



SUBMISSION

Submission to Treasury on the
Review of Competitive Neutrality
Policy

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The Business Council of Australia is a forum for the chief executives of Australia's largest companies to promote economic and social progress in the national interest.

This is the Business Council of Australia's submission to the Federal Treasury's review of the Commonwealth Government's Competitive Neutrality Policy.

Competitive neutrality policy is a critically important element of Australia's National Competition Policy. The policy aims to serve two important purposes:

- it puts in place strong disciplines on all Australian governments in support of efficient public spending, particularly spending by large government businesses
- it boosts the confidence of the private sector to make long term investments in parts of the economy where the government also has significant business activities on the basis that the government will not use public ownership to seek an unfair advantage in the market

Rigorous adherence by governments to competitive neutrality policy leads to a more efficient and competitive economy and supports fiscal stability, the provision of high quality goods and services and growth in high paying jobs.

Competitive Neutrality policy

Competitive neutrality aims to ensure that government business activities (including Government Business Enterprises (GBEs)) do not receive a competitive advantage over other businesses due to their public ownership.

This means GBEs should not receive favourable taxation or regulatory treatment, their cost of debt should be comparable to that of a similar private business and not that of the government, and their prices must be set to fully cover all costs and to make a commercial rate of return on the government's investment.

The policy means private businesses can compete on a level playing field with government businesses which leads to more efficient investment and better services.

All governments introduced the policy in 1995 and then committed to its enhancement in the 2006 Competition and Infrastructure Reform Agreement, where they agreed to 'enhance the application of competitive neutrality to government business enterprises' in these areas in relation to GBE objectives:

- that the enterprise has clear commercial objectives
- that any non-commercial objectives or obligations established for the enterprise are clearly specified and publicly reported.

This distinction between commercial and non-commercial obligations and how they are funded is fundamental to competitive neutrality policy. In short, the policy requires GBEs to earn market-based rates of return on operations that meet commercial objectives, with non-commercial objectives or obligations of GBEs clearly specified, publicly reported and funded transparently.

This review is timely

With government potentially re-emerging as an owner of new infrastructure businesses there is a need for a renewed commitment by governments to the competitive neutrality policy.

Despite a wave of privatisations there remain many government businesses operating in Australia and new Commonwealth GBEs have also recently been established, for instance, NBN Co and the Moorebank Intermodal Terminal Company. A new corporation is to be established to build and operate Western Sydney Airport.

The use of the GBE model is attractive to governments wanting to invest in infrastructure as it can overcome budget funding constraints and potentially improve public infrastructure delivery through better corporate governance and a more commercial business model. Governments can sell their businesses to private investors and recycle the capital into new infrastructure investment.

If governments are to create new GBEs to deliver infrastructure, it is sound practice to first undertake a rigorous and transparent cost–benefit analysis and then to apply competitive neutrality in full.

Furthermore, governments need to carefully manage the conflicts that could arise from being a new business owner in a market in which they also regulate competition. The Competitive Neutrality policy assists governments to manage this potential conflict by disallowing new or existing GBEs from exercising “regulatory or planning approval functions in markets where they compete with private sector enterprises”.

Implementation of competitive neutrality will also be important should governments adopt Harper Review recommendations for greater choice and innovation in human service delivery by increasing competition in parts of the economy that are not yet fully contestable, such as education, health and infrastructure. Private companies entering these markets will need assurance that they will be able to compete fairly with existing government businesses.

Issues around the current application of competitive neutrality

Australia’s governments should be commended for their ongoing commitment to the competitive neutrality policy over the past 22 years, but there are opportunities for improvement. The Commonwealth should use this review to strengthen the policy by addressing concerns and challenges that have arisen from recent activity. These include that:

- The guidance documentation for the application of competitive neutrality is dated and unclear in describing how the complaints investigation process should operate. There are several documents on government websites setting out guidance when a single up-to-date document would be preferable.
- Recent experiences of the application of the competitive neutrality complaints resolution process at the Commonwealth level raise questions about the commitment to competitive neutrality and the quality of public reporting around complaints.
- The timeliness of annual public reporting of competitive neutrality compliance by COAG and the Council on federal Financial Relations has been poor.

Concerns resulting from recent competitive neutrality investigations

The investigation of a complaint by several private businesses against NBN Co in 2011 by the Australian Government Competitive Neutrality Complaints Office (AGCNCO), housed within the Productivity Commission, provides a case study that highlights our concerns about the operation of the competitive neutrality policy in practice.

While it is over six years since this investigation concluded, it raised lingering concerns that future investigations could be similarly dismissed unless the policy is strengthened.

AGCNCO found a potential ex-ante breach of competitive neutrality in NBN Co's business model due to a lower than commercial rate of return. AGCNCO made these recommendations that were consistent with the government's policy:

- 'The Australian Government should arrange for an analysis of the nature and magnitude of the non-commercial benefits required to be delivered by NBN Co. On receipt of the analysis, the Australian Government should put in place accountable and transparent community service obligation funding ...
- To comply with competitive neutrality policy, NBN Co would need to adjust its pricing model by taking into account funding by the Australian Government for its community service obligations and would need to demonstrate that the adjusted pricing model is expected to achieve a commercial rate of return that reflects its risk profile.¹

