealth's, NSW's and Victoria's 1996 Policy Statements.

The complainant, who had interests in privately-owned freight businesses in competition with NRC, made a complaint to the AGCNCO that the NRC had not earned a commercial rate of return on its assets. This case focused on the extent to which such failure could reasonably be held to be the fault of the relevant SOE. When the NRC was established, the Shareholders Agreement envisaged that there would be an "establishment period" from 1993 to 1998, and thereafter, the NRC would be operating profitably. However, the NRC's progress towards profitability was significantly delayed as a result of:

- a number of policy changes by the relevant Governments, which meant that the original plan for NRC to be a vertically-integrated entity (thus having access both to rolling stock and tracks) did not occur – which then meant that before the NRC could obtain access to rail tracks to carry out its freight business, it needed to have entered into commercially-negotiated third party access agreements with the relevant rail track operators (which were in turn delayed by delays in implementing the relevant access regimes for rail infrastructure);

- significant delays incurred in transferring the relevant rolling stock assets to NRC; and

- delays in obtaining relevant freight approvals.

The AGCNCO investigated the NRC's financial accounts and confirmed that, as at January 2000, it had not achieved a commercial rate of return (in fact, it had made a loss in that year). However, bases on the following considerations AGCNCO concluded that NRC was not in breach of the rate of return guidelines:

- the impact of the abovementioned external factors;

- the NRC's commitment to making a profit over the following two-year period; and

- that the concept of a commercial rate of return necessarily involves an assessment of a reasonable period of time (even though it held that in this case, there was no reasonable period over which NRC had made a profit),

This was a reasonably generous approach, and indicates a recognition that an SOE should only be held responsible for breaching competitive neutrality requirements where this arose from the actions of the SOE itself and not from circumstances which were completely outside its control. In addition, the decision may well have been affected by the knowledge that the shareholders in NRC were actively proposing to privatise NRC (which happened two years later).[111]

4.7.3 Australian Institute of Sport Swim School[112] – categorisation of shared assets, costs, tax and regulatory aspects

One of the early complaints made to the AGCNCO involved the activities of the Australian Institute of Sport Swim School (AISSS), a sub-body of the Australian Institute of Sport (AIS). The AIS was established to develop, and provide facilities for the development of, elite athletes. The AISSS used spare capacity in the AIS' swimming facilities to provide commercial swimming services to the public. [113]

This case covered a range of competitive neutrality principles, and served as an avenue for the AGCNCO to clarify its approach to these principles. In particular, it clarified the possible and preferred approaches taken by complaints offices in relation to allocating the costs of assets that are shared by public and commercial activities.

The AGCNCO agreed that the AISSS was carrying out a business and that competitive neutrality requirements should apply (specifically, because it had a significant market share within its catchment area). The core allegations were:

- that the relevant charges did not cover the costs of providing the service;
- that the AISSS did not have to earn a commercial rate of return;
- that the AISSS should use a corporatised model to deliver competitive services;
- that the AISSS was exempt from relevant taxes;
- that regulatory neutrality was not present; and
- that the AISSS should not provide services that were already being provided by the private sector.

<u>Costs, rate of return and corporatisation</u>

[111] See "Joint Media Release: Combined Sale of Freightcorp and National Rail", Cth, NSW and Victorian Governments, 31 January 2002.

[112] "Australian Institute of Sport Swim School" by the Commonwealth Competitive Neutrality Complaints Office (CCNCO), 1999 Canberra, December

[113] These activities were in accordance with the relevant establishment Act, the *Australian Sports Commission Act 1989* (Cth)

The core allegation was that the charges for the commercial swimming services did not reflect the costs of providing the service. Importantly, the AGCNCO made the point that in this case, the swimming facilities had been constructed primarily for the use of elite athletes, and thus the relevant costs of providing the commercial swimming services were only the extra costs incurred – i.e. those costs that would have been avoided had the commercial swimming services not been provided. These are referred to as avoidable costs.

This approach led to a significantly different outcome from the situation that would have applied had the AGCNCO defined the costs as a proportion of the overall costs based on purely time-based usage periods. In this case, the AGCNCO confirmed that the services were priced (and the AISSS paid to AIS a rental charge) to more than cover the avoidable costs incurred.

In assessing the rate of return, the AGCNCO noted the AIS's commercialisation guidelines, which provided any commercial projects which fail to achieve agreed profit margins or which require subsidisation would be closed. In conjunction with a review of the accounts, the AGCNCO concluded that the AISSS was covering all relevant costs and operating at a profit well in excess of any minimum required by competitive neutrality. On this basis, the AGCNCO concluded that requiring the AISSS to corporatise was "unnecessary and unwarranted" and it was sufficient to adopt a full cost pricing process.

Tax

In assessing the tax issue, the AGCNCO reviewed the AISSS' accounts. The AGCNCO identified only minor equipment purchases that were exempt from sales tax, and confirmed that there was no public-private discrepancy in relation to payroll tax. The AGCNCO used the abovementioned avoidable cost principle to work out the proportion of ACT Government rates and taxes payable (which, as these rates and taxes would have had to be paid anyway for the "public" purposes of the AIS, resulted in there being no avoidable costs). Based on this it concluded that that the AISSS received no significant competitive advantage in relation to taxation. However, in its recommendation to adopt a full cost pricing approach, it noted that such an approach would ensure that no future tax-related competitive advantage could accrue.

