

Contact: Heather Cerutti
Phone No: (03) 6233 5603
File No: COM014 HC/AR
Our Ref: 05/12518

General Managers
All Tasmanian Local Government Councils

Dear General Manager

COMPETITIVE NEUTRALITY COMPLAINTS MECHANISM

I am writing in regard to an issue raised with the Government Prices Oversight Commission in its role in investigating breaches of the Competitive Neutrality Principles (CNPs) under National Competition Policy (NCP). As you are aware, Treasury has recently amended its Guideline for National Competition Policy *Applying the Principles to Local Government in Tasmania* (the Guideline). Under the revised Guideline it is the Commission not the Council that determines whether a business activity is a significant business activity to which the CNPs are to be applied.

A recent case raised with the Commission has raised some important issues in regard to the determination of what business activities may be determined to be significant business activities to which the CNPs must be applied in accordance with NCP and the impact of Council's regulatory, planning and licensing functions on the market. The Hobart City Council also recently requested advice on how the Commission would make a determination as to whether a business activity was a significant business activity. The following outlines the approach the Commission has taken in relation to State Government business activities.

In considering whether a Government business activity is 'significant', the general approach that I have adopted in investigating CNPs complaints is to look to the influence, or the potential influence, of the Government business activity on the market. The factors considered in this regard are: what is the relevant market for the good or service, including whether there are ready substitutes for the good or service; the barriers to entry in the market; the degree of concentration in the market, including the number of competitors and market shares; the dynamic characteristics of the market; the relative importance of that market in the economy, including the criticality of the good or service provided; and the potential impact on other markets (eg the loss of efficiency in an upstream or downstream market). This approach is similar to that adopted by other regulatory bodies in examining competition and market power issues, for example, the Australian Competition and Consumer Commission (ACCC) in examining merger

proposals. However, markets naturally change over time, and therefore, whether a business activity is a significant business activity can only be established taking into account the facts of each case at the time the complaint arises.

Markets change as the number of competitors, the relative size of the competitors, and the availability of substitutes etc vary over time. Further, Governments and Councils through their own regulatory, planning and licensing functions have the potential to impact on these parameters and thus alter how the market functions. For instance, license restrictions may limit the number of competitors in the market. Therefore, Councils (and State Government Agencies) need to be mindful of the potential impact of each of its decisions, including decisions made in relation to its regulatory, planning and licensing functions, on the market and thus the status of its business activities. Some of these decisions may give rise to NCP obligations in relation to those business activities. I am aware that State Government Agencies are required to review periodically their business activities to establish whether the structure of the market or the significance of the business activities within the market has altered. You may wish to consider this approach and also consider consciously reviewing the impact of regulatory, planning or licensing decisions on the business activities of the Council and any potential downstream markets.

As you are aware, the application of the CNPs by Government business activities is also subject to a 'public benefit test'. The CNPs only require the application of full cost attribution to significant business activities 'to the extent that the benefits to be realised outweigh the costs'. To assist Government Agencies and Local Government in this regard the Government issued its *Guidelines for Considering the Public Benefit under the National Competition Policy* in March 1997. The public benefit test should, amongst other things, consider the potential effect of the behaviour of the Government business activity on competitors in the market. I do not believe that the additional costs associated with full cost attribution are likely to be material in most circumstances, as management are likely to be applying some form of activity based costing to these activities. Nevertheless, if a robust public benefit test has been applied to the business activity and the relevant Government body has determined that there is no net benefit from applying full cost attribution, then the CNPs will not apply to that business activity. Therefore, under the CNPs, in addition to considering whether an activity is a significant business activity, I must necessarily take into account the outcome of any public benefit test in making any determination as to whether full cost attribution should be applied.

I hope this is of assistance in the Council in undertaking future reviews of its business activities and the Council's NCP obligations. If you have any queries in relation to the above, please contact Ms Heather Cerutti on telephone 6233 5603 or by email to Heather.Cerutti@treasury.tas.gov.au.

I also intend to publish this letter on the Commission's website www.gpoc.tas.gov.au.

Yours sincerely

A handwritten signature in black ink, appearing to read 'A. Reeves'.

Andrew Reeves
COMMISSIONER

10 June 2005

cc: Local Government Association of Tasmania
Department of Treasury and Finance
Office of Local Government, Department of Premier and Cabinet