November 2014

Competition Policy Review Draft Report – NSW Government Submission

Contents

Executive summary

The NSW Government is firmly committed to improving competition. Effective competition, and the innovation it inspires, is a critical driver of productivity and economic growth. It enables a healthy and dynamic business and public sector, and improves the wellbeing of consumers and the wider community. The Competition Policy Review provides a timely opportunity to reinvigorate the microeconomic reform agenda across the nation.

NSW welcomes the Panel's Competition Policy Review – Draft Report. The Draft Report has highlighted a number of key areas for reform to competition policy, law and institutions. NSW supports the Review's emphasis on maintaining an ongoing focus on competition policy to ensure it remains effective and delivers benefits to consumers and businesses.

We welcome the Panel's recommendations to improve the competitiveness of various industries in Australia. If implemented, they would deliver reform to overturn a range of decisions by Commonwealth, State and local governments over many years that resulted in unnecessary regulatory impediments to competition in a number of sectors in Australia.

The NSW Government has been taking steps to improve competition in the State, including by engaging the private sector in service delivery and infrastructure provision, and streamlining regulation. The NSW Government is committed to further reforms to increase the attractiveness of NSW as a place to work and invest. Other areas identified by the Panel will require the Commonwealth to take a leadership role in progressing reforms that affect national markets, such as parallel imports, coastal shipping and intellectual property arrangements.

The Commonwealth Government also has a key leadership role to play in supporting and encouraging jurisdictions to work together to achieve reforms. Ultimately many of the proposed reforms involve upfront costs to some parties, while the benefits are likely to be dispersed and take time to be finalised.

NSW welcomes the Panel's recommendation of using competition payments. NSW calls on the Commonwealth to use the future boost to its revenues to fund a further round of competition payments going forward. Competition payments are critical not only to help facilitate, incentivise and lock-in reforms, but also to help share the economic growth and revenue benefits from competition reforms that largely accrue to the Commonwealth government.

The NSW Government supports some of the draft recommendations in principle, but more work is required to better explain the scope of reform and how the recommendations would be implemented. The issues identified by the Panel are important, and many involve significant areas of State responsibility, and could have large implications and risks for the States.

The Draft Report also needs to be considered in the context of the wider debates taking place as part of the White Papers on the Reform of the Federation and Reform of the Taxation System. Many of the draft recommendations move towards cooperative federal

structures and reduced State-based regulation. This will make sense in areas where there are clear benefits from national markets and national regulatory frameworks. However, there will be other areas where it will make more sense for States to retain control over their arrangements, while still allowing competitive national markets to develop and competition to be enhanced.

This submission focuses on six key areas:

1. **Competition institutions:** The case for change is strongest where there are identified gaps in regulatory and institutional arrangements and where there would be clear net benefits from making a change. This acknowledges that change is not costless, and that there are existing institutional capabilities. In the case of a national access and pricing regulator, there may be benefits in consolidating the regulatory functions of multiple national regulators into one entity (e.g. gas, electricity and telecommunications) where national infrastructure markets exist and where there are industry sectors already regulated under a national regime.
2. **Applying competition law to government activities:** While recognising the importance of competition when government undertakes commercial activities, NSW notes there are potential costs and risks associated with further extending competition laws to government. There is potential to fetter and add complexity to legitimate policy intent so careful consideration is warranted to avoid potentially unforeseen consequences. Given the potential costs and constraints on government, NSW recommends that if they are to be applied at all, competition laws should only be further applied to government activities where there is a demonstrable net benefit.
3. **Merger exemption processes:** NSW agrees with the Panel's view that merger exemption processes should be accessible and effective. It is of paramount importance to NSW that applicants have timely access to review of ACCC decisions and other actions, including informal clearances, by the Australian Competition Tribunal. Any changes to law or practice which constrain current rights to review by the Australian Competition Tribunal (and the Federal Court) would be detrimental to the State's interest in undertaking major transactions. The Panel's recommended changes to the formal merger exemption process in Draft Recommendation 30 have potentially significant implications for how businesses finalise major transactions. NSW considers that the Panel's proposed changes to the formal merger exemption mechanism may not help to resolve the issue of improving the timeliness and effectiveness of the decision making process.
4. **National Access Regime:** The provisions of the National Access Regime under Part IIIA of the *Competition and Consumer Act 2010* (CCA) should be clarified and consistently applied to ensure that third party access is only mandated where there is a net public benefit in doing so. NSW considers that the Part IIIA regime should continue to be applied in limited circumstances where its application would result in a net public benefit.