Regulatory requirements

Although the AGCNCO found that the AIS was not subject to certain water quality regulations, it did, in practice, have a "powerful incentive" to comply with equivalent standards and incur comparable costs, and did so (again, the relevant costs incurred by the AISSS were calculated on an avoidable cost basis). The AGCNCO clarified that its obligation as investigator was not to determine whether regulations should or should not apply, but to confirm that no resultant competitive advantage accrued.

"Unfair"

The AGCNCO did not accept the complainant's argument that public enterprise should not provide services in competition with private enterprise, instead noting that the use of the swimming facilities in periods of under-use was an efficient use of the public's resources.

4.7.4 Queensland Rail[114] - what is required to "recover costs"

The allegations in this case were by a bus company and concerned the introduction by Queensland Rail (QR) of a Brisbane-Helensvale rail passenger service for which the fare failed to recover operating costs or provide a return on capital (due to QR's operating costs being the subject of a subsidy from the Queensland Government), as well as procedural and regulatory advantages held by QR. The QCA confirmed that QR carried out a significant business activity and that the complaint was properly directed to it.

QR alleged that it did not breach competitive neutrality because it was recovering its costs through a combination of service pricing and the CSO, and that the CSO was not related to its Government ownership. However, the QCA found that:

- the receipt of subsidies from the Queensland Government permits QR to set prices below its operating costs;
- QR receives these subsidies because it is owned by the Queensland Government;
- the subsidies should have been (but weren't) renegotiated and formalised under the Government Owned Corporations Act 1993 (Qld) (GOC Act), which imposes stronger transparency and accountability requirements;
- the charges may not have been determined in accordance with the GOC Act; and
- the charges do not contribute towards the capital infrastructure,

Based on this the QCA concluded that the arrangements therefore do not promote competition in the public transport sector (including between bus/rail), and there is no relevant policy or other reason why QR should be exempt from competitive neutrality requirements. The QCA recommended to the Minister that: (i) a CSO framework be implemented that reflects the efficient price for bus and rail services and provides for competition; (ii) further research be done to assess the public transport situation in the particular corridor; and (iii) an interim arrangement be implemented to ensure that the competing bus service does not close down. However, the Minister rejected the QCA's finding that QR had breached competitive neutrality principles, on the grounds that the QCA had insufficient information to reach this decision.

4.7.5 Ballarat Childcare[115] - operation of the public interest test

This case, which went to the Competitive Neutrality Unit (CNU) of the Victorian Department of Treasury and Finance, concerned the provision of childcare services by the City of Ballarat (Council) through two childcare centres in Ballarat. This case was interesting because it was a case in which the SOE was held to be carrying out a significant business activity and breaching competitive neutrality principles, but that the application of the public interest test meant that competitive neutrality principles should not apply. The CNU confirmed that these activities were significant businesses, particularly as they constituted 13% of the relevant market. The

[114] See "Competitive Neutrality Complaint – Complaint by Coachtrans Australia against Queensland Rail – Findings and Recommendations", Queensland Competition Authority, June 1998

[115] See "Competitive Neutrality Complaint Investigation – Summary of Findings" (regarding City of Ballarat), Competitive Neutrality Unit, Department of Treasury and Finance, April 2003

complainant alleged that the Council childcare centres operated at a loss and were subsidised by Council; and the Council paid its workers above the Federal Award levels.

In relation to the first point, the Council advised that:

- it was undertaking a public interest test process to assess the level of community support for Council involvement in the provision of such services and balance these against its NCP obligations, in particular against the background of an identified shortfall of childcare services in the relevant area; and

- the imposition of full cost pricing on the services would have a detrimental effect on the ability of the community to access the services, and thus the ongoing provision of services to meet community needs requires the Council to subsidise the services, so that no commercial rate of return will be achieved.

The CNU concluded that the Council had not breached competitive neutrality requirements, based on the following considerations:

- it was only necessary to implement competitive neutrality reforms to the extent that it was in the public interest;

- the Council's public interest test was thorough;

- the provision of services to meet community needs would be jeopardised if full cost pricing was required (in particular, Council had already experimented with increasing prices and had experienced a rapid resultant fall in usage from 85% to 48%),

5. Consideration of Australia's approach and applicability to other sectors

5.1 Assessment of the National Competition Policy

As flagged in section 1.4 of this Paper, in 2005 the Productivity Commission assessed the status of competition reforms generally, and concluded that competitive neutrality reforms [116] at that stage had been completed in every jurisdiction except for WA (WA completed the relevant reforms shortly afterwards, in late 2005). Specifically, the Productivity Commission found [117] that:

- all jurisdictions had published competitive neutrality policy guidelines;

- all jurisdictions had established complaints handling offices;

- the broad principles underlying the competitive neutrality regime remain appropriate and no major changes were required to this regime, although a level of fine-tuning might be appropriate;

- the competitive neutrality regime should be extended beyond the life of the current NCP; [118]

[116] See p xvii of the NCC Submission

[117] See PC Paper

[118] See Recommendation 10.4 of the PC Paper and p 295

- an independent national review should be conducted into national freight transport to map out what is required to achieve competitive neutrality across all transport modes to ensure that the most efficient (from a public interest sense) transport mode is chosen; [119] and

- competitive neutrality reforms should be expanded to other key sectors, particularly health services and universities.

5.2 The core components of the Australian approach

If the core components of Australia's competitive neutrality reforms can be extracted from the detail, it can be seen that the following system (as detailed in the following subsections) was broadly used.

