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Articles

Competitive neutrality and the challenge of social enterprise

*Bronwen Morgan, Sophia Bai and Jyotsana Bhasker**

Globally, the past decade has seen many countries, including the United Kingdom, United States and Canada, introducing legislation that creates distinctive hybrid legal models for social enterprise. Although Australia has no dedicated legal model for social enterprise, its growing salience poses a challenge to competitive neutrality policy regimes. The challenge posed by social enterprise is both conceptual and practical. At the conceptual level, we argue that the underlying analytical framework of competitive neutrality sits uneasily with the premises of social enterprise. At the practical level, we show how the qualitative cost-benefit balancing flowing from the public interest test embedded in the Australian competitive neutrality regime is quite different from the way social enterprises achieve their social objectives, despite some apparent initial similarities. This challenge arises from the implicit baseline of competitive neutrality, which tends to generate analyses that place efficiency values in competition with social, environmental or other 'non-economic' values. Articulating and responding to this challenge is important for the enhancement of opportunities for social enterprise to grow and strengthen, and thereby contributes to rising political and consumer demand for more sustainable business models.

I Introduction

This article explores the challenge posed to competitive neutrality policy regimes by the growing salience of social enterprise in economies worldwide. Although Australia has no dedicated legal model for social enterprise, its importance here as elsewhere is growing, and many countries including the United Kingdom ('UK'), United States ('US') and Canada have introduced legislation that creates distinctive hybrid legal models for social enterprise. The challenge posed by social enterprise is both conceptual and practical, and arises from a disjunction between a view of the economy as primarily concerned with the maximisation of competitive efficiency, and a view that would place social and environmental priorities on an equal par with such values. This latter view underpins a growing interest around moving to more sustainable business models: as recent scholarship argues, 'eco-social' enterprises can be seen as important constituent parts of a future more equitable and sustainable society.[1] While the adjective 'eco-social' nicely captures the importance of both environmental and social dimensions in

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1 Nadia Johanisova and Eva Fraňková, 'Eco-social Enterprises' in Clive L Spash (ed), *Routledge Handbook of Ecological Economics: Nature and Society* (Routledge, 2017) 507–16.

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emerging new business models, this article will employ the narrower term 'social enterprise' for succinctness and familiarity, but will return to the broader concerns in the conclusion.

At the conceptual level, we argue that the underlying analytical framework of competitive neutrality sits uneasily with the premises of social enterprise. At the practical level, we show how the qualitative cost-benefit balancing flowing from the public interest test embedded in the Australian competitive neutrality regime is quite different from the way social enterprises achieve their social objectives, despite some apparent initial similarities. More specifically, the implicit baseline of competitive neutrality regimes is one that views market competitiveness as the key criterion of a 'level playing field', and consequently tends to generate analyses that place efficiency values *in competition with* social, environmental or other 'non-economic' values. Social enterprise, on the other hand, and as we shall show, integrates social, environmental and economic objectives into hybrid internal corporate governance processes that intentionally *blur the distinction between* for-profit and not-for-profit activities. As such, social enterprise poses a distinctive challenge to competitive neutrality regimes. Articulating and responding to this challenge is important for the enhancement of opportunities for social enterprise to grow and strengthen, and thereby contributes to rising political and consumer demand for more sustainable business models.

The article proceeds in two stages. In Part II, we describe the key features of competitive neutrality policy in Australia in the context of the broader reforms embedded in the National Competition Policy, followed by an argument that these features establish an 'implicit baseline' relevant to the rise of social enterprise. In Part III, we describe briefly the nature and salience of social enterprise and its current legal salience in Australia, followed by an argument that it poses a distinctive challenge to the assumptions underpinning the implicit baseline explored in Part II.

II Competitive neutrality and the National Competition Policy

The structure of competitive neutrality

The foundation of competitive neutrality can be traced back to the late 1980s in Australia and New Zealand[2] when governments started exposing government business[3] to competition.[4] Australian States first showed interest, and introduced the issue to the federal stage at the first Special Premiers'

2 One aspect of the reform process in New Zealand was the creation of a 'level playing field' in 1984. For more details see Steering Committee on Government Trading Enterprises (NSW), *A Policy Framework for Improving the Performance of Government Trading Enterprises: A Report* (1988) 7.

3 Government businesses in this context adopted the *Hilmer Report* definition, which includes government departments, statutory authorities and other government bodies that provide commercial goods or services to the public, private firms or other government agencies. See Frederick Hilmer and Independent Committee of Inquiry into Competition Policy in Australia, *National Competition Policy Review* (1993) 293 ('*Hilmer Report*').

