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Competitive Neutrality and State-Owned Enterprises in Australia

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REVIEW OF PRACTICES AND THEIR
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Matthew Rennie, Fiona Lindsay

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Abstract

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

By Matthew Rennie & Fiona Lindsay¹

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.

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- the increasing level of inter-State and Territory economic activity (given existing ad hoc competition arrangements³);
- 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 report¹³ (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 1995¹⁷ 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 noted³² 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

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