5. **Competitive neutrality:** It is timely for all jurisdictions to review their competitive neutrality policies with a view to clarifying and strengthening their application. It is also timely for all States to review competitive neutrality policies as they apply to local governments with a view to recommitting local governments to the application of competitive neutrality requirements and ensuring effective complaints handling mechanisms. However, NSW is concerned with the proposal to establish threshold tests to determine what constitutes a significant business activity.
6. **Human services:** NSW agrees with the Panel that there are potentially significant gains from introducing greater choice and diversity in human services.
    - A holistic approach should be taken to reform, recognising that there is a broad range of options which can deliver the benefits of greater competition and contestability in human service delivery. Whether choice-based models or separation of funding, regulation and service delivery are appropriate should be assessed on a case-by-case basis.
    - The benefits and costs of a nationally-driven reform agenda should be assessed. There could be some merit in jurisdictions crafting a high-level agreement on reform principles insofar as it supports an impetus for reform, the development of more viable and efficient national provider markets, and a common understanding of principles underpinning effective competition and contestability in service delivery.
    - A framework to support governments sharing effective strategies and models that can be used to implement more contestable delivery of all government services may be of merit.

Principles, governance frameworks and incentives

NSW sees value in establishing a set of national competition principles that steer reform efforts by governments to promote the long term interest of consumers.

One of the principles set out in Draft Recommendation 1 is that governments should, over time, undertake reforms that support a shift towards separating remaining public monopolies from competitive service elements, and separating contestable elements into smaller independent business activities. NSW supports this principle and considers that it is appropriate to recommit governments to address the unfinished business from the previous National Competition Policy (NCP) reforms.

To this end the NSW Government has undertaken substantial reforms affecting the number and structure of its commercial businesses, including major asset sales and long-term leases of its assets. Reforms are also underway to identify contestable elements in government service delivery, with a view to promoting the benefits of greater choice and diversity in service provision.

As NSW stated in its first submission, and as the Panel has acknowledged, well-designed architecture of competition law and policy institutions is necessary to achieve lasting and ongoing competition reforms.

NSW acknowledges that where there are gaps in institutional arrangements and capabilities, they will need to be addressed. Combining the functions of a number of national regulators may deliver improved outcomes, but where a new national institution is proposed there needs to be a clear case made for the benefits this would provide and why its functions could not be adequately undertaken by existing institutions.

Australian Council for Competition Policy

The business case for establishing a new national body would be strengthened if it included:

- the role it would play in administering competition payments to jurisdictions;
- how it would play a stronger role advocating for, helping develop and overseeing a reinvigorated competition policy agenda; and
- centralising markets studies, with clearly defined roles and responsibilities, particularly relative to other institutions such as the Productivity Commission and the ACCC.

These elements are necessary if there is to be a sharper focus on competition issues and to encourage a stronger commitment to reform overall. They also are necessary to help establish the value proposition, acknowledging that change is not costless and establishing new bureaucracies does present challenges for governments. To the extent that any of these elements are missing, the rationale and support for establishing an ACCP is weakened.

NSW agrees with the Panel that there may be merit in more clearly separating competition policy enforcement functions from the policy setting function due to potential conflicts of interest.

The arrangements for establishing the Australian Council for Competition Policy (ACCP) and its governance structure need to be developed, with careful consideration given to the overarching institutional structure, the proposed governance and funding arrangements, and its broad functions. These details will be required before NSW could agree to the proposal. NSW is supportive of the broad scope of functions of the ACCP, but notes that the Panel's Draft Report indicates a sizeable work program that would require significant resourcing.

Institutional structure

The Panel's Draft Recommendation 39 calls for an intergovernmental agreement to establish the ACCP, and that it be overseen by a Ministerial Council comprised of Treasurers from each jurisdiction as this would help ensure the ACCP is accountable to all jurisdictions. The Panel also recommends that the Treasurer of any jurisdiction should be empowered to nominate members of the ACCP.

The proposed institutional structure may help to build support across Australia for reforms of national significance, as all participants will share in the decision making and help to promote competition within their jurisdictions. The challenge with such a structure is to find a way for the ACCP to be truly independent and to have a national rather than Commonwealth focus.

Governance and funding arrangements

NSW would welcome seeing further detail on an ACCP governance model, including:

- how power would be shared between jurisdictions;
- whether any single jurisdiction will have veto powers; and
- the implications if one or more jurisdictions chose not to participate.

