



**REVISED CLAUSE 7 STATEMENT ON THE
APPLICATION OF COMPETITION PRINCIPLES
TO LOCAL GOVERNMENT UNDER THE
COMPETITION PRINCIPLES AGREEMENT***

September 2002

***This document contains a statement on the application of competition principles to particular local government activities and functions, as required under clause 7 of the Competition Principles Agreement. It is also being published for the purposes of Part 4 of the *Government Business Enterprises (Competition) Act 1996*.**

It has been produced by the Government of South Australia with the assistance of the Local Government Association of SA.

TABLE OF CONTENTS

1	INTRODUCTION.....	3
1.1	Broad Intent and Policy Elements of National Competition Policy	3
2	REVIEW AND REFORM OF LAWS RESTRICTING COMPETITION	5
2.1	Existing By-laws.....	5
2.2	New Legislative Proposals.....	5
3	STRUCTURAL REFORM OF PUBLIC MONOPOLIES	5
3.1	Industry Regulation	6
3.2	Review of Structure.....	6
4	COMPETITIVE NEUTRALITY	6
4.1	Corporatisation.....	7
4.2	Commercialisation.....	7
4.3	Cost Reflective Pricing.....	8
5	SIGNIFICANT BUSINESS ACTIVITY	8
5.1	Definitions	8
5.2	Cost-Benefit Assessment.....	10
6	COMPETITIVE NEUTRALITY COMPLAINTS.....	10
7	REPORTING.....	11
	Appendix 1 Definition of “Public Trading Enterprises” and “Public Financial Enterprises”	13

1 INTRODUCTION

In 1994 the Council of Australian Governments (COAG) – made up of the Commonwealth Government, each of the State and Territory Governments and the Australian Local Government Association – accepted, in principle, the recommendations of a report entitled *National Competition Policy*, commonly referred to as “the Hilmer report”. This report was the outcome of an inquiry, chaired by Professor Fred Hilmer, into improving resource allocation within the Australian economy through increased competition.

In April 1995 COAG endorsed a package of legislative and administrative reforms to implement most of the recommendations of the Hilmer report. This package of reforms included the Competition Principles Agreement (see www.ncc.gov.au for the full text). Clause 7 of that agreement required each State and Territory government to prepare a Clause 7 Statement on the application of competition principles to particular business activities and functions of local government, in consultation with local government.

An initial Clause 7 Statement was agreed between the South Australian Government and the Local Government Association of South Australia in 1996, after appropriate consultation. The statement was revised in May 2002 after further consultation between the parties. This July 2002 version of the Clause 7 Statement has been reorganised and revised to be consistent with the revised State Competitive Neutrality Policy of July 2002 (available at the Department of Premier and Cabinet website, www.premcab.sa.gov.au).

The Clause 7 Statement and the *Government Business Enterprises (Competition) Act 1996* provide the framework for implementing National Competition Policy by local government entities in South Australia.

1.1 Broad Intent and Policy Elements of National Competition Policy

The main aims of National Competition Policy are to:

- develop an open and integrated Australian market for goods and services by removing unnecessary barriers to trade and competition;
- ensure no buyer or seller in a market is able to engage in anti-competitive conduct against the public interest;
- as far as possible, apply the same rules of market conduct to all market participants, regardless of the form of business ownership – that is government business activities should not enjoy any net advantages solely as a result of their public ownership; and
- ensure that regulation of business activities which restrict competition is subject to an assessment of the likely costs and benefits.

National Competition Policy does not mean competition at any cost. The Hilmer report, at page xvi states:

Competition policy is not about the pursuit of competition per se. Rather it seeks to facilitate effective competition to promote efficiency and economic growth while accommodating situations where competition does not achieve efficiency or conflicts with social objectives.

Introducing competition principles will not be required in all circumstances. For instance, reform of legislation which restricts competition is not required where the public benefits of the restriction outweigh the costs generated by the restriction. Similarly, the principles of competitive neutrality only need to be implemented where they are appropriate and only to the extent that the benefits to be realised from the implementation outweigh the costs. Other considerations which might come into play in assessing the implementation of competition principles include the issues caused by: lack of a market; the remoteness of facilities; small scale of the operations; high administrative costs which will ensue; social welfare issues; equity and community service considerations.