5.2.1 Identifying the existence of distortions

The first stage comprised a recognition that competitive neutrality distortions existed in a market, meaning that the competitive neutrality distortions were constraining the development of the market, resulting in the absence of a competitively neutral playing field. In Australia's case, the specific sectors identified at first were significant Government business activities, as well as the electricity, gas, water and transport industries. More recently, the areas being targeted include continued reforms in the transport sector, but also new areas such as health and aged care, which did not figure prominently in the original plan.

Clearly, preliminary recognition that an issue exists is necessary for a country to identify that the issue needs to be resolved. In Australia's case, this came about due to the presence of pre-existing reforms, which resulted in the particular issues coming to light. However, an alternative could well have been a dedicated investigation to identify the presence of any such distortions.

5.2.2 Identifying details of distortions

Once the various targets had been identified at a broad level, a specific review process[120] was used to identify, among more general competition issues, the particular distortions present in the relevant markets – such as regulatory distortions, tax immunity, reduced costs of debt and the lack of any obligation to achieve a commercial return on assets.

This specific review also raised the policy question of whether SOEs should continue to operate in areas in competition with private enterprise. It would also be possible to combine this section with the above, using an investigative process to first identify the presence of distortions and then to identify the particular distortions and the way they operated.

5.2.3 Commitment to action

Once the distortions were identified, the relevant Australian Governments reviewed the policy questions raised by the specific investigation and committed to address the competitive neutrality distortions. This commitment was separated into two streams, being:

[119] See Recommendation 8.8 of the PC Paper

[120] See the Hilmer Review

- the entry into of specific agreements under which the Australian Governments undertook to eliminate competitive neutrality distortions for certain types of businesses (regardless of the particular industries in which those businesses operated). Although the agenda for such reforms was up to each individual Government (subject to an appropriate cost-benefit analysis), there was a broad obligation to pursue corporatisation and specific neutrality targets (e.g. tax neutrality, debt neutrality and regulatory neutrality) in relation to significant SOEs. Part of this involved the establishment of the Legislative Review Program. A core component was the public interest test – this enabled the Governments to assess the cost-benefit outcomes of applying the reforms. It also placed the burden of proof on those entities seeking to avoid the application of competitive neutrality;[121] and

- the commitment by the majority of Australian Governments to separate reforms in the electricity, gas and water industries and the transport industry. Although these were run outside the core competitive neutrality reforms (due to their nature as specific industries with specific issues), they were driven by the National Competition Policy reforms, largely regulated by CoAG or similar multi-Governmental bodies, and incorporated competitive neutrality drivers within these reform programs. Due to the nature of the particular industries, the extent to which each State or Territory implemented these reforms varied. For instance, the "national electricity market" commenced in 1998 with the participation of only 5 out of the 8 State or Territory Governments (with one of these 5 notionally replicating the national reforms due to not being physically connected to the electricity industries of the other participating States). Even now, WA and the Northern Territory have not implemented these reforms, due primarily to the distance separating their electricity networks from the "national grid". WA has implemented its own reform process based on a different market operation, whilst the Northern Territory is still considering implementing them.

Conceptually, the separation in reform trends between "general" reforms and "industry-specific" reforms is appropriate. However, careful consideration will need to be given to which industries should be treated separately, together with ensuring that the industry-specific reform programs are directed to achieving the same goals as the more general reforms.

5.2.4 Action plan

The structure set up by each Australian Government for implementing these "general" reforms was broadly similar. It involved identification of significant businesses and identification of the distortions previously identified. A mechanism was then implemented to systematically assess the costs and benefits of removing the identified distortions. Once distortion removal was identified as being in the public interest, a systematic process was implemented to put the significant business in the same position as it would have been in had it been a private enterprise. In many cases this involved the establishment of mechanisms at general government level – e.g. tax equivalent regimes,[122] additional debt costs and legislative amendment (such as through the Legislative Review Program).

---

[121] See p 134 of the PC Paper

[122] In 1998 the Commonwealth, States and Territories entered into the Intergovernmental Agreement to Reform Commonwealth-State Financial Relations and agreed to introduce a National Tax Equivalent Regime (NTER). The NTER rendered State and Territory Government businesses

Furthermore, complaints mechanisms were implemented, and these complaints offices often provided general overview documents that enabled relevant personnel to more clearly understand that direct obligations applying as a result of competitive neutrality.

As discussed in section 1.1, Australia operates as a federation[123], with various roles being specifically delegated to the Commonwealth Government through the constitution and all other roles being retained by the State Governments. This arrangement requires a good deal of flexibility to enable the various Governments to work in tandem with one another to achieve goals without compromising particular operating methods or particular circumstances peculiar to each Government. This was referred to in the assessment of the Hilmer Review,[124] as follows:

> … the Hilmer proposals represent a significant challenge for the effective implementation of Co-operative Federalism and the issue of State Sovereignty in economic and social affairs.

Clearly, the level of prescription may well vary depending upon whether the particular country follows a unitarian model or a federated model. In addition to the "general" reforms, a structure was implemented for the ad hoc industry-focused reforms whereby a representation of Governments (e.g. CoAG) agreed on certain policy actions and the Governments negotiated the adoption of those policy actions. In the electricity industry, this has taken the form of "national" electricity legislation being implemented in one State, and adopted by each participating State using its own particular legislation. This structure is required as electricity is one of the powers reserved to the States under the Constitution, and the Commonwealth has no powers to enact overriding legislation.