4 Gary L Sturgess and Confederation of British Industry, *A Fair Field and No Favours: Competitive Neutrality in UK Public Service Markets* (2006) 28. Also see Deborah Healey,

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Conference in February 1990.[5] Soon after the first Special Premiers' Conference, political leaders agreed to examine a national approach to competition policy as they recognised that an uncoordinated approach to reform under Australia's federal system might undermine the benefits and increase the costs of change.[6] Consequently, an independent inquiry headed by then Dean of the New South Wales Graduate School of Management, Professor Frederick George Hilmer, was commissioned.[7] In August 1993, the Committee's report (now known as the '*Hilmer Review*' or '*Hilmer Report*', after the Chair of the Committee) was released.[8]

Competitive neutrality, as a distinct competition policy element in Australia, was first put on the agenda for reform by the *Hilmer Report*, and the current competitive neutrality framework owes much of its structure to the central tenet of competition policy articulated by that report, although it has also been further advanced by the recent *Competition Policy Review* ('*Harper Review*') chaired by Professor Ian Harper. The *Hilmer Report* emphasised that competition policy in Australia:

> is not about the pursuit of competition for its own sake. Rather, it seeks to facilitate effective competition in the interests of economic efficiency while accommodating situations where competition does not achieve economic efficiency or conflicts with other social [goals].[9]

Accordingly, the principle of competitive neutrality is designed to promote competition, but at the same time it acknowledges that there are situations where competition does not achieve economic efficiency or conflicts with other social objectives.[10] As we shall see, that conflict is handled by requiring a process to weigh up the costs and benefits of implementing competitive neutrality, but for present purposes, we can note the sense of conflict between competition and 'other social goals'.

The continued development of competitive neutrality policy has been reinvigorated by the recent *Harper Review* in 2015. The *Harper Review* outlines future reforms in the area of competitive neutrality policy, including a recommitment to competitive neutrality by renewing and updating the

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'Competitive Neutrality: Addressing Government Advantage in Australian Markets' in Josef Drexl and Vicente Bagnoli (eds), *State-Initiated Restraints of Competition* (Edward Elgar, 2015) 6.

5 Gary Sturgess, 'Competitive Neutrality: Implementation and Evolution' (presentation, 2015).

6 Bronwen Morgan, *Social Citizenship in the Shadow of Competition: The Bureaucratic Politics of Regulatory Justification* (Ashgate, 2003) 66.

7 Ibid.

8 Matthew Rennie and Fiona Lindsay, 'Competitive Neutrality and State-Owned Enterprises in Australia: Review of Practices and their Relevance for Other Countries' (Organisation for Economic Co-operation and Development ('OECD') Corporate Governance Working Papers No 4, OECD, 1 August 2011) 7.

9 *Hilmer Report*, above n 3, 6.

10 Situations where competition does not achieve economic efficiency or conflicts with other social goals are often called 'market failure' by economists. In other words, competitive neutrality policy acknowledges concerns in situations where there is a market failure or where there might be a market failure. For more general discussion, see Stephen King, 'The Economics of National Competition Policy' in Christopher Arup and David Wishart, *Competition Policy with Legal Form: Reviewing Australian and Overseas Experience* (Federation Press, 2002) 12–13.

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existing competitive neutrality policies in each jurisdiction. For instance, the 1996 Commonwealth *Competitive Neutrality Policy* is currently under review by the Treasury.[11] It recommends, inter alia, the improvement of transparency and accountability by requiring government business to include a statement on compliance with competitive neutrality policy in their annual reports and requiring an independent body to take responsibility for investigation of competitive neutrality complaints.[12] The rationale and the possibility of extending the application of competitive neutrality to human services sector also received detailed attention in the *Harper Review*.[13]

The core principle of competitive neutrality remains in the *Harper Review*, which can be summed up as the principle that '[g]overnment businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership'.[14] This principle has two key dimensions relevant to the purposes of this article: the rationale for competitive neutrality and its means of implementation.