The key policy elements of National Competition Policy are:

- extending the *Trade Practices Act 1974* to cover government businesses and natural persons;
- providing access, on equitable conditions, to services provided by infrastructure of national significance;
- providing a mechanism for the oversight of prices charged by monopolistic government business enterprises;
- requiring the review of structural arrangements, including the removal of regulatory functions, before the introduction of competition into a market traditionally supplied by a public monopoly or the privatisation of a public monopoly;
- application of competitive neutrality principles and practices to significant government business activities;
- the review of legislation to ensure that, where legislation which restricts competition is identified, alternative means for achieving the objectives of the legislation are considered and, if no suitable alternatives are available, to assess whether the public benefits of the restriction outweigh the costs generated by the restriction; and
- introducing reforms to improve competition in the electricity, gas, water and road transport sectors.

Important Note: National Competition Policy *does not* require governments to divest themselves of business activities, to contract out services or to engage in competitive tendering for the purchase of goods and services. Decisions of this nature are policy decisions of the governments themselves.

Three of these elements require specific action by local government in South Australia. They are:

- competitive neutrality;
- the review of all local government by-laws;
- structural reform of public monopolies.

2 REVIEW AND REFORM OF LAWS RESTRICTING COMPETITION

Many impediments to effective competition are included in Acts, regulations and by-laws. The Competition Principles Agreement requires that all laws and by-laws restricting competition be reviewed, and, where appropriate, reformed by 30 June 2002. All proposals for new legislation must also be reviewed.

2.1 Existing By-laws

Any regulation, including a local government by-law, which places barriers on market entry or conduct or discriminates between competitors is a restriction on competition. While such restrictions may be required in the public interest it is important that existing local government by-laws which restrict competition are reviewed. The review should examine whether the community benefits of each restriction on competition through legislation outweigh the cost, and if so, whether restricting competition is the only means of achieving the objectives of the by-law.

The review of existing local government by-laws must:

- clarify the objectives of the by-law;
- identify the nature of the restriction on competition;
- analyse the likely effect of the restriction on competition and on the economy generally;
- assess and balance the costs and benefits of the restriction;
- consider alternative means for achieving the same result, including non-legislative approaches.

2.2 New Legislative Proposals

Local government entities should not forward to State Parliament any new by-law restricting competition unless the statement accompanying the by-law demonstrates that:

- the benefits of the restriction to the community as a whole outweigh the costs;
- the objectives of the legislation can only be achieved by restricting competition.

3 STRUCTURAL REFORM OF PUBLIC MONOPOLIES

The Competition Principles Agreement indicates that each party to the agreement is free to determine its own agenda for the reform of public monopolies. The National Competition Policy does not require that governments privatise statutory corporations or outsource the supply of services.

Where, however, a government determines to privatise a statutory monopoly or to introduce competition into a market traditionally supplied by a public monopoly, then industry regulation and structural arrangements need to be considered as set out in 3.1 and 3.2 below.

3.1 Industry Regulation

No monopoly business operated by a local government agency is to retain any responsibility for industry regulation if it becomes subject to competition or if it is privatised.

3.2 Review of Structure

Before a local government agency introduces competition to, or sells, a monopoly business it will conduct a review jointly with the State Government into the matters required under clause 4(3) of the Competition Principles Agreement.

If a change in State regulation is to result in the introduction of competition for a local government monopoly business, the State Government will consult relevant local government entities in the course of conducting the required review.

4 COMPETITIVE NEUTRALITY

The broad intent of competitive neutrality is to ensure that where governments and local governments provide goods and services in a competitive market these business activities do not have an unfair advantage over private sector businesses by virtue of their government or local government ownership. In this situation, these businesses should be subject to the same rules and regulations as private businesses, including the application of similar costs for taxes and borrowings.

Government and local government businesses may enjoy advantages in the running of those businesses that the private sector cannot access. Such advantages could include:

- an operational structure that does not separate commercial and non-commercial activities;
- being able to operate without the pressure of business risk, e.g. no fear of liquidation;
- non-payment of taxes;
- access to cheaper finance;
- exemption from certain legislation.

The objective of competitive neutrality is to eliminate those competitive advantages, either by the removal of the advantage or by applying some surrogate which neutralises the advantage (e.g. a tax equivalent regime, debt guarantee fees).

It is important to understand that competitive neutrality applies only to government and local government businesses and business activities. The non-business, non-profit activities that governments engage in because they are governments are not subject to National Competition Policy.

There are three major mechanisms available to implement competitive neutrality:

- Corporatisation
- Commercialisation
- Cost Reflective Pricing

The appropriate measure to be applied to a significant local government business activity will depend on a number of factors including: the costs and benefits of applying the policy; the organisational context of the activities exposed to competition; the level of resources used in the supply of the good or service; and any special requirement such as increased accountability or a greater emphasis on efficiency.