The Productivity Commission noted[125] that in the case of the electricity and gas industries, the initial reform commitments were quite specific, whilst those for water and road transport were more general. This caused delays in the latter group of industries compared with the former. From this, it can be seen that the more prescriptive the goals are that are specified (while still retaining inbuilt flexibility), the easier and quicker it is to progress those goals. Otherwise, the discussion concerning the nature of the goals will expand.

For industries having strongly vertically-integrated structures, the approach used in the electricity reforms (as an example) is worth considering. The first stage in these reforms was to separate each business component, first as a separate business within the SOE, and later following up with corporatisation of each business unit. This resulted, for example, in the QEC first separating into generation, transmission, distribution and retail functions and later separating within those business units (for example, the previous Queensland Generation Board now comprises three separate generation businesses, each a separate corporate entity[126]). This

---

subject to an income tax equivalent regime, administered by the Australian Taxation Office (ATO).

[123] See also p 130 of the PC Paper

[124] See "National Competition Policy: Overview and Assessment", by Kain, J., Research Paper No. 1, Parliamentary Research Services, 1994

[125] See p 131 of the PC Paper

[126] Note that the "Shareholder Review of Queensland Government Owned Corporation Generators", November 2010, proposed a model whereby the three generation SOEs would be restructured to two SOEs to manage future regulatory risk.

process only took between two and three years for each State to complete, and addressed many of the competitive neutrality issues at an early stage.

5.2.5 Maintaining the momentum

Another important aspect of the Australian reforms was the regular reviews, including annual reports by each Government and longer-term reviews by relevant Commonwealth Government departments such as the NCC and Productivity Commission. These reviews, together with the competition payment structure: (i) helped keep the issue of competitive neutrality reforms "front-of-mind" for each Government; (ii) drove the continuing uptake of competitive neutrality reforms by encouraging the delivery of outcomes as measured against the overarching competitive neutrality principles (instead of using a mechanistic rules compliance approach without regard for outcomes); and (iii) quantified the benefits of the reforms. In the NCC's submission to the Productivity Commission, the NCC noted that these competition payments had materially contributed to the success of the reforms. [127]

5.3 Competitive advantages targeted in Australia

As discussed in sections 2.2 and 2.3, Australia particularly focused its competitive neutrality reforms on taking the following actions to address advantages held by SOEs:

- transparency and accountability – by imposing appropriate transparency and accountability requirements on SOEs so that SOEs were subject to the same general obligations as private enterprises are to their shareholders and directors;

- taxation neutrality – to make SOEs either subject to the same taxation arrangements as competing private enterprises, or to a tax equivalent regime having the same net effect as the taxation arrangements applying to those private enterprises;

- debt neutrality – to impose additional fees on SOEs to compensate for the imbalance in debt financing costs experienced by SOEs so that both SOEs and private enterprise are subject to comparable debt financing costs;

- rate of return neutrality – to implement cost accounting procedures to ensure that the revenue stream receivable by SOEs for the provision of goods or services covers the relevant costs to those SOEs of providing these services, so that private enterprises were not consistently undercut in price by SOEs; and

- regulatory neutrality – amending the regulatory regime to ensure that SOEs and private enterprises operating in competition with each other (or seeking to do so) were subject to the same regulatory requirements.

5.4 Applicability of Australia's approach to non-Australian industry sectors

Naturally, it will not be appropriate to apply Australia's 1996 Competitive Neutrality Policy or its successor, the National Reform Agenda, wholesale to other countries without a systematic analysis of the causes and locations of competitive neutrality failings in those countries. In addition, as competitive neutrality reforms have been implemented in Australia, the Australian

[127] See p 36 of the "Submission to the Productivity Commission Review of National Competition Policy Arrangements", National Competition Council, June 2004

Governments have become more familiar with the relevant processes and made changes to their competitive neutrality policies in light of this experience. Those wishing to establish competitive neutrality reforms either in other Australian industries or in industries overseas, would be well-advised to avoid a rigid, mechanistic application of rules and concepts and ensure that they first conduct a careful analysis of the particular circumstances present in that country and relevant industries.

For example, the NCC, in its submission to the PC Paper, made the following statement [128]

> A major strength of the NCP agreements is their reliance on the 'spirit' of reforms and the flexibility afforded to governments in meeting their commitments and to the Council in assessing progress. The agreements extend over many years, yet are flexible enough to cope with changing circumstances and different approaches while remaining sufficiently clear to facilitate an objective assessment.

The Council has no doubt that rigid highly prescribed agreements set down in black letter law would have been an inferior model. However, the systematic nature of Australia's competitive neutrality approach is well worth applying to overseas industries in which a lack of a competitively neutral framework has been identified. The Productivity Commission also noted[129] that systematic processes were critical to permitting informed decision-making by Governments.

5.5 Learnings from the Australian experience

In addition to those preparation aspects referred to in section 5.4 of this Paper, aspects of the Australian experience that were praised as being effective included the below. [130]

- *Broad, integrated program.* Australia's approach to a reform program that not only applied generally to SOEs but also to specific industries, and Australia-wide rather than separated according to State boundaries, ensured that substantial parts of the economy were subject to reforms. Together with the competition payments incentive, this meant that these parts would benefit from these reforms, resulting in a large economic advantage for Australia.