Rationale for competitive neutrality

The economic rationale for competitive neutrality, put simply, is that it enhances economic efficiency by improving the likelihood that resources will be allocated where they provide the most value.[15] More concretely, in Australia, for analytical purposes at least, competitive neutrality policy is primarily concerned with competition (actual or potential) between two parties: government business and another business. In other words, competitive neutrality policy, at least in the Australian context, is formulated with respect to the business behaviour of government businesses — the business activities of government entities. Here, it is instructive to dig deeper into the relevance of why the application of competitive neutrality policy in Australia requires at least one participant to be a government business.[16] This view is arguably based on the understanding that the source of competitive neutrality concerns in Australia most often arise from the participation of government business in the market. For example, the local council may provide child care services that compete directly with private child care

11 Treasury has established a Competitive Neutrality Review Secretariat to review the Commonwealth's Competitive Neutrality Policy: Treasury, *Competitive Neutrality Review* (21 April 2017) <https://consult.treasury.gov.au/market-and-competition-policy-division/competitive-neutrality-review/>.

12 Ian Harper et al, *Competition Policy Review: Final Report* (2015) 50–1 ('*Harper Review*').

13 Ibid 265–6.

14 Council of Australian Governments, *Competition Principles Agreement* (11 April 1995), as amended (13 April 2007) cl 3(1).

15 Allocative efficiency, as identified in the *Hilmer Report*, is one of the components of economic efficiency. To oversimplify, allocative efficiency is achieved when resources are allocated in accordance with consumer demand. In contrast, when one or more producers receives favours from the governments because of its ownership, consumers might not face the real cost of their choices resulting in allocative inefficiency. Having competitive neutrality in place can improve allocative efficiency by neutralising the net competitive advantages that government business activities enjoyed because of their ownership. See more discussion, *Hilmer Report*, above n 3, 3–4.

16 According to the *Hilmer Report* definition, government businesses include government departments, statutory authorities and other government bodies that provide commercial goods or services to the public, private firms or other government agencies: ibid 293.

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providers. Without competitive neutrality policy, the child care service provided by the council may have competitive advantages flowing from government ownership, such as fees charged by the council that may not fully reflect costs. Accordingly, it will make private child care service operators (who need to charge fees that reflect costs to make a profit) difficult to compete and hence undermine competition.[17] As the *Hilmer Report* noted:

> the most systematic distortions appear to arise when government businesses participate in competitive markets. In particular, government businesses were often seen as enjoying a unique set of competitive advantages by virtue of their ownership, including exemption from tax.[18]

However, it is worth noting that the advantages of government business in competitive neutrality context may be significant and easy to observe or subtle.[19] For instance, the *Hilmer Report* identified seven advantages that flow from government ownership that government business often enjoyed:

> immunity from various taxes and charges; immunity from various regulatory requirements; explicit or implicit government guarantees on debts; concessional interest rates on loans; not being required to account for depreciation expenses; not being required to achieve a commercial rate of return on assets; and effective immunity from bankruptcy. In some cases, a government business will also operate in both monopoly and competitive markets, presenting opportunities for cross-subsidisation.[20]

Conceptually, competitive neutrality has been characterised explicitly as not intending to address non-profit and non-commercial activities carried out by the public sector.[21] Consequently, the application of competitive neutrality policy may involve distinguishing between the 'commercial' and 'not-for-profit' activities of a particular legal entity. For example, the *Hilmer Report* defines government businesses as 'government departments, statutory authorities and other government bodies *that provide commercial goods or services* to the public, private firms or other Government agencies'.[22]

Thus, a question sometimes arises in practice about what constitutes 'non-commercial' activities and whether and how they can be easily or practically distinguished from the commercial business activities of government entities. Some, such as regulatory functions, are conceptually distinct from market activities. But because regulation can also constitute markets, it also becomes necessary to define the thresholds of commercial market activity. For instance, the thresholds used in the Commonwealth to determine business activities are the following:

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17 A more specific example related to child care services can be found in the competitive neutrality investigation conducted by the Victorian Competition and Efficiency Commission. See Victorian Competition and Efficiency Commission, *Competitive Neutrality Complaint Investigation: Hobsons Bay City Council — Child Care Centres* (27 January 2015).

18 *Hilmer Report*, above n 3, 293.

19 Deborah Healey, 'Competitive Neutrality: The Concept' in Deborah Healey (ed), *Competitive Neutrality and Its Application in Selected Developing Countries* (United Nations Conference on Trade and Development, 2014) 5.

20 *Hilmer Report*, above n 3, 296–7.

21 Rennie and Lindsay, above n 8, 17.

22 *Hilmer Report*, above n 3, 293 (emphasis added).