Another important factor which needs to be carefully considered is how the proposed ACCP is funded given that the establishment and ongoing costs could be significant. The Panel recommends that it be funded jointly, though does not provide any detail on how this might work in practice. A useful starting point to think about the funding arrangements would be to consider pooling funding from wrapping up existing bodies (such as NCC) and transferring identified functions (such as from the ACCC), and then looking at how any resulting funding shortfalls might be met.

Proposed functions

As NSW recommended in its first submission, an independent national body should be responsible for monitoring progress in implementing reforms, periodically identifying areas for competition reform, making recommendations on these areas to governments, and playing an advocacy role.

The proposed roles and functions are broad and will create a significant ongoing work program for the ACCP. As such, the ACCP will need to be adequately resourced. In addition, it is evident that the ACCP's independence and national perspective will be of paramount importance to ensure it can deliver a broad work program and to be influential, trusted and authoritative in undertaking its role.

Draft Recommendation 41 proposes that the ACCP be given the power to undertake market studies. NSW agrees that market studies can be a useful tool in addressing concerns about anti-competitive behaviour within a market, but which do not fall within the remit of competition law. A comprehensive review of businesses operating, and the role of government, in the market can help policymakers determine whether policy changes are needed to promote competition. This is particularly important in markets where government policy may be distorting a market or reducing competition.

There is currently no dedicated body to undertake market studies in Australia; market studies are undertaken on an ad-hoc basis by the Productivity Commission, ACCC (through price inquiries) and at a State government level (including regulators, market analysis, ad hoc committees and independent inquiries conducted on behalf of government). This is in contrast to many other established economies, including the United Kingdom, European Commission, United States and Japan, where the competition authority has the power to undertake market studies. The OECD has consistently raised this as an issue in its assessment of Australia's competition framework.

There may be a benefit in centralising the market review function as it would mean that there is a consistent approach taken to undertake market studies and reviews. However, as noted by the Panel, there needs to be clear boundaries between the proposed market studies function for the ACCP and similar functions in other bodies such as the Productivity Commission and the ACCC.

If the ACCP is tasked with the responsibility for undertaking market studies, providing it with mandatory information gathering powers would be important as rigorous market studies require granular market data on prices, costs, margins and market share. However, many companies would be reluctant to provide this commercial-in-confidence data.

NSW supports the Panel's Draft Recommendation 42 in principle, which proposes allowing governments and other market participants to request the ACCP to undertake a competition study of a particular market or competition issue. However, it is important to recognise that the resource requirements on the ACCP arising from the function may be significant. As such, it will be important to ensure that the ACCP is sufficiently well-resourced to deal with the volume of work and has well-established and transparent criteria for prioritising market studies to undertake.

NSW supports the intent of Draft Recommendation 33, which proposes that, were it to be established, the ACCP undertake an analysis of developments in the competition policy environment, both in Australia and internationally, and the proposal in Draft Recommendation 11 that the ACCP undertake a review of regulatory restrictions and make its report available for public scrutiny. However, it may be worth considering undertaking these reviews every two to three years. A less frequent time period recognises the broad scope of functions the ACCP will be charged with carrying out and the significant volume of work involved in such reviews and the slow pace of regulatory reform. Alternately each report could cover developments and certain selected sectors, with the sectors changing each year.

Competition payments

NSW welcomes the Panel's Draft Recommendation 44 which proposes:

- tasking the Productivity Commission with undertaking analysis to estimate the effect of reforms on revenue in each jurisdiction; and
- using competition policy payments to ensure that revenue gains flowing from reform accrue to the jurisdictions undertaking the reform.

The Industry Commission's analysis of the potential impacts of reforms and the distribution of benefits was critically important in the first round of competition policy reform in the 1990's and it established the foundations for the National Competition Payments. A similar modelling exercise by the Productivity Commission will be beneficial as Australia embarks on a second round of competition reforms. However, it is important to recognise that before the modelling can be undertaken it will be necessary to further develop the details of the reforms.

As the Panel has acknowledged, competition payments play a critical enabling role in this institutional framework by encouraging jurisdictions to undertake important reforms where they may otherwise face disincentives from unilateral action. Competition payments are critical as they:

- Redress the misalignment between reform costs and benefits. The largest revenue benefit arising from competition-enhancing reforms which boost economic growth goes to the Commonwealth, through the increase in tax revenue, though for many types of reform the costs are largely borne by State governments.
- Contribute to the implementation costs of reform that are borne by the States, which are typically upfront while the benefits accrue over time. These costs can also include transition assistance for businesses and households that may be required for particular reforms.
- Assist in securing national reform where the benefits of reform are not shared evenly between the States. Competition payments and coordinated reform effort can help overcome the various barriers to reform which governments may face, such as strong vested interests, community scepticism on the benefits of change,

or concerns about potential costs.[1] In some instances there are also disincentives for one jurisdiction implementing a reform ahead of another and there can be spillover benefits in coordinated action. Incentive payments can ensure that reforms that create spillover benefits are undertaken.[2]

NSW notes that the source of funds for competition payments, the quantum of funding available and whether parties other than the States and Territories could be eligible to receive these payments is not yet clear. Given the important enabling role competition payments can play NSW calls on the panel to make clear recommendations in this area.