- *Flexibility.* As discussed in section 5.4, the federated nature of Australia's governmental system and the differing goals of each of the States, Territories and Commonwealth, meant that a flexible approach involving specific goals rather than specific action items was invaluable in progressing reforms.

- *Good processes.* As detailed in section 5.4, Australia's systematic process was highly effective.

- *Concrete incentives*. The provision of competition payments by the Commonwealth to the States and Territories was seen as a definite plus in the application of the reforms. The provision for penalties to be applied for lack of progress (and the flexibility of being able to suspend the payments) was an essential element of these payments.

---

[128] See p 35 of "Submission to the Productivity Commission Review of National Competition Policy Arrangements", National Competition Council, June 2004

[129] See p 140 of the PC Paper

[130] See section 6.2 of the PC Paper, Senate Select Committee Report 2000

- *Regular reviews*. The requirement on individual jurisdictions to report on the progress of their reforms, together with regular independent reviews, was crucial in ensuring that areas of slippage were rapidly identified, and, if necessary, penalties in the form of withheld competition payments applied to such areas. Other aspects of Australia's reform program that were not as consistently well-applied, and which could be improved upon, included the following. [131]

- *Clarity*. A number of aspects of the reforms were less clear than others, leading to greater time being taken to resolve the details of the intended reforms prior to taking action. In addition, confusion over some of the concepts was not uncommon. Given the relatively brief timeframe for implementing the reforms, a clear understanding of the goals and mechanisms to achieve those goals was essential. Areas such as electricity and gas contained sufficient specificity to achieve this, in contrast with other areas such as public transport, in which reform progress significantly lagged behind.

- *Priority.* In some cases, it may have been appropriate to prioritise analysis of relevant regulation, first addressing areas where substantial gains could be obtained from relatively low levels of input, and defer consideration of more minor regulation until after the central areas had been addressed. This led to individual jurisdictions tending to address less complex legislative reforms before attacking the core areas, resulting in the NCC having to specify ten areas as priority areas – but this was not done until 2001.

- *Clear public benefit test.* The scope of the concept of "public benefit" in the public benefit test was not immediately apparent to many industry participants, notwithstanding that the Competition Principles Agreement specifically referred[132] to factors such as social welfare, industrial relations, economic development and ecologically sustainable development as considerations to be applied. In particular, the Senate Select Committee noted [133] that the failure to do so was one of the handful of major concerns with the implementation of NCP, resulting in Governments favouring tangible and determinable economic cost-benefit analysis over less definite intangible attributes. Even once the scope was understood, the precise mechanics of accounting for these aspects was not detailed in any official documents. Many of the associated guidelines and other documents expounding upon policy intent were only produced in the very late 1990s or mid-2000s. Earlier implementation of such ancillary documents could be expected to accelerate the implementation of the reforms.

- *Transparency of reviews.* A common theme that recurred throughout the competition reforms was the need to ensure that review panels were truly independent (including in relation to industry stakeholders) and that the processes of review and assessment were sufficiently transparent and contained sufficient detail of the analysis undertaken to ensure that the public at large, and industry in particular, could thoroughly understand these processes. This could be augmented through various public education programs and public consultation processes.

[131] See section 6.2 of the PC Paper

[132] See section 1(3) of the Competition Principles Agreement

[133] See p xiii of the Senate Select Committee Report 2000

- *Imbalance in incentives.* Although the existence of a competition payments structure was highly thought of, a number of criticisms were levelled at the detail of this payment regime, including:

    - the inability of local governments to access such payments, even through a parallel set of reforms was being imposed upon local government – only some of the States elected to share their payments received with local government;

    - the Commonwealth Government not being subject to any form of penalty for failing to adhere to targets; and

    - a perceived lack of transparency in applying penalties, without due regard for the totality of the progress within the relevant jurisdiction.

In conclusion, Australia's competition reforms can be viewed as highly successful overall, even though certain areas remain to be completed and the process of reform remains a perpetual work in progress. Importantly from the point of view of competitive neutrality, the comprehensive analysis undertaken of the presence and nature of relevant market distortions and the specific commitment by each Australian Government to taking certain actions under the Competition Principles Agreement meant that the majority of these reforms were implemented within the first five years.

Any country seeking to address such distortions could do worse than to follow Australia's model, particularly with the advantage of hindsight some fifteen years after the Hilmer Review and the ability to leverage off the experience obtained in Australia since that date.

GLOSSARY

Term	Definition
1996 Policy Statements	All of the competitive neutrality policy statements issued by the various Australian Governments in 1996, including revisions and updates.
ACCC	Australian Competition and Consumer Commission
ACT	Australian Capital Territory
AGCNCO	Australian Government Competitive Neutrality Complaints Office within the Productivity Commission
CoAG	Council of the Australian Governments
Commonwealth Statement	Commonwealth Competitive Neutrality Policy Statement, June 1996
Cth	Commonwealth of Australia
Energy Advisory Services	Energy Advisory Services Pty Ltd ACN 134 487 880
Guidelines for Managers	Commonwealth Competitive Neutrality – Guidelines for Managers, February 2004
Hilmer Review	The Independent Committee of Inquiry into a National Competition Policy), National Competition Policy, by Prof Hilmer, F.G., Rayner, M. and Taperell, G., Australian Government Publishing Services, Canberra, 1993.
MCE	Ministerial Council on Energy
MCE Reform Report	Report to the Council of Australian Governments – Reform of Energy Markets, MCE, 11 December 2003
NCC	National Competition Council
NCC Submission	Assessment of governments' progress in implementing National Competition Policy and related reforms, NCC, October 2005
NCP	National Competition Policy