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- there must be *user-charging* for goods or services (the user may be in the private sector or public sector);
- there must be an actual or potential competitor (either in the private or public sector) ie users are not restricted by law or policy from choosing alternative sources of supply; and
- managers of the activity [must] have a degree of independence in relation to the production or supply of the good or service and the price at which it is provided.[23]

The *Hilmer Report* envisaged that measures like corporatisation, commercialisation, full cost pricing and sometimes privatisation (if appropriate) could be used by governments to facilitate the application of competitive neutrality as these measures provide a relatively clear separation of 'non-profit' or 'non-commercial' activities from 'for-profit' or 'commercial' activities of government business.[24]

How social enterprise relates to this menu of potential measures is discussed in Part III of this article. For present purposes, it is sufficient to emphasise the conceptual and analytical structure that treats 'commercial' activities as a set of practices that are distinct from non-commercial activities. For instance, competitive neutrality policy does not extend to the regulatory activities of government that may have an impact on business and competition. Yet while this was always the case, the regulatory behaviour of government in this circumstance under the *Hilmer Report* still had to take account of the core principle of the National Competition Policy as a whole, as that policy imposed an extensive review of existing government legislation under the *Competition Principles Agreement* to ensure that existing regulatory and legislative policies only limited market competition when justified in the public interest.[25] Other ongoing modes of regulatory review continue in place today with the aim of limiting unjustified government intervention in the market.

Implementation

As mentioned at the beginning, competitive neutrality policy only needs to be implemented where the benefit of implementation outweighs the cost. It is interesting and significant that both competitive neutrality and regulatory review have relied on the 'public interest test' articulated under the *Competition Principles Agreement* to give effect to this principle of implementation. This reflects the commitment noted above in relation to the National Competition Policy as a whole — that despite the aspiration to promote competition, there are situations where competition does not achieve economic efficiency or conflicts with other social objectives. All the processes instituted in relation to competitive neutrality, legislative review and regulatory review recognise this. They rely upon the application of a public interest test outlined in the *Competition Principles Agreement* to give effect to it.

The test is contained in cl 5(1) of the *Competition Principles Agreement*:

23 At the Commonwealth level, see *Competitive Neutrality Policy Statement* (1996) 7 (emphasis in original).
24 *Hilmer Report*, above n 3, 302.
25 Morgan, above n 6, 63–73.

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> The guiding principle is that legislation ... should not restrict competition unless it can be demonstrated that:
>
> (a) the benefits of the restriction to the community as a whole outweigh the costs; and
> (b) the objectives of the legislation can only be achieved by restricting competition.

Satisfaction of this test thus justifies the maintenance of any public policy that prima facie restricts competition. Policies for which a public benefit *cannot* be demonstrated must be repealed or modified so that they do not reduce competition. The *Competition Principles Agreement* listed seven relevant matters that could be taken into consideration by responsible government agencies[26] in weighing up these costs and benefits:

- ecologically sustainable development;
- social welfare and equity considerations, including community service obligations;
- occupational health and safety;
- employment growth;
- competitiveness of Australian businesses; and
- efficient allocation of resources.[27]

Government authorities were given leeway in crafting specific bureaucratic procedures to implement these obligations.[28]

The *Competition Principles Agreement* applies explicitly to rules that are made formally through legislative processes but is also intended to apply to an accretion of policy decisions that treat government entities differently from private entities, such as in the context of competitive neutrality. In that context, there is often confusion as to whether what is intended is a strict 'cost-benefit analysis' or a 'public interest test'.[29] The principle-based *Competition Principles Agreement* is silent on this matter, leaving the decision as the responsibility of governments in individual jurisdictions.[30] Various

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26 Given the implementation of competitive neutrality is a principle-based approach, what factors to be taken into consideration and whether the implementation of a competitive neutrality measure would compromise other public policy objectives is the responsibility of relevant government agency in individual jurisdictions and often applied in a case by case manner. See more Victorian Competition and Efficiency Commission, *Competitive Neutrality Inter-jurisdictional Comparison Paper* (2013) 1–2.

27 Council of Australian Governments, above n 14, cl 1(3).

28 Morgan, above n 6, 117–23. For a recent example of a state taking advantage of the flexibility accorded under the National Competition Policy, see Department of Treasury and Finance (Vic), *Competitive Neutrality Policy* (2012) <http://www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/Competitive-neutrality-policy>, indicating that Victoria articulates two separate processes for weighing the public policy dimensions of competitive neutrality: a standard cost-benefit analysis, and a separate process for considering the public benefit issues listed in cl 5 as well as some additional objectives related to local economic development and local community impacts.