NSW would welcome the opportunity to be involved in the design of any competition payment regime to ensure that it is focused on achieving agreed competition outcomes while also providing States with flexibility to adopt innovative approaches to achieve these ends. Financial arrangements will also need to be considered in the context of the processes occurring as part of the White Papers on the Reform of the Federation and Reform of the Taxation System.

National access and pricing regulator

There may be benefits in consolidating the regulatory functions of multiple national regulators into one entity (e.g. gas, electricity and telecommunications) where national infrastructure markets exist and where there are industry sectors already regulated under a national regime. This includes the regulatory functions of the ACCC and NCC.

However, at this point in time NSW is not convinced of the need or scope for further transfer of responsibilities in areas currently regulated by the States to a national regulator. The States may be best placed to regulate local infrastructure that is not nationally significant. In considering whether to transfer powers to a national regulator it will be important to draw on past experience and build on the lessons learned from earlier processes.

One challenge in moving new sectors to a national access and pricing regulator is ensuring that the regulator can accommodate the current diversity of market structures and regulatory approaches across jurisdictions that cater to specific market contexts. One pertinent example is the water sector which is characterised by a diversity of industry structures and different approaches to competition and regulation across States.

One of the key benefits of retaining State-based pricing and access regulators stems from competitive federalism. Competition between regulators allows jurisdictions to share experiences of implementing different policies and compare evidence of the merits of different approaches in practice. It provides the ability to benchmark performance and refine methodologies across regulators. This can result in better performance and more effective approaches.

[1] Corden, S, *Australia's National Competition Policy: Possible Implications for Mexico*, OECD, 2009.

[2] CEDA, *Six myths of federal-state financial relations*, 2009, available at: http://www.ceda.com.au/research-and-policy/research/2009/11/economy/six_myths_federal_state.

Competition laws

Application of competition law to government

The NSW Government recognises the importance of the competitive process in undertaking its commercial activities. However, NSW is concerned with the Panel's proposal in Draft Recommendation 19 that competition laws be extended further to other government activities as it raises a number of potential costs and risks. These risks warrant more careful consideration to avoid potentially unforeseen consequences.

Governments play a unique role which involves public policy influencing the considerations taken into account to achieve the greatest public benefit. Governments are accountable to all citizens and as such, decisions will necessarily involve equity and access considerations. Governments are also obliged to provide social, cultural, security and other services which are important to citizens but may not be adequately provided by the market – for example, cultural and sporting venues, and policing and defence. In addition to public benefit objectives, some of these services also typically involve some level of commercial activities. In many cases, the commercial activities are integrated with non-commercial activities.

Careful consideration is necessary to understand the costs and benefits of further extending the CCA to government activities particularly where it is difficult to separate commercial from non-commercial activities, and whether there may be alternative approaches to achieving the same policy goal at a lower cost.

Existing application of competition policy to government commercial activities

Extending competition laws as part of the NCP reforms to government where it carries on a business was an important part of promoting the benefits of competition. These reforms meant that competition laws apply to the activities of State Owned Corporations (SOCs), and more widely to Government where it carries on a business.

The commercial disciplines of competition also apply to the Government's commercial activities more broadly. Competition considerations form part of the Government's commercial decisions in its day-to-day procurement activities and major transactions.

Major transactions require an appropriate balancing of regulatory and pricing interests with financial considerations. In finding the appropriate balance, the Government always factors in competition considerations. For NSW, getting the competition settings right is crucial to ensure that benefits to citizens are maximised.

This is particularly relevant at present given the program of asset recycling initiatives that NSW is undertaking with support from the Commonwealth Government. NSW is preparing scoping studies into a number of major asset recycling transactions, and competition is one of the key factors considered in these studies.

Recent reforms to NSW's procurement policies aim to open up government supply chains to greater levels of competition. The reforms are designed to encourage better value for money and improved outcomes through changes to procurement practices, and reducing the cost and complexity of doing business with the NSW Government. NSW agencies are

required to encourage new entrants to apply for government business and expand the number of prospective suppliers where possible. The NSW Procurement Board is also required to take into account competition impacts in forming procurement category management plans. Reforms to the NSW procurement model supports testing the benefits of strategic commissioning approaches, such as outcomes-based contracting, which are designed to increase competition and contestability in government service delivery.