NSW	New South Wales
NSW Statement	NSW Government Policy Statement on the Application of Competitive Neutrality", June 1996 (updated 2002)
NT	Northern Territory
OECD	Organisation for Economic Co-operation and Development
OECD Working Party	Working Party on State Ownership and Privatisation Practices
Paper	This paper entitled "Competitive Neutrality in the Presence of State-Owned Enterprises: Australian Practices and their Relevance for other OECD Countries".
PC Paper	Review of National Competition Policy Reforms, Productivity Commission Inquiry Report, 28 February 2005
Queensland Statement	National Competition Policy Implementation in Queensland: Competitive Neutrality and Queensland Government Business Activities, Queensland Government, July 1996
SA Statement	Competitive Neutrality Policy Statement, South Australia, 1996, updated July 2002
Senate Select Committee	Riding the Waves of Change, A Report of the Senate Select Committee on the Socio-Economic Consequences of the National Competition Policy, (Sen. J. Quirke, Chairman), Senate Printing Unit, Canberra, February 2000
SOE	Refers to an enterprise which is owned by an Australian Government (whether the Commonwealth or a State or Territory).
Tas Statement	Application of the Competitive Neutrality Principles under National Competition Policy, Government of Tasmania, June 1996
Victorian Statement	Competitive Neutrality Policy Victoria 2000, Victorian Government
WA	Western Australia
WACC	Weighted average cost of capital
WA Statement	Policy Statement on Competitive Neutrality, Western Australian Government, June 1996

ANNEX A – SPECIFIC UTILITIES REFORMS

OVERVIEW OF THE AUSTRALIAN UTILITIES SECTOR

The traditional view of utilities provision

The traditional Australian view was that public utilities were best retained in Government ownership, particularly because they constituted "natural monopolies". However, this view had changed by the 1980s as the public utilities businesses grew ever more expansive and, in many cases, less efficient and with lowering performance standards. The Hilmer Review identified that[134] there were opportunities for electricity, gas, water and rail utilities to increase GDP by over A$8 billion (1993 dollars).[135] The Hilmer Review also identified inefficiency costs in the electricity sector alone at A$2.2 billion (1991 dollars). [136]

This traditional view of public utility ownership was strongly challenged in the Hilmer Review, which stated that legislated monopolies for public utilities constituted a significant regulatory restriction on competition.[137] In particular, the Hilmer Review noted that:

While many public utilities were traditionally considered to be "natural" monopolies, so that a single producer could supply the entire market at least cost, technological changes and other developments have shown that the area of genuine natural monopoly is relatively small and diminishing. [138]

Moreover, the natural monopoly element often accounts for only a small part of the range of activities carried on by legislated monopolies. [139]

The Hilmer Review specifically drew a distinction between:

- "natural monopolies" constituted by electricity transmission grids; and
- areas such as electricity generation, which the Committee did not consider to be a genuine "natural monopoly".

Importantly, the Hilmer Review emphasised that any retention of protection from competitive market outcomes should be justified on clear, consistent and open public interest grounds and subject to regular review. [140]

---

[134] See p 129 of the Hilmer Review, referencing Industry Commission: Rail Transport (1991): Energy Generation and Distribution(1991); Water Resources and Waste Water Disposal (1992).

[135] See also p 3 of "Corporatisation in Practice – A Victorian Experience", Fearon, P., 1-3 December 2004, presented to Asia Pacific Infrastructure Forum

[136] See p 193 of the Hilmer Review, referencing "Energy Generation and Distribution in Australia", Industry Commission, 1991

[137] See p xxix of the Hilmer Review

[138] See p 12 of the Hilmer Review

[139] See p 193 of the Hilmer Review

The new approach

Once the general competition reforms started to gain traction nationally, various sectors were subject to specific reforms – in particular, the electricity, gas, water and transport sectors. The approach to these specific reforms adopted the new view that the majority of "public infrastructure" did not constitute a natural monopoly and should not be isolated from competition on this basis.

True examples of monopoly infrastructure, such as electricity transmission lines, were subject to a number of stringent regulatory requirements, involving mandatory third party access regimes and regulated pricing. This was designed to "open up" this infrastructure to private enterprise and ensure that it did not constitute a barrier to competition.

THE ELECTRICITY INDUSTRY REFORM PROCESS

The electricity industry pre-1995

The electricity industry in Australia originated as small utilities owned and operated by either local governments or small private enterprise. However, with the continued electrification of the country, these enterprises were systematically subsumed into State- and Territory-based organisations, which carried out activities ranging from generation, transmission and distribution right through to retail. [141]

Triggers for competition reform generally

By the start of the 1990s, the performance of these utilities was commonly viewed as non-compliant with the goals of competition, and there was a belief that the prices of electricity did not appropriately reflect the costs incurred by the utilities. In addition, the level of services was viewed as below par. The following extract[142] notes that:

By the 1990's the publicly owned, vertically integrated monopoly energy utilities were perceived by many as not generating maximum benefits for [its] citizens or customers. A number of weaknesses had emerged, such as poor capital decisions, over-capitalisation of assets, low plant availability and inefficient work practices.