29 House of Representatives Standing Committee on Financial Institutions and Public Administration (Cth), *Cultivating Competition: Report of the Inquiry into Aspects of the National Competition Policy Reform Package* (1997) ch 2 Public Interest Test, 11.

30 This list was not intended to be exhaustive and governments are free to consider more than listed matters or prioritise some factors. For instance, Victorian competitive neutrality statement provides cost and benefits assessment in s 5 and public interest test in s 6: see Department of Treasury and Finance (Vic), above n 28, 6–8.

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processes and approaches to assessing cost and benefits in the competitive neutrality context can be observed. However, one thing in common among jurisdictions is the difficulty and challenge of evaluating the social and environmental elements listed in the public interest test. Although the National Competition Council ('NCC') pointed out that 'all public interest considerations intrinsically carry equal weight',[31] concerns have been repeatedly expressed that the application of the test at least in practice restricts the ability of the government to evaluate social and equity issues effectively, and increases the possibility that social or environmental factors will be downplayed given that they are generally difficult to quantify or value.[32]

This is precisely the kind of issue which the rising salience of social enterprise poses in more pointed form, in ways that are discussed in Part III of this article. More broadly, the difficulties of applying the public interest test points to the broader challenges, both technical and political, that have accompanied the implementation of the National Competition Policy in Australia.[33] These broader macro-challenges are important to the challenge posed by social enterprise for the application of competitive neutrality policy. It is, thus, important to understand the conceptual underpinnings of competitive neutrality from a broader policy perspective for the purpose of this article. A prime example, from this perspective, is provided by the Organisation for Economic Co-operation and Development that '[c]ompetitive neutrality occurs where no entity operating in an economic market is subject to undue competitive advantages or disadvantages'.[34] Thus, at the fundamental conceptual level, competitive neutrality can be understood as 'a level playing field' amongst all market competitors — that is between private and public businesses.[35] As Thomas Cheng has commented in support of this line of thinking:

> the notion of competitive neutrality need not be confined to the public-private ownership context and can be extended to all sorts of scenario in which there is differential treatment of firms competing in the same market.[36]

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31 National Competition Council ('NCC'), *National Competition Policy: Some Impacts on Society and the Economy* (1999) 20.

32 Eg, John Quiggin argues that the public interest test is frequently ignored in favour of a narrow approach based solely on economic efficiency: see John Quiggin, 'Governance of Public Corporations: Profits and the Public Benefit' in Michael J Whincop (ed), *From Bureaucracy to Business Enterprise: Legal and Policy Issues in the Transformation of Government Services* (Ashgate, 2003) 34; Michael Paddon and Rai Small (eds), *Competition: In Whose Interest? The Socio-Economic Impacts of National Competition Policy* (Public Sector Research Centre and Public Interest Advocacy Centre, 1999) 43; Gary Banks, 'Competition and the Public Interest' (Paper presented at the National Competition Council Workshop: The Public Interest Test Under National Competition Policy, Colonial Stadium, Melbourne, 12 July 2001) 9.

33 Morgan, above n 6, ch 5 145–214.

34 OECD, *Competitive Neutrality: Maintaining a Level Playing Field between Public and Private Business* (2012) 15.

35 Ibid 3.

36 Thomas Cheng, 'Competitive Neutrality from an Asian Perspective' (Paper presented at the 123rd Meeting of the OECD Competition Committee, 16–18 June 2015) 3.

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Indeed, competitive neutrality, as a level playing field, can be 'affected by ownership, institution forms or the specific objectives for certain [entities]'.[37] While Australia's framework is focused on government business, this broader understanding of competitive neutrality opens up its relevance to social enterprise which will be explored in Part III.

First, however, it is necessary to make visible some key assumptions embedded in the policy framework within which competitive neutrality operates. In the next section, we analyse the conceptual structure of the public interest test more closely, arguing that it is embedded in a social logic that views market competitiveness as the key criterion of a 'level playing field', and consequently tends to generate analyses that place efficiency values *in competition with* social, environmental or other 'non-economic' values. Even though all values in principles can 'count', the onus of proof tends towards the priority of maximising market competition. This, in effect, skews the 'level playing field' in a particular direction.

The implicit baseline of the National Competition Policy

This section explores what could be called the 'social logic' underlying the National Competition Policy, which at its inception included not only competitive neutrality regimes but also programs of legislative review and structural reform in infrastructure and essential services. All these facets of the National Competition Policy were premised on a social logic of institutions and processes, including regulatory review and complaints mechanisms, that sought to embed economic rationality on a systematic basis into the everyday routines of governmental policymaking.