Potential risks associated with extending competition laws to government

NSW considers that there is still considerable work to do before a case is established for extending the application of competition laws beyond its present operation, and if so, the scope of any such extension (including the legal mechanisms by which any such extension could be effected). The Panel should consider whether competition laws should be extended at all and if so it will be important to clearly delineate to which activities competition law would apply, and what is sought to be achieved. This delineation will need to be carefully considered. If a case can be made, it also does not necessarily follow that the CCA (at least in its current form) is the right legislative framework for governments. State-based legislation may be more appropriate to govern impacts on State governments and local governments.

NSW has four major concerns. First, governments undertake a broad range of commercial activities that vary in nature and scale; many of these activities are not necessarily significant and are generally intertwined with government policy functions, for example procurement for schools. In contrast, the provisions of the CCA are designed for businesses which predominately undertake commercial activities in the interests of shareholders. The broad application of competition laws to government commercial activities risks compromising the policy functions of government. Potentially an independent regulator, such as the ACCC, or the courts could be adjudicating government policy decisions and weighing up competition and public benefit objectives.

Box 1 provides an example from the United Kingdom, which illustrates how in some circumstances there may be conflict between the views of government and an independent body on whether a government decision is likely to result in a net public benefit.

Box 1: Proposed merger of the Royal Bournemouth and Christchurch Hospitals, and the Poole Hospital Trust

In October 2013, the Competition Commission in the United Kingdom (UK) ruled against a proposed merger of the Royal Bournemouth and Christchurch Hospitals, and the Poole Hospital Trust. It was the first merger case affecting the UK's National Health Service that had been considered by the Competition Commission.

The Commission was of the view that the proposed merger would result in a substantial lessening of competition in the provision of a number of inpatient and outpatient services. The Commission did not accept the arguments that there would be consumer benefits accruing from the merger, including lower prices, higher quality services, greater choice or increased innovation. The Commission decided that the only effective remedy was to prohibit the merger.

Second, governments undertake commercial activities in markets where full competition may not be necessary, or in some cases appropriate, to achieve the greatest public benefit. For example, NSW's strategic commissioning reforms aim to increase competition and contestability in service provision in a broad range of ways which do not always involve fully competitive markets, and instead might include benchmarking government-provided services against alternative service providers or establishing public-private partnerships. The CCA, on the other hand, assumes that activities occur in fully competitive markets. While increased competition and contestability can bring service improvements, imposing the disciplines of the CCA may constrain the government's ability to design reforms to achieve the greatest public benefit and create disproportionate regulatory costs for government.

Third, broad application of the CCA to government commercial activities is likely to create significant ambiguity around how competition laws apply to particular activities. The regulatory uncertainty for government and business will inevitably impose significant costs, such as obtaining legal advice, responding to potential legal disputes or being subject to court proceedings, about whether the CCA applies to certain circumstances.

NSW notes that the application of competition law to State Government activity is fraught with legal complexity. By way of preliminary example only, a legal test such as "in trade or commerce" is not necessarily easy to apply in a government context. Further legal complexities arise from the Australian Federation, for example there will be constitutional limitations on the Commonwealth's ability to amend the CCA (or introduce other Commonwealth laws) to purport to apply to State Government activities, in the absence of referral laws by the States. Ultimately, it could be contrary to the Panel's objective to simplify and clarify the application of competition laws.

Fourth, some asset recycling and infrastructure reinvestment processes have commenced in NSW on the assumption that current procurement and transaction process arrangements will remain in place. The end result of these processes is to deliver competitive outcomes. However, introducing uncertainty into these processes at this critical point in time may have unintended consequences for State and Commonwealth asset recycling and infrastructure reinvestment commitments.

Given the likely costs and constraints on government, NSW recommends that if they are to be applied at all, competition laws should only be further applied to government activities where there is a demonstrable net benefit. Like any regulation, the costs associated with complying with the requirements of the CCA (or other legislation) needs to be weighed against any potential benefits, and they should be proportionate to the problem being addressed. In that regard, NSW suggests the Panel should:

- clearly define the problem that needs to be addressed;
- consider whether there are alternative measures which could address the issue, including, for example, developing a National Law that establishes a competition law framework specifically designed for State and Local Governments, or State-based frameworks;

- clearly specify to which activities the law would apply (and, in the Panel's view, how this would be legally implemented);
- estimate the regulatory costs and benefits of applying competition laws to clearly defined areas of government activity; and
- recommend applying competition laws only to areas where there is a demonstrable net benefit in doing so.