Approach to competitive neutrality and competition reforms in the electricity industry

A decision was made by the Australian Governments to take many of the competition reforms for the electricity industry partially "off-line" from the core NCP reforms and deal with this industry on a progressive basis (albeit complying with the undertakings under the Competition Principles Agreement) through directions from CoAG implemented by the Ministerial Council on Energy (MCE), being a body comprising Ministers with responsibility for energy from each Australian Government.

Relevant to competitive neutrality, these reforms involved:

---

[140] "Parliamentary Research Service: Research Paper Number 1 1994 – National Competition Policy: Overview and Assessment" by Kain, J., 21 February 1994, p 31

[141] See also p 21 of the PC Report

[142] See p 3 of "Corporatisation in Practice – A Victorian Experience", Fearon, P., 1-3 December 2004, presented to Asia Pacific Infrastructure Forum

- disaggregating the individual business units of the State-wide electricity commissions, both vertical separation (to separate the generation, transmission, distribution and retail aspects of the electricity industry) and horizontal (for example, splitting the generation business units into multiple separate units operating independently). In general, this disaggregation was completed by around 1998 for most of the States except for Western Australia and the Northern Territory (which have much smaller populations);

- structurally corporatising the majority of the resultant business units, particularly in the eastern States. Currently, the Northern Territory is the only jurisdiction which retains non-corporatised electricity businesses (albeit vertically disaggregated into separate business units), as Western Australia completed its structural reforms in 2006;

- introducing full retail contestability, whereby all electricity customers can choose their electricity retailer. This was a staged process operating independently in each jurisdiction whereby customer tranches of progressively lower usage were progressively permitted to select their retailer of choice (as opposed to being required to source electricity from the incumbent SOE retail entity). This process commenced after the above reforms and has varied widely in timing of adoption – for example, South Australia, NSW, Victoria and the ACT all reached full retail contestability (i.e. when every customer can choose its retailer) in the period 2002-2003. However, Queensland only reached this point in 2007 and WA, Tasmania and the Northern Territory are still working down through the customer tranches (and are currently at 50 MWh/a, 150 MWh/a and 750 MWh/a, respectively);

- increased transparency in the provision of CSOs directly by Governments in exchange for particular services provided, generally under the relevant State's Act dealing with SOEs; and

- bringing monopoly infrastructure (originally all, and still largely, held by SOEs) under appropriate pricing regulation (to restrict returns to commercial levels) and access regulation (to provide standard terms and conditions upon which third parties can access the infrastructure).

There has been a wide variation in the timing of implementation of these reforms, which has resulted in each of the States and Territories having different characteristics. Some States, such as Victoria, embraced privatisation as the optimal method for addressing competitive neutrality issues, and disposed of the vast majority of their electricity assets (including their monopoly electricity infrastructure). In contrast, Western Australia's electricity networks and the majority of their generation and retail businesses are held by SOEs that have undergone structural corporatisation. The Northern Territory is the sole jurisdiction that has not yet carried out formal structural reforms, although internal business separation and imposition of commercial goals has occurred. This is largely due to the particular characteristics of the Northern Territory, including a sparse population, isolated networks and isolated generators. The remainder of the States and Territories have a mix of private and public sector operations, with consistent regulatory, tax and accountability requirements imposed on them.

THE WATER INDUSTRY REFORM PROCESS

Triggers for competition reform generally

Reforms to the water industry commenced in the early 1980s, triggered by: [143]

- excessive water use (both rural and residential);
- the cost of dam construction;
- increasing environmental damage to key waterways (e.g. siltation) and land (e.g. salinity) and the resultant adverse impacts on flora and fauna; and
- recognition of the need to move to a sustainable pattern of development.
- CoAG agreed to a package of water industry reforms in 1994, which applied to both surface and sub-surface water, including:
- the corporatisation of SOEs involved in the water and sewerage businesses, to be completed by the late 1990s, including the separation of various sub-roles within these businesses (e.g. managing water resources, setting standards, providing services and regulation);
- establishment of a new water pricing regime based on consumption and cost recovery. This regime would involve revenue allocations for future asset development;
- requiring new water infrastructure to be subject to a cost-benefit analysis; and
- establishment of a system for detailed water entitlements independent of property rights, including for the environment, and a water trading regime.

Competitive neutrality reform progress in the water industry

As in the electricity industry, the water industry contained a number of complexities, and was dealt with primarily outside the NCP reforms, whilst still incorporating the core planks of those reforms being coordinated by CoAG.

By 2005, significant progress had been made in each of the jurisdictions. Relevant to competitive neutrality:

- institutional and administrative reforms had been either fully or substantially introduced, including the separation of service provider and regulatory roles and the establishment of a commercial business focus; and
- urban water providers had fully or substantially introduced cost recovery, with most of the larger rural water providers moving towards achieving this. [144]

[143] See pp 26, 200 of the PC Paper, "A Full Repairing Lease: Inquiry into Ecologically Sustainable Land Management, Report no. 60" Industry Commission, AGPS, 1998, Canberra, "Assessment of Governments' Progress in Implementing the National Competition Policy and Related Reforms, vol. 1: Overview", NCC, 2003, AusInfo, Canberra

Other, more complex areas (such as the allocation of water entitlements to the environment and consideration of environmental impacts) naturally had not been resolved within the relevant timeframe. In addition, the creation of markets for water entitlement trading had not been completed[145] – these markets would incorporate competitive neutrality requirements upon establishment.

This led to the introduction of the National Water Initiative in 2004[146], which was eventually adopted by each of the Australian Governments.[147] Under the National Water Initiative, Governments committed to, among other things:

- achieving consistent pricing policies for water storage and delivery, to help foster competitive neutrality;[148]
- implementing consistent water access entitlements across Australia to improve competitive neutrality;[149] and
- ensuring competitive neutrality in relation to trading of water entitlements in the Southern Murray-Darling Basin.[150]

One of the more complex areas in full cost pricing, particularly in rural areas, is the need to price not only to recover the SOE's costs, but also to impose prices that reflect the scarcity and value of the natural resource. As the policy documents did not go into detail concerning specific mechanisms by which such externality-reflective pricing could be implemented in practice (in conjunction with the differing environmental needs in different areas), this led to significant delays in this aspect of the reform process whilst Governments attempted to quantify and manage this particularly complex area.[151]

---

[144] See p 27 of the PC Paper

[145] See p 201 of the PC Paper

[146] See the Intergovernmental Agreement on a National Water Initiative

[147] Tasmania joined in June 2005 and Western Australia in April 2006.

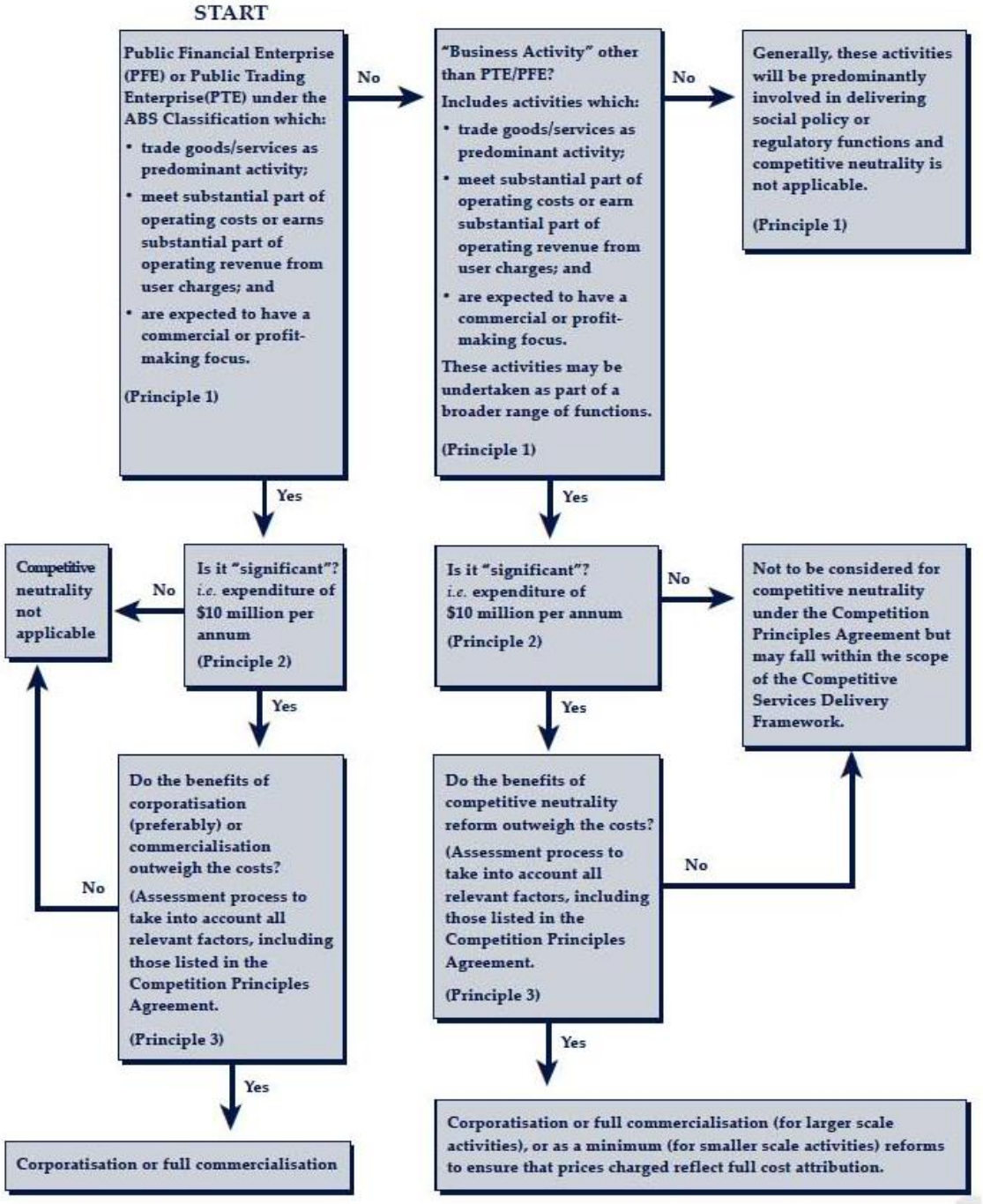
[148] See "Pricing Policies" section of the National Water Commission website at http://www.nwc.gov.au/www/html/259-pricing-policies.asp

[149] See clause 25(vii) of the Intergovernmental Agreement on a National Water Initiative

[150] See clause 63(ii) of the Intergovernmental Agreement on a National Water Initiative

[151] See p 205 of the PC Paper

ANNEX B - FLOW CHART FOR DETERMINING APPLICATION OF COMPETITIVE NEUTRALITY



Note. This diagram from the Queensland Statement clarifies the proposed application of competitive neutrality to Queensland SOEs.