This social logic placed an extra-political constraint on lawmaking, one which institutionalised scepticism about public ownership and state control, both in terms of their efficacy and in relation to the positive social benefits flowing from them. It did so by subjecting legislative and executive discretion to the rule-based constraints of economic rationality, thereby imposing a kind of 'rule-of-economics'. This social logic has implications for both the rationale and the implementation dynamics of competitive neutrality policy.

Rationale

The basic premises underlying competitive neutrality are the ones that seek to impose pro-competitive disciplines on the ways in which goods and services imprinted with a public interest (including those provided by government-owned businesses) are delivered. The conceptual framework of these premises rests in important ways upon treating commercial and non-commercial objectives separately. This separation has already been noted above, but can be illustrated by the example of how competitive neutrality policy articulates community service obligations ('CSOs'). CSOs are envisaged as clearly identified, properly costed and transparently founded obligations undertaken by government businesses when they also operate in a competitive market to avoid non-transparent internal cross-subsidies — in other words, as a separate obligation grafted onto a core structure envisaged

37 OECD, above n 34, 15; *Harper Review*, above n 12, 255.

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as commercial and for-profit in nature.[38] While competitive neutrality policy does not therefore ignore public interest objectives such as those embodied in CSOs, its treatment of them as analytically separate has practical implications — these obligations should, under competitive neutrality policy, be transparently costed and provided for separately by the government if they are to be retained. This process faces technical challenges and can generate political vulnerability for the public interests thereby identified, particularly in sectors such as human services — we return to these points below. For now, we confine our point to making visible the conceptual assumption of competitive neutrality policy that for-profit and not-for profit objectives be separately evaluated, funded and institutionalised.

Implementation

Just as other aspects of the National Competition Policy under the *Hilmer Report* applied this discipline to public rulemaking and policymaking processes, so too competitive neutrality regimes require policymakers to satisfy a public interest test to justify the non-application of competitive neutrality policy. In principle, this public interest test as noted above allows equal consideration of economic, social and environmental dimensions of service delivery and policymaking. However, empirical research has shown that in practice the application of the public interest test in the broad context of the National Competition Policy (and particularly in the legislative review regime) led to considerable difficulties in incorporating redistributive goals, and more broadly a sense of social cohesion and community, into its social logic.[39] We argue here that these difficulties are tied to an implicit baseline in the conceptual framework of the policy regime that creates an onus of proof that favours the pursuit of competition and efficiency goals. In legislative review, then, policies for which a public benefit could not be demonstrated had to be repealed or modified so that they do not reduce competition. Similarly, entities delivering public services or running public infrastructure had to carry out their functions on a 'level playing field' that maximises the opportunity for competition with for-profit entities.

As noted above, the key obligation imposed by the *Competition Principles Agreement* — its 'guiding principle' — was articulated in cl 5(1):

> 5.(1) The guiding principle is that legislation ... should not restrict competition unless it can be demonstrated that:
>
> (a) the benefits of the restriction to the community as a whole outweigh the costs; and
>
> (b) the objectives of the legislation can only be achieved by restricting competition.

The way officials interpreted this led to the notion that the agreements created an 'onus of proof', and more specifically one *against* regulatory

38 The concept of community service obligations ('CSOs') is not defined in the *Competition Principles Agreement*, however it could be understood generally as '[w]hen services are provided in a context where "normal commercial practice" would not provide service, the provider is refunded by the government to the extent of that Community Service Obligation (CSO)'. See more Morgan, above n 6, 93.

39 Morgan, above n 6, ch 5; David Wishart, *Australia's National Competition Policy 1995-2005* (PhD Thesis, Australian National University, 2014) 360–3.

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intervention.[40] Broad as the 'guiding principle' of giving primacy to competition goals in regulatory policymaking may seem, sharp debates took place within the bureaucracy regarding the precise onus of proof implied by the wording. Was the purpose of the 'guiding principle' to create a presumption against a decision to intervene politically in the economy, especially via command-and-control regulation? Many of those implementing the reform program were committed to this interpretation. The general rules of the review regime may not *preclude* a decision to regulate, they argued, but they are intended to discourage it. For example, the NCC insisted in its very first assessment of progress in implementing regulation that under cl 5, unless actual empirical evidence was provided in support of government intervention, the *presumption* would be against government intervention.[41] In the federal government, officials from what is now called the Office of Best Practice Regulation were strongly committed to the notion that the most important facet of the *Competition Principles Agreement* involved its challenge to the status quo through the establishment of a burden of proof that militated in favour of change.[42] Absent an 'adequate' case in favour of regulatory intervention, deregulation would be the presumptive solution.