Mergers

The Panel's recommended changes to the formal merger exemption process in Draft Recommendation 30 have potentially significant implications for how businesses finalise major transactions. It is of paramount importance to NSW that applicants have timely access to review of ACCC decisions and other actions (including informal clearances) by the Australian Competition Tribunal. Any changes to law or practice which constrains current rights to review by the Australian Competition Tribunal (and the Federal Court) would be detrimental to the State's interest in undertaking major transactions. NSW is concerned that the proposed framework may have unintended consequences particularly in relation to the timing and flexibility of the formal application process.

NSW agrees with the Panel's view that the formal merger exemption process should be both accessible and effective – timely decision making is imperative. It is important to consider the potential effects of any changes to the application process on businesses decisions to finalise transactions. In that regard, NSW raises some concerns which it considers will be important to take into account in finalising a revised framework for the formal merger exemption process.

There is a risk that reintroducing a two-step process may result in lengthier formal exemption processes, making the formal avenue of merger exemption less attractive. If the ACCC is to be the first-instance decision maker for all formal merger exemptions, the ACCC should be required to publish its reasons at the same time as it publishes its decisions. Ensuring strict statutory timelines around the formal process will be particularly important, and these timelines should be transparent and clearly communicated to the parties.

There are costs in bidders holding finance in place for lengthy periods. These costs should be weighed against the benefits of establishing any new process.

NSW welcomes any changes to the formal merger exemption process which removes unnecessary restrictions or compliance burdens on applicants. However collapsing the existing two alternative avenues for formal applications may actually restrict perceived options and flexibility under the merger exemption framework. There does not appear to be sufficient evidence to show that the two alternate avenues for formal applications discouraged businesses to make formal applications.

Also as a result of collapsing the two alternative formal exemption avenues, the ACCC would determine formal applications on both anti-competitive effects and public benefit grounds. This would be a change to the ACCC's existing decision making role, which

currently involves determining formal applications only on any potential anti-competitive effects. NSW notes that the ACCC has experience in applying the public benefits test through its previous decision making role for merger authorisations. Nonetheless, the proposed role may still test the ACCC's decision making in the future. For example, in situations where the ACCC determines a merger is likely to have anti-competitive effects it may influence its assessment of whether the merger may still be in the public benefit.

Ultimately, any potential benefits of having the ACCC being the first instance decision maker for all formal applications needs to be balanced against any potential implications from collapsing the existing two alternative avenues of application.

National Access Regime

NSW agrees with the Panel's view that the regulatory regime for third-party access under Part IIIA of the CCA creates potential regulatory costs on the economy. Given this, the current Part IIIA framework should be evaluated based on whether its application is likely to produce net public benefits.

The Panel's recommended changes to the declaration criteria under Part IIIA appear reasonable to ensure that the provisions are clarified and consistently applied, and to ensure that third party access is only mandated where there is a net public benefit in doing so.

NSW is of the view that it is appropriate to maintain the current scope of application of the Part IIIA regime in circumstances where the benefits arising from increased competition in dependent markets are likely to outweigh the costs of regulated third party access.

NSW also notes that effective access regimes have been established under a range of State and national frameworks. These frameworks continue to provide an effective, and often superior, alternative to the Part IIIA framework.

Competitive neutrality

NSW agrees that it is timely for all jurisdictions to review their competitive neutrality policies with a view to clarifying and strengthening the application of competitive neutrality principles to significant government business activities. However, NSW is concerned with the proposal to establish threshold tests to determine what constitutes a significant business activity.

For local governments, NSW considers that States should, at a minimum, renew their policy frameworks which clarify the application of competitive neutrality and recommit local governments to competitive neutrality principles.

Application to significant business activities

A clear and common understanding between jurisdictions on how 'significance' should be evaluated will be important to strengthening the application of competitive neutrality principles. However, NSW is concerned with the Panel's proposal in Draft Recommendation 13 to establish threshold tests to determine what constitutes a

significant business activity. An evaluation of significance should be made on a case-by-case basis and relative to the market in which the government business operates. It would not be appropriate to apply prescriptive thresholds, particularly dollar values, as this is inherently arbitrary and may not capture the significance of a government business relative to the market. A test of 'significance' should be based on a set of relevant factors, such as:

- size of the government business activity relative to the market in which it operates;
- influence the government business activity has on the market (which may depend on its relative size);
- resources used by the government business activity; and
- potential effects on government of poor performance.[3]

NSW agrees with the Panel's view that it will be important for governments to work overtime towards ensuring that community service obligation (CSO) payments are transparent to support effective competition in service markets.