The former government's response was provided by the former portfolio minister, the Minister for Broadband, Communications and the Digital Economy, who was also a joint shareholder in NBN Co. The minister said the AGCNCO was 'misguided' in its view, that 'while the company is to operate as a commercial entity, it is not expected to earn a private sector rate of return – rather, a modest return sufficient to fully recover its costs of funds' and 'the government does not agree with the AGCNCO's recommendations in these areas and will not be adopting the recommendations'.²

This case study highlighted the following problems that could recur under future complaints:

- At the Commonwealth level competition policy is within the Treasurer's ministerial portfolio, yet the application of the policy allowed for a portfolio minister with a shareholding in the investigated business to respond to an AGCNCO finding, although the guidelines are ambiguous on this responsibility.³

1. Australian Government Competitive Neutrality Complaints Office, 'NBN Co – Investigation No. 14', Canberra, November 2011, p. 34

2. Office of Senator the Honourable Stephen Conroy, 'Conroy Defends Uniform Pricing Model for NBN', Media Release, 8 December 2011.

3. The guidelines for the complaints process in the 1995 *Commonwealth Competitive Neutrality Policy Statement* say that the Treasurer should lead the government's response to an AGCNCO finding within 90 days. The 1998 version of the *Australian Government Competitive Neutrality Guidelines for Managers* places the onus on the portfolio minister to decide whether to implement any changes but is less clear on how the government overall should respond to findings arising from the complaints process. The updated 2004 version *Australian Government Competitive Neutrality Guidelines for Managers* does not have a section on the complaints process but does say that the AGCNCO provides 'independent advice to the Treasurer on the application of competitive neutrality'. Furthermore, the guidelines state that 'in preparing your case for exclusion, or partial exclusion from CN [competitive neutrality], you must conduct an appropriate cost/benefit analysis and retain the documentation relating to your cost/benefit analysis as it may be required by the AGCNCO in the event of a complaint against you' (p. 14).

- The government dismissed the findings and recommendations of its own independent expert about the application of one of its core economic policies (competition policy).
- The dismissal of the findings was not informed by a cost-benefit analysis to justify the potential *ex-ante* breach
- There was a lost opportunity to potentially achieve more efficient investment in the telecommunications sector (as the competitive neutrality policy is designed to achieve).
- There was no recognition of established private business owners and employees whose livelihood is affected when a new public company enters the market with an unfair advantage.
- Business confidence to invest rests on government regulations and policies being applied fairly, especially when they relate to the government's own operations and businesses. This type of response is harmful to business confidence.

(An independent cost-benefit analysis of the national broadband network was subsequently undertaken by the current government in 2014.)

In a separate investigation in April 2012 AGCNCO made recommendations to alter PETNET Australia's business following a competitive neutrality complaint. We can find no public ministerial response from the then Commonwealth Government to this report.

More generally in the aim to achieve 'enhanced application' of competitive neutrality, a 2012 paper by the Victorian Competition and Efficiency Commission found that across the federation there remains scope for greater consistency in the institutional and procedural application of competitive neutrality and its enforcement.⁴

Reporting of competitive neutrality compliance

Another concern is that the reporting of competitive neutrality compliance has been patchy. In some recent years the publication of the 'competitive neutrality matrix' on the COAG or Council on Federal Financial Relations websites has not occurred for a year or more after the end of the relevant financial year. At the time of writing (15 May 2017) the most recent published matrix is for the 2014-15 financial year.

The former COAG Reform Council expressed concern about the quality of the explanation of exceptions and variations to the competitive neutrality principles in earlier reporting by governments, and raised questions about the effective implementation of the 2006 agreement for 'enhanced application' of competitive neutrality.⁵

Recommendations to strengthen competitive neutrality

Based on these experiences and assessments, and with government re-emerging as an owner of significant new infrastructure businesses, we believe there is a need for the government to restate its strong commitment to the competitive neutrality policy and implement clear procedures for its application that set out:

- principles for identifying and specifying non-commercial objectives of government businesses and how those activities should be transparently funded

4. Victorian Competition and Efficiency Commission, *Competitive Neutrality Inter-Jurisdictional Comparison Paper*, February 2012

5. COAG Reform Council, *Seamless National Economy: Report on Performance 2011–12*

- guidance on how competitive neutrality should be applied to new, start-up government businesses, for example, on the matter of the length of time over which a commercial rate of return should be achieved
 - the Business Council supports the suggestion in the Discussion Paper for start-up business activities to be required to publish their pricing policies, including how they will lead to a commercial rate of return within a reasonable period of time
- a clear process for how the government should respond to competitive neutrality investigations including which minister should respond and in what timeframe, with any exemptions endorsed and announced by the minister responsible for competition policy
 - the response should not be solely provided by a minister with a portfolio or shareholding interest in the business under investigation
- time limits for implementing the recommendations of the AGCNCO (or relevant state agency)
- transparent and easy-to-locate reporting on the government's response to findings by the AGCNCO (or relevant state agency) and remedial actions taken.

A single, updated competitive neutrality 'guidelines for managers' document should be made easily available on the Treasury website.

The government should commit to timely and comprehensive public reporting of the competitive neutrality compliance of its businesses, preferably within six months of the end of each financial year. The Business Council supports the suggestion in the Discussion Paper that government entities be required to include a statement on competitive neutrality compliance in their annual reports.

The 'competitive neutrality matrix' should be published on the Council of Federal Financial Relations website within six months of the end of the financial year.

A website should be established for competitive neutrality complaints that makes available the investigation report and the government's formal response, including any remedies that were implemented.

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