Once the appropriate measure is selected, whether or not it is implemented must be judged against whether the public benefits outweigh the costs of the implementation (see clause 3(6) of the Competition Principles Agreement, available at www.ncc.gov.au).

4.1 Corporatisation

This involves the creation of a separate legal entity (business) to provide the relevant goods or services. Such an entity is characterised by:

- clear and non-conflicting objectives;
- managerial responsibility, authority and autonomy;
- effective performance monitoring; and
- effective rewards and sanctions related to performance.

Local government agencies considering whether to adopt a corporatisation model for their business activities may make use of material published on the concept by the State or Commonwealth Governments and the experience many local government agencies have already acquired in setting up separate business entities under sections 42 and 43 of the *Local Government Act 1999*.

4.2 Commercialisation

This means the application of “commercial practices” to business elements of the organisation (e.g. business units), but without setting up a separate legal entity. Typically, there are a number of attributes of commercialisation, not all of which need to be implemented to achieve competitive neutrality. The attributes include:

- the clear definition and delineation of commercial and non-commercial activities, generally through a business plan;
- separate accounting for and funding of non-commercial activities;
- clear commercial performance targets;
- the separation of regulatory functions from any commercial activity;
- the valuation of all assets used in the specific business activity on a deprival value basis;
- the determination of an appropriate return on investment based on the assets employed in the business activity;
- the application of a tax equivalent regime;
- the application of debt guarantee fees;
- clear reporting requirements;
- separate financial recording and reporting;
- arrangements for the allocation of “profits” from the business activity.

4.3 Cost Reflective Pricing

Corporatisation or commercialisation can be difficult to apply to smaller business activities. This is likely to be the case for most local government business activities, given their generally small scale (e.g. caravan parks) or the likelihood that the activity is a small portion of a broader local government function (e.g. private road works). In such cases the application of cost reflective pricing will be appropriate to comply with competitive neutrality. Cost reflective pricing is a calculation of the cost of providing the service, taking account of:

- the actual costs of providing the good or service on a full-cost basis;
- the cost advantages of local government ownership (e.g. non-payment of taxes, lower cost of finance, mix of commercial and non-commercial activities, exemption from the operation of legislation);
- the cost disadvantages of local government ownership (e.g. increased accountability and administration, higher award rates or costs associated with enterprise agreements, higher superannuation contributions);
- return on investment and dividend payments to local government owners;

to arrive at a price which is competitively neutral.

Cost reflective pricing may be introduced by ring-fencing the business from other activities of the local government authority, or within the authority's structure, depending on the size of the activity.

Over the long term, the price for the goods or services provided should largely reflect this cost. However, the price will also take account of the market place, pricing strategies, technological advantages or disadvantages of competitors and the level of competition in the market place.

5 SIGNIFICANT BUSINESS ACTIVITY

5.1 Definitions

Competitive neutrality principles should be applied, where appropriate, to a **significant business activity** carried out by a **local government agency**, unless the **costs of implementing the principles are greater than the benefits** to be realised from the implementation. Whether a business is significant will depend on its size and influence in the relevant market.

A **local government agency** includes a council, a body established by a council or councils under the Local Government Act 1999 and the Local Government Finance Authority of South Australia.

A **business activity** includes any activity undertaken:

- (a) which falls within the Australian Bureau of Statistics classification of “Public Trading Enterprise” and “Public Financial Enterprise” (refer Appendix 1); or
- (b) where:
 - (i) the activity is primarily involved in producing goods and services for sale in the market; and
 - (ii) the activity has a commercial or profit-making focus; and
 - (iii) there is user charging for goods and/or services; and
 - (iv) the activity is not primarily funded from rate or grant revenue; or
- (c) where the local government agency submits a tender as part of a tendering process in competition with the private sector.

However, an activity will not be a business activity if:

- (d) it provides goods or services to the local government agency and for reasons of policy or law there is no competition with alternative suppliers; or
- (e) it is clear that the intention of the local government agency is that the activity’s predominant role is regulatory or policy-making, or where the achievement of community benefits is the main priority of the activity.

Whether an activity is a significant business activity to which competitive neutrality principles should be applied is a matter for each local government agency to determine. This determination should be made taking into account:

- the intent of National Competition Policy;
- whether the business activity possesses sufficient market power to create a competitive impact in the market that is more than nominal or trivial;
- whether the size of the business activity relative to the size of the market as a whole is more than nominal or trivial.