Review of competitive neutrality policies – independent oversight

The Panel should provide further clarification on the intended role of the independent body it proposes in Draft Recommendation 13 to oversee a review of jurisdictions' competitive neutrality policies. Independent oversight could be beneficial, however it should be for individual jurisdictions to decide on the appropriate revisions to their competitive neutrality policies.

Local government

The NCP reforms extended competitive neutrality principles to Commonwealth, State and Local governments. At that time, NSW's Department of Local Government developed a policy statement on the application of competitive neutrality principles to local governments, supported by implementation guidelines and a complaints handling process. NSW considers that it is timely for all jurisdictions to review their existing competitive neutrality policies as they apply to local governments, with a view to strengthening their application to relevant business activities.

At the very least, this should involve State governments revising competitive neutrality principles and re-committing local governments within their jurisdictions to these principles through policy directives. A review of competitive neutrality policies and guidelines should be undertaken in consultation with local governments and involve redefining relevant business activities, reinstating reporting requirements and revising complaints handling mechanisms to ensure they are effective.

[3] NSW Treasury, *Policy and Guidelines paper TPP 02-1: NSW Policy Statement on the Application of Competitive Neutrality,* NSW, January 2002.

Human services

NSW agrees with the Panel's views on the importance of increasing choice and diversity in human service delivery, and notes that there are potentially significant benefits of such reforms including improved quality services which better meet the needs of service users.

However, we are cautious about signing an intergovernmental agreement and would only do so if it does not constrain jurisdictions' freedom to decide on the best approach to implement human services reforms.

Intergovernmental agreement

As NSW recommended in its first submission, governments could consider developing their own frameworks for reform to increase competition in the delivery of human services. Alongside this, there could be some merit in jurisdictions crafting a high-level agreement on reform principles as it may help drive reform within jurisdictions and could align the efforts of jurisdictions to build deeper and more competitive national markets. It would also ensure there is a common understanding across jurisdictions of the principles underpinning effective competition and contestability in service delivery. The application of the principles within jurisdictions could be supported by State-based implementation plans, allowing jurisdictions to manage their own reform processes.

NSW would like to see further consideration given to the benefits and the risks that might come from developing a nationally-driven reform agenda as proposed in Draft Recommendation 2. An intergovernmental agreement could risk imposing undue constraints on jurisdictions' policy flexibility, may delay reform processes within jurisdictions, and is likely to require additional resources to implement reforms. Given this, there needs to be a clear net benefit associated with any agreement between jurisdictions.

NSW also notes that through the White Paper on the Reform of the Federation the Commonwealth Government is leading a process to reform interactions between Commonwealth and State governments. Human services, particularly health, education, and housing and homelessness, is a key area of focus in the White Paper process. One of the key aims of the White Paper is to "clarify roles and responsibilities for State and Territories so that they are, as far as possible, sovereign in their own sphere."[4] Any new intergovernmental agreements for human services should not pre-empt the recommendations of the Federation White Paper by imposing conditions on a State's human service delivery.

Separation of funding, regulation and service provision

Structural separation of service delivery by splitting funding (purchasing), regulation and service provision can be appropriate for some human services, as it can encourage competition and potentially help improve choice and diversity for service users. In some cases, these benefits can be achieved by separating out the provider without significant changes to funding and regulation roles. In some cases, however, the separation of

[4] Prime Minister of Australia, *White Paper on Reform of the Federation*, Media Release, 28 June 2014.

funding, regulation and service provision roles may bring unintended consequences if incentives and roles are not appropriately aligned. NSW believes that arrangements for particular services need to fit the individual circumstances.

The Panel acknowledges that careful thought needs to be put into market design to set up regulators, funders and providers. This is crucial to aligning incentives and promoting the interest of service users. There is a risk that independent regulators, by regulating the quality or standards of service provision, may actually make decisions relating to policy matters, and as such could have undue influence on outcomes for service users and the costs of funding services. In designing markets for public services, a key issue is how standards are set for the services that are provided. The standards set impact on cost for clients and the government depending on the extent of cost recovery and subsidy.

It is important when designing some human services markets that the parties that set the standards are also those responsible for funding. There can be a risk of misalignment of costs and benefits if one party sets the service standard and another party is required to fund the cost without choice over the level of service provision.

The potential risks and benefits of structural separation of regulatory and funding roles need to be evaluated on a case-by-case basis when reforms are being developed. There should not be a presumption of structural separation of these roles.

