

Identification and management of significant business activities by local government in Tasmania to comply with competitive neutrality principles

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1. Introduction

This document has been prepared to provide guidance to Local Government on the definition and reporting of significant business activities for the purposes of competitive neutrality in accordance with the *National Competition Policy: Applying the Principles to Local Government in Tasmania*, December 2013 (Application Statement) (www.treasury.tas.gov.au).

This document and the 2013 Application Statement apply not only to individual councils and their activities but also to single and joint local government authorities established under the *Local Government Act 1993*.

The 2013 Application Statement is designed to assist Local Government in the continued application of competition principles to its activities. This document is to be used in conjunction with the 2013 Application Statement.

The application of competitive neutrality principles, under National Competition Policy (NCP), continues to be sound public policy. Local Government bodies are encouraged to proactively consider the application of competitive neutrality with regard to the delivery of those activities that actively compete, or could compete, with the private sector.

This document overrides all previously issued guidelines and materials on the identification of significant business activities by local government.

2. Competitive neutrality

NCP requires that government businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership. This is the principle of 'competitive neutrality'. The objective of competitive neutrality is the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities so that ultimately all government businesses compete on fair and equal terms with private sector businesses, where this is in the public benefit.

Competitive neutrality principles are only required to be implemented to the extent that it is in the public benefit.

As described in the 2013 Application Statement, there are two separate methods for implementing competitive neutrality principles: the corporatisation model and the full cost attribution model.

The 2013 Application Statement sets out a staged approach to the implementation of competitive neutrality which reflects the principles set out in subclauses 3(4) and 3(5) of the *Competition Principles Agreement*, one of the three Agreements that comprise the National Competition Policy.

This involves:

- Local Government bodies identifying all business activities;
- Local Government bodies identifying which of these are significant business activities;
- application of full cost attribution (including cost reflective pricing) to those significant business activities;
- identification of those significant business activities which are potentially suitable for corporatisation;
- undertaking a public benefit assessment of the corporatisation of those business activities; and

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- corporatisation of those business activities where a public benefit assessment indicates that the benefits outweigh the costs of doing so.

This document will focus on the first two steps – identifying business activities and significant business activities. Councils and other Local Government bodies should refer to the documents listed later in this document.

Under NCP, the application of competitive neutrality principles applies only to significant business activities. However, there is no prescribed definition of “significant business activities”. A Local Government body must make its own assessment to determine whether, in each case, an activity is:

- a business; and if so
- a significant business.

To ensure that Local Government meets its NCP obligations, it is important that significant business activities are identified and that the list of these activities is regularly reviewed. In addition, the principles are only to be applied to these activities to the extent that it is in the public benefit, as set out in section 4.2.

3. Step 1 – definition of business activity

The first part of the assessment clarifies whether an activity is a business, rather than a regulatory or governance function.

The National Competition Council considers that, in defining a business activity, the relevant considerations are the nature of the activity and the contestability of the market. In line with this, a business activity is one that involves the production of goods and/or services in a market that is, or has the potential to be, competitive.

Certain activities are excluded from this definition:

- isolated and one off transactions are not business activities. Business activities must involve repetition and regularity;
- regulatory or policy functions are not business activities and nor is the imposition of fees and charges associated with performing such functions;
- taxing and licensing activities are excluded; and
- services provided and used solely by a Local Government body, whether or not under a tied contract arrangement, are not subject to the competitive neutrality principles agreed under the Competition Principles Agreement.

The fact that there is no competition, actual or potential, with other providers of the same goods or services does not automatically imply that an activity is not a business, as the Local Government body may be setting artificially low prices and so preventing potential competitors from entering the market. For example, providing goods or services free of charge does not necessarily mean that the provision is not made in the course of a business activity.

The provision of a good or service that is considered to be necessary or essential, or involving an element of public service, does not prevent an activity from being considered a business activity.

The ultimate decision as to whether an activity is a business activity may need to be resolved by the Tasmanian Economic Regulator in the event of a complaint under the *Economic Regulator Act 2009*. Examples of such decisions are referred to in the *State Government Entities Directions Paper – Recreational Vehicle Overnight Camping Services*, September 2012, listed later in this document.

4. Step 2 – determining if a business activity is significant

Once an activity has been determined to be a business activity, the next step is to determine if it is a significant business activity. A business activity will not necessarily be significant simply because a competitor alleges that it is adversely affected by that business.

A defined financial threshold measure (such as turnover) is not a satisfactory indicator of significance, as it may not reflect the actual or potential impact of that business' activities on other businesses, especially in small markets such as those in and between municipalities. Financial size is a necessarily arbitrary measure and difficult to apply on a consistent basis across Australia.

Neither should significance be determined according to the Local Government body's expenditure or revenue on an activity relative to that body's total revenue or expenditure. The impact of the activity on the relevant market is a more appropriate indicator.

Useful questions for assessing "significance" are:

- What is the relevant market?
- What is the size of the relevant market and of the Local Government body's activity compared to the whole market?
- What is the competitive impact (including the potential competitive impact) of the business activity in the relevant market? Is the business activity a major player in the overall market? If the business activity is the only local or regional provider of the service to the community, would competitors emerge if tenders were called?

Single and joint local government authorities are required to adhere to competitive neutrality principles under section 36 of the Local Government Act when performing their functions outside municipal boundaries.