Empirically then, implementation of this framework required threshold justification of government intervention or state ownership, a justification that uses competitive market principles as its implicit benchmark. Legislative justification had to be framed in precise terms of addressing a market failure. Furthermore, redressing the failure should only involve government intervention if absolutely necessary. 'A [command-and-control] regulatory approach should be the last option. Economically they are the least efficient and may impose significant costs on the community.'[43] Or, as the guidelines commissioned by the Victorian Government insisted, 'market failure is a necessary but not sufficient ground for government intervention'.[44] That is, *government* failure had to be disproved as well as market failure proved for legislative review. Moreover, competitive neutrality required the *removal* of advantages flowing from state ownership, benchmarking the 'level playing field' by reference to the standards of market competition between commercial for-profit entities, as the Victorian *Competitive Neutrality Policy* terms it, ensuring that government business enterprises are either corporatised or 'subject to taxation, financial and regulatory requirements *equivalent to the private sector*'.[45]

Under the National Competition Policy, states have latitude on how they specifically implement the *Competition Principles Agreement*. But although different political leadership has led to varying emphasis on the priority of

40 Morgan, above n 6, 67.

41 NCC, *Considering the Public Interest under National Competition Policy* (1996).

42 Bronwen Morgan, 'The Economisation of Politics: Metaregulation as a Form of Nonjudicial Legality' (2003) 12 *Social and Legal Studies* 489, 502.

43 Council of Australian Governments, *Principles and Guidelines for National Standard Setting and Regulatory Action by Ministerial Councils and Standard-Setting Bodies* (1997) 20.

44 Victorian Government, *National Competition Policy: Steps to Assist Agencies in Complying with the Guidelines for the Application of the Competition Test to New Legislative Proposals* (1995) Point 5 of Step 3.

45 Department of Treasury and Finance (Vic), above n 28, 10 (emphasis added).

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market competition and efficiency objectives,[46] a common thread has been retained across the different approaches of insisting on 'a culture of transparency and reasoned justification in economic policy' that actively demonstrates that non-economic public benefit policy objectives would be jeopardised if market competition and efficiency were *not* prioritised.

To sum up, in theory, a policy decision to deregulate or to restructure government business using the criteria of private sector commercial business would still require governments to consider some of the 'social' facets of regulation/public ownership listed in cl 1(3) of the *Competitive Principles Agreement*. But the conceptual structure of this inclusive approach still depends upon an analytical separation of commercial and non-commercial objectives. And the modus operandi of its implementation undermines the practical and political viability of the latter, because the processes of implementation create an implicit baseline that effects a demanding onus of proof for any arguments retaining non-commercial objectives.

III Social enterprise: A challenge to the implicit baseline?

This brings us to the question of why social enterprise might pose a challenge to the concept and operation of competition principles articulated in this way, whether in legislative review or competitive neutrality procedures. It is important to state at the outset that social enterprise does not refer to a specific kind of legal entity. Rather, it is a broad descriptive term for a variety of practices that challenge traditional assumptions of doing business that is increasingly popular both within[47] and beyond[48] Australia. Social enterprise is a term which has been in use in public discourse sporadically since the mid-70s.[49] Initially it was used in connection with relatively small-scale efforts to create community-based sustainability initiatives, from the Solar Centre in the US[50] to Schumacher College in the UK, inspired in part by the 19th century cooperative movement.[51] The notion that social enterprise is a 'movement' in an activist sense is less visible since social enterprise has become institutionalised in formal policy terms, particularly in the UK from

46 Morgan, above n 6, 117–23. For a more recent example, see Department of Treasury and Finance (Vic), above n 28, regarding Victoria's two separate processes for weighing the public policy dimensions of competitive neutrality.

47 Jo Barraket et al, 'Classifying Social Enterprise Models in Australia' (2017) 13 *Social Enterprise Journal* 365; Bronwen Morgan, 'Legal Models Beyond the Corporation in Australia: Plugging a Gap or Weaving a Tapestry?' (2018) *Social Enterprise Journal* (forthcoming).