Choice at the heart of service delivery

NSW recognises that choice can play an important role in improving service provision for users and in achieving better outcomes. NSW supports the Panel's view that governments should agree on common principles to guide the implementation of user choice in human services.

NSW notes that the Panel's Draft Recommendation 2 proposes that user choice should be placed at the heart of service delivery, and supports this as a guiding principle in the context of a holistic approach to reform that considers a range of factors including choice, social equity and minimum quality. A holistic approach allows governments to focus on the outcomes they wish to achieve and design to service delivery models accordingly.

As NSW pointed out in its first submission, a truly contestable system provides the competitive tension that ensures the provider is always incentivised to cost effectively provide the best service for the customer. There is a broad range of service delivery models which can underpin a truly contestable system; the appropriate delivery model should be considered on a case-by-case basis. In its discussion around diversity of providers, the Draft Report notes outcomes-based commissioning and public-private partnerships as two of the possible reform models. NSW notes that there is a very broad range of alternative service delivery models which should also be considered, including:

- *Keep-and-improve*: applying contestability to government service provision by benchmarking it against potentially alternative service providers. As a result of this process – which applies competitive pressure – the government may retain its current service delivery role, but make improvements to efficiency or quality.

- *Recommissioning*: redesigning previously outsourced or privatised services to improve outcomes.
- *Payment by results*: paying providers based on outcomes rather than inputs or outputs. It combines a high-stake form of performance contracting with a focus on outcomes. NSW's Social Benefit Bonds are an example of this, where private investors provide upfront capital to a service provider to achieve a particular outcome. Achieving this outcome should reduce the need for, and therefore government spending on, acute services later on. Part of the resulting savings is then used to repay the principal investor and provide a financial return. This return depends on the extent to which outcomes have improved.
- *Public-private joint ventures*: allows the technical expertise of the public sector to be brought together with the commercial and managerial expertise of the private sector.
- *Public service mutuals*: mutual organisations are either owned by and run in the interests of existing members or employees, or owned on behalf and run in the interests of the wider community.
- *Commercialisation or corporatisation*: involves establishing a separate business entity which operates under commercial principles and is paid for providing public services (as appropriate). Corporatisation involves establishing a legal entity. The government continues providing strategic direction and retains public ownership.
- *Privatisation*: ownership is fully transferred to the private sector. The government plays a stewardship role which involves setting up regulatory agencies and holding the regulator to account for its performance.

Implementation

NSW acknowledges the Panel's view that trials and pilot schemes can facilitate reform implementation. NSW's first submission also outlined several important considerations governments should take into account in planning and implementing reforms. Over time, jurisdictions will learn lessons arising from their own implementation experiences. There can be value in jurisdictions sharing reform experiences on an informal basis and through established inter-jurisdictional arrangements, before new formal intergovernmental processes are considered.

Other issues

Simplifying the *Competition and Consumer Act*

NSW recognises that the disciplines imposed by the CCA are important to protecting the competitive process in markets, and forms an important underpinning to the economy's productivity and growth. Like any regulatory framework, competition laws need to be sufficiently clear in their application and avoid unnecessary complexities. Regulatory uncertainty can impose costs on businesses and the economy. Overly complex or prescriptive provisions can potentially limit the potential for laws and regulations to adapt to changing circumstances.

On that basis, NSW supports in principle the Panel's Draft Recommendation 18 to clarify and simplify the provisions of the CCA to ensure that the legal framework remains sufficiently adaptable over time, does not impose unnecessary costs, and continues to protect the competitive process.

Proposed changes to section 46 of the *Competition and Consumer Act*

It is appropriate that to protect the competitive process, competition laws should be directed at the effect of commercial conduct on competition, not the purpose or intent of competitors. On that basis, NSW sees merit in Draft Recommendation 25 which proposes changes to section 46 to:

- redirect the law towards the impact on the competitive process rather than individual market participants; and
- simplifying section 46, making it consistent with other parts of the CCA.

On the other hand, introducing an 'effects test' to section 46 represents a significant shift in how potential misuses of market power by businesses are assessed, which potentially captures a broader category of business conduct (noting the Panel's proposed defences aim to address potential capture of pro-competitive conduct).

Intellectual property

NSW welcomes the Panel's draft recommendations in relation to intellectual property (IP). It is important to ensure the IP framework encourages innovation and allows costs to be recovered (including risk adjusted profit margin) but does not become a means of protecting particular companies or countries.

Further information and contacts

For further Information or clarification on issues raised in the submission, please contact the NSW Treasury's Economic Policy Division on 02 9228 5893.