Significant business activities are categorised as follows:

- Category 1:* business activities with an annual revenue in excess of \$2 million, or employing assets in excess of \$20 million.
- Category 2:* all other significant business activities.

5.2 Cost-Benefit Assessment

In making an assessment of **costs and benefits** of implementing competitive neutrality local government agencies will take into account:

- any broad material policy considerations, including:
 - Government legislation and policies relating to ecologically sustainable development;
 - social welfare and equity considerations, including community service obligations;
 - Government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity;
 - economic and regional development, including employment and investment growth;
 - the interests of consumers generally or of a class of consumers;
 - the competitiveness of Australian businesses;
 - the efficient allocation of resources;
- the impact on actual and potential competitors of the relevant local government business activity;
- local policies relating to economic and business development, local employment, quality of supply of goods and services, including the timeliness of supply;
- the impact on the local community;
- the impact on the State and national economies, if any.

Possible benefits to be considered include:

- increased market contestability, which produces incentives for lowering costs and increasing choice for consumers;
- improved assessment of the performance of a significant business activity, which will lead to operating efficiencies;
- the clearer definition of the objectives and roles of business and non-business components of local government operations.

Possible costs include:

- management and cultural changes;
- research and analysis to determine cost reflective pricing arrangements;
- administration of tax equivalent and debt guarantee frameworks;
- compliance and the monitoring of compliance.

6 COMPETITIVE NEUTRALITY COMPLAINTS

Competitive neutrality needs to be implemented in an open and accountable manner. To ensure the necessary transparency, local government agencies must adopt appropriate procedures for handling complaints about the manner in which competitive neutrality has, or has not, been implemented.

Where a local government agency establishes a system for handling complaints about competitive neutrality, or modifies an existing complaints handling process to deal with

competition complaints, it must ensure that any complaint is dealt with by a party independent of the matter or decision which is the subject of the complaint.

Complaints about local governments agencies should be addressed to the Competitive Neutrality Complaints Secretariat in the Department of Premier and Cabinet, 200 Victoria Square, Adelaide, SA 5000. They must be in writing and contain full details of the alleged infringement. The Secretariat will refer the complaint to the local government agency concerned for investigation, response and possible resolution. Where a complaint cannot be resolved satisfactorily between the local government agency and the complainant, and the complainant wishes to pursue the complaint, consideration will be given to assigning it to the Competition Commissioner for investigation.

On assignment of a complaint the Commissioner will conduct an investigation and report on whether the complaint has been substantiated and the reasons for the decision. Complaints will be assessed by the Commissioner using the competitive neutrality policy in place at the time the investigation is assigned. If the principles have been infringed, the Commissioner may recommend the implementation of policies and practices to avoid further infringement.

A summary of the decision will be prepared and be publicly available on the Department of Premier and Cabinet internet site (www.premcab.sa.gov.au). The summary will not contain confidential information.

Any investigation of a competitive neutrality complaint must ensure that sensitive or confidential information is safeguarded. It is not the intent of this Clause 7 Statement that commercially sensitive or confidential information be released into the public domain, or that commercially sensitive or confidential information provided by one of the parties to a complaint be provided to another without express permission.

Where a complaint against a significant business activity has been previously investigated by the Commissioner and the significant business activity was found to be fully complying with the appropriate principles of competitive neutrality, further complaints will not be assigned to the Commissioner for investigation unless:

- the nature of the significant business has changed; or
- the competitive neutrality principles being applied have changed.

7 REPORTING

Each local government agency shall include in its annual report, wherever relevant, information in relation to:

- the commencement or cessation of significant business activities controlled by the agency;
- the competitive neutrality measure applied to each significant business activity controlled by the agency;
- the review and reform of by-laws which restrict competition, including proposals for new by-laws;
- complaints received alleging a breach of competitive neutrality principles by the agency;

the structural reform of public monopolies.

The information included in the annual report may be in summary form.

Appendix 1 Definition of “Public Trading Enterprises” and “Public Financial Enterprises”

These definitions are adapted from material in the ABS publication (5512.0 – 1996/97), *Government Finance Statistics*, specifically page 63.

Public trading enterprises - Commonwealth, State/Territory and local government undertakings which aim at covering most of their expenses by revenue from sales of goods and services, including major commodity marketing authorities.

Public financial enterprises - Commonwealth, State/Territory and local government bodies primarily engaged in financial transactions in the market involving both incurring liabilities and acquiring financial assets.