48 Levinus Timmerman, Alexander Schild and Matthijs De Jongh, 'The Rise of the Social Enterprise: How Social Enterprises are Changing Company Law Worldwide' (2011) in Sam Muller et al (eds), *The Law of the Future: A Collection of 'Think Pieces'* (Torkel Opsahl Academic ePublisher, 2011); Ofer Eldar, 'The Role of Social Enterprise and Hybrid Organizations' (John M Olin Center for Studies in Law, Economics, and Public Policy Research Paper No 485, Yale Law School, 2015) 485.

49 Barraket et al, above n 47.

50 Peter Barnes, *Capitalism 3.0: A Guide to Reclaiming the Commons* (Berrett-Koehler Publishers, 2006).

51 Alex Nicholls, *Social Entrepreneurship: New Models of Sustainable Social Change* (Oxford University Press, 2008).

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the late 1990s onwards, but the resonance of that activist history continues in a longstanding divergence between two strands of social enterprise literature.[52] One, influential in mainland Europe and often supported by government policies or funding frameworks, is rooted in the cooperative tradition with a strong emphasis on democratic participation. The other, more dominant in the US, particularly in certain networks of foundations and universities, conceptualises social enterprise as an outcome-focused business model where commercial activity provides funds for a social cause. We will come back to this divergence below, but a particularly widely cited definition in Australia of social enterprise leaves room for both of these strands. This definition is articulated in the study on *Finding Australia's Social Enterprise Sector* ('*FASES*') conducted in 2010 and updated in 2016 which defines social enterprises as entities that:

- Are led by an economic, social, cultural or environmental mission consistent with a public or community benefit;
- Trade to fulfil their mission;
- Derive a substantial portion of their income from trade; and
- Reinvest the majority of their profit/surplus in the fulfilment of their mission.[53]

The challenge presented by social enterprise to competitive policy is twofold. As argued in Part 1, the competitive neutrality policy regime is embedded in a commitment to competition principles that assume that the 'level playing field' is a competitive market, and that public benefits of a social kind are distinct from, additional to, or operate externally to, that market. From a broad policy perspective, social enterprise challenges this because it seeks to blur the line between for-profit and not-for-profit organisational structures. In doing so, social enterprises internalise the pursuit of social outcomes into their corporate governance structures, thus modifying competition 'from the inside out', so to speak. This leads to a misfit between the conceptual underpinnings and policy rationale of competitive neutrality on the one hand and social enterprise on the other. This poor fit we initially discuss in relation to the broad policy thrust of both social enterprise and competitive neutrality.

Although as noted above, 'social enterprise' has no specific legal referent, its rise is encouraging scholars and policymakers to prise open the black box of company law, and specific hybrid legal models apt for social enterprise have emerged in a number of jurisdictions. Our second perspective on the challenge of social enterprise takes into account this greater level of legal specificity, though given the absence of any specific Australian legal model for social enterprise to date,[54] we focus more on the policy implications of legal structure, rather than any applied doctrinal legal analysis. The legal models emerging in other jurisdictions broadly reflect the divergence already noted above, insofar as the main variants developed thus far are either legal models

52 Jacques Defourny and Marthe Nyssens, 'Conceptions of Social Enterprise and Social Entrepreneurship in Europe and the United States: Convergences and Divergences' (2010) 1 *Journal of Social Entrepreneurship* 32, 34, 38.

53 Jo Barraket et al, *Finding Australia's Social Enterprise Sector: Final Report* (2010) 4; Jo Barraket, Chris Mason and Blake Blain, *Finding Australia's Social Enterprise Sector 2016: Final Report* (2016) 3.

54 Morgan, above n 47.

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of social enterprise premised on *multi-stakeholder ownership*, or legal models that formally incorporate commitments to *specific social impacts or outcomes*. We argue that the challenge to competitive neutrality regimes is much more marked in relation to the former than the latter. But first, we explore the 'fit' between the broad policy thrust of social enterprise and competitive neutrality.

The challenge from a broad policy perspective

The definition of social enterprise from the *FASES* study cited above rests on the 'how' and the 'why' of what social enterprise entities do, and not on their formal structure. Putting this 'how and why' into practice, however, has the general effect of blurring the boundaries between not-for-profit and for-profit legal models for companies or associations, no matter what legal forms are adopted. Indeed, this is explicitly the motivation underpinning social enterprise, and consequently the new legal structures emerging in recent years in response to the rising salience of social enterprise aim to institutionalise hybridity at an internal organisational level as a matter of law. This institutionalised hybridity moves away from separating the economic and the social within corporate governance, and instead braids profit and social purpose closely together. As noted recently in a US legal professional publication:

> These forms were created in response to growing frustrations in the entrepreneurial community with corporