

Competitive Neutrality Review Secretariat  
The Treasury  
Langton Crescent  
Parkes ACT 2600  
Via email: [cnreview@treasury.gov.au](mailto:cnreview@treasury.gov.au)

27 April 2017

Attention: Mr Jongsok Oh  
Senior Adviser  
Structural Reform Group

Dear Mr Oh,

## **Review of the Commonwealth Government's Competitive Neutrality Policy**

### **This Submission**

Competitive Neutrality (CN) exists when government business activities do not enjoy net competitive advantages over their private sector competitors simply by virtue of public sector ownership.

This Submission reviews the current policy in the light of:

1. Commonwealth Competitive Neutrality Policy Statement, June 1996 (CN Policy Statement);
2. Australian Government Competitive neutrality Guidelines for Managers, February 2004 (CN Guidelines); and
3. Our experience as advisors to both Government businesses and private-sector competitors of Government businesses.

### **Accountability and Reporting under the Current Policy**

The Consultation Paper asks: Are current compliance reporting and accountability requirements for government entities adequate? In particular, should government entities also be required to include a statement on competitive neutrality compliance in their annual reports?

Current policy places obligations on a range of Government organisations:

1. Government Business Enterprises (GBEs);
2. Government companies and authorities that operate significant businesses in markets that are open to competition;
3. Government Business Units operating within an agency or Department; and

GPO Box 1989, Canberra  
ACT 2601, DX 5719 Canberra  
19 Torrens St Braddon ACT 2612

Telephone +61 2 6246 3788  
Facsimile +61 2 6248 0639

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4. Business activities of an agency or Department where the business activity is substantial even if not operated by a separate business unit.<sup>1</sup>

These obligations are placed both on Government Business Enterprises and on authorities that operate significant businesses in markets that are open to competition. Obligations are placed on both managers and businesses.

The full cost pricing obligations in the CN Guidelines appear to be inconsistent with the CN Policy Statement. The full cost pricing principles of the CN Policy Statement do not seem to require that the prices of particular goods or services be based on fully-allocated costs. They state:

*The Competition Principles Agreement requires that where Agencies undertake significant business activities as part of a broader range of functions, then agencies, where appropriate, should pay all applicable taxes or tax equivalents and debt guarantee charges. In addition, agencies should ensure that prices charged reflect full cost attribution for these business activities. The Commonwealth considers that this requirement can be met by agencies meeting appropriate financial targets for specified business activities. Accordingly, it is not proposed to review individual prices charge by businesses, but to assess the overall financial performance of the business activity.*

This principle makes perfect sense. It is similar to the pricing policy of a private sector organisation. Such an organisation (for example, a supermarket) will not aim to recover fully-allocated costs on each item. Rather, it will aim to recover direct costs on each item and to make a sufficient margin on direct costs on each item that, when these margins are summed over all items they enable it to at least cover its overheads.

Although the CN Guidelines state that significant government business should price their goods and services on a comparable basis to private sector organisations, the CN Guidelines suggest that this will require that the prices of individual goods and services cover fully-allocated costs. The CN Guidelines state:

*CN requires that significant government businesses price their goods and services on a comparable basis to private sector organisations. This involves:*

- *identifying costs attributable to the business activity; and*
- *setting prices that take into account all relevant costs (including allowances for a commercial RoR) that would apply to private sector competitors.*

We **recommend** that the CN Guidelines be re-drafted to state clearly that managers are not required to set individual prices in any particular way but they are required to abide by the full cost pricing principle as it is stated in the CN Policy Statement.

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<sup>1</sup> CN Policy Statement, pp 10 and 11.

## Scope of the CN Policy

The Consultation Paper asks: What is the appropriate scope of the CN Policy to best fulfil the objective of competitive neutrality? In particular, could the current test for 'significant business activities' be improved and should the application of CN be subject to a broader public interest test?

The current CN policy has an important lacuna: the policy does not cover conduct by government and conduct by government agencies that do not undertake significant business activities when that conduct creates competitive advantages for government business activities over their private-sector competitors. CN policy does not constrain government policy; it only constrains the actions of government business activities and the managers of those activities.

Perhaps the best-known example of government policy that favours a government business activity over its private competitors gave rise to the three complaints against NBN Co and the subsequent report by AGCNCO.<sup>2</sup> Because competitive neutrality policy imposes obligations only on government business activities and the managers of those activities, the complaints were directed to the policies of NBN Co. However, the real problem was government policy. This policy might be able to be justified by a form of community service obligation. However, Government elected to implement its policy by means of non-transparent subsidies. This is contrary to the principles of competitive neutrality. To quote the CN Policy Statement:

*Competitive neutrality does not require governments to remove community service obligations (CSOs) from their government businesses. Where CSOs exist, competitive neutrality and other competition policy reforms may limit the ability for these CSOs to be financed through cross subsidies within the businesses. Transparent, non-discriminatory funding of CSOs through budget funding or specific charges is thereby encouraged.*<sup>3</sup>

A second example of government policy that is contrary to the principles of competitive neutrality is government policy towards universities. With the exception of a few programs (such as nursing and education) the Commonwealth does not support places for students at private universities – such as Bond University and the University of Notre Dame.<sup>4</sup> Because the HECS scheme is only available for students on Commonwealth Supported Places, students at private universities cannot access the HECS scheme.

A third example comes from the area of hospitals. The prices of prostheses are fixed by Government regulation. Government determines that, in general, public hospitals pay lower prices for prostheses than do private hospitals. On 21 November 2016, the Senate referred this matter to the Senate Community Affairs References Committee for inquiry and report. The report is due on 10 May 2017.

It is unlikely that any single measure could force governments to abide by the principles of competitive neutrality. However, legislation could be introduced to increase transparency

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<sup>2</sup> Australian Government Competitive Neutrality Complaints Office, Investigation 14, NBN Co, 24 November 2011.

<sup>3</sup> CN Policy Statement, p 5, emphasis in the original.

<sup>4</sup> <http://studyassist.gov.au/sites/studyassist/help-paying-my-fees/csps/pages/commonwealth-supported-places>

in subsidies paid to government business activities which compete with private businesses.

We **recommend** the Government consider legislation to require a net public benefit justification for the payment of government funds if the payment creates a competitive advantage for a government business activity over competitor private business activity. The legislation should have carve-outs of the kinds mentioned in the CN Policy Statement – including for explicit community service obligations.

### **Start-up government businesses**

The Consultation Paper asks: How should the competitive neutrality policy be applied to new government business activities in their start-up phase?

As we observed above, the Committee agrees with CN Policy Statement to the effect that CN policy should assess the overall financial performance of government business activity. This should apply both *ex ante* and *ex post*. In the case of a start-up government business, the *ex ante* assessment should be made on the basis of the business case presented to government. If that business case is to be competitively neutral, it should show a positive net present value (NPV), when the NPV is assessed taking into account the adjustments that are applied to standard **ex post** assessments of competitive neutrality.

We **recommend** that the competitive neutrality of start-up government businesses should be assessed by asking whether the business case justifying government investment did or did not show a positive net present value (NPV). The NPV should be calculated using an estimate of the commercial rate of return (that is, for a non-government business undertaking functions similar to those of the government business).

If you have any questions in relation to this submission, in the first instance please contact the Committee Chair, Fiona Crosbie, on 02 9230 4806 or via email: [fiona.crosbie@allens.com.au](mailto:fiona.crosbie@allens.com.au)

Yours sincerely,



**Teresa Dyson, Chair**  
Business Law Section