4.1 Who determines Significance?

The responsibility for initially assessing whether a business activity is significant, and for applying the competitive neutrality principles as appropriate, rests with the relevant Local Government body.

All councils are required to identify SBAs for reporting purposes, as detailed in Part 6 of the Act, and for the application of competitive neutrality principles. It is not the role of the Departments of Treasury and Finance or Premier and Cabinet (Local Government Division) to oversee councils' work in this matter.

The assessment of "significance" involves a degree of judgement, and this makes it critical for a Local Government body to document its reasoning so that its assessment of significance is defensible and can withstand scrutiny.

In the event of receiving a complaint alleging a breach of competitive neutrality principles, the Regulator has a statutory responsibility to undertake a preliminary assessment to determine whether or not an investigation of the complaint is necessary or appropriate. The process for investigating complaints is set out in the Economic Regulator Act. In determining whether a complaint is justified, the Regulator is called upon to determine, amongst other things, whether or not the complaint is related to a significant business activity.

The steps taken by the Regulator in determining this are detailed in the *Competitive Neutrality Complaints Guideline*, 2010, published by the Regulator.

4.2 Onus of Proof: Public Benefit Test

As noted above, the competitive neutrality principles must be applied, unless it can be demonstrated that it is in the public interest not to do so. The onus is therefore on Local Government bodies to conduct an objective public benefit test to substantiate a view that the public benefit will not be served by applying competitive neutrality.

For example, if a complaint is lodged with the Regulator that the competitive neutrality principles have not been applied to a Local Government body's SBA, the Local Government body must be able to demonstrate that its earlier decision to not apply, or fully apply, the competitive neutrality principles was based on a robust and independent public benefit test.

If the Regulator accepts that the public benefit case justifies not applying some or all of the competitive neutrality principles, it is possible that the complaint may not be upheld, as there would be no breach of the principles. It is therefore in the interests of Local Government bodies to undertake an objective and robust assessment of the costs and benefits of applying the competitive neutrality principles to SBAs if there is doubt as to whether it is in the public benefit to apply the principles, in part or in full.

5. Remaining steps – application of the competitive neutrality principles to SBAs

Once Local Government bodies have identified their SBAs in accordance with the guidelines contained in this document, the following steps must be taken to fulfil the State's competitive neutrality responsibilities:

- apply full cost attribution and cost reflective pricing to all SBAs, unless the costs exceed the benefits of doing so;
- identify those SBAs which are potentially suitable for corporatisation and, for those SBAs identified, undertake a public benefit assessment of corporatisation; and
- corporatise those SBAs where a public benefit assessment indicates that the benefits outweigh the costs of doing so.

For more detailed information in relation to the application of the competitive neutrality principles, please see the following document:

- *National Competition Policy: Applying the Principles to Local Government*, December 2013 (www.treasury.tas.gov.au).

Additional information can also be obtained from the following documents:

- *Corporatisation Principles for Local Government Business Activities*, December 1998 (www.economicregulator.tas.gov.au);
- *Full Cost Attribution Principles for Local Government*, June 1997 (www.economicregulator.tas.gov.au);
- *Application of the Competitive Neutrality Principles under National Competition Policy*, June 1996 (www.economicregulator.tas.gov.au);
- *Community Service Obligation Policy and Guidelines for Local Government in Tasmania*, November 2000 (www.dpac.tas.gov.au); and
- *State Government Entities Directions Paper – Recreational Vehicles Overnight Camping Services*, September 2012 (www.treasury.tas.gov.au).

Further information is also available on the National Competition Policy website at ncc.gov.au.

In particular, it is recommended that Local Government bodies review the document titled *Community Service Obligation Policy and Guidelines for Local Government in Tasmania* when determining the manner in which prices will be set in order to meet competitive neutrality principles. For example, a council can still satisfy objectives such as social objectives while meeting the competitive neutrality principles by ensuring that the manner in which these objectives are met is clear and transparent in the council's reporting and pricing.

6. Review and reporting

It is recommended that Local Government bodies regularly review their activities to determine if there are any new activities which should be classified as SBAs, or existing activities which have changed such that they now warrant classification as SBAs, and to which the competitive neutrality principles should be applied.

Accordingly, councils will report details of their SBAs in their annual reports.

The specific reporting requirements for annual reports are discussed below. Councils are required by section 72 of the Local Government Act to prepare an annual report, and to include any matter which is prescribed.

Further, section 84(2)(da) requires all councils to include in their annual report a statement of the operating, capital and competitive neutrality costs in respect of each SBA undertaken by these councils during that financial year, together with a statement of the revenue associated with that activity.

The State Government requires councils to demonstrate their compliance with NCP by also reporting on the following matters in their annual reports:

- a list of the councils' SBAs as determined by councils and any determined as such by the Regulator following a competitive neutrality complaint;
- the outcome of any public benefit assessments undertaken in relation to the extent to which the competitive neutrality principles should be applied to a SBA;
- any complaints received and the outcome of investigation of those complaints; and
- any actions taken by a council following a competitive neutrality investigation by the Regulator.

These items are required by section 84 of the *Local Government Act 1993* and are also set out in the Treasury document *National Competition Policy – Applying the Principles to Local Government in Tasmania*.

7. Contact

Copies of this document can be obtained from the Economic Policy section of the Treasury website: <http://www.treasury.tas.gov.au> or by contacting Treasury as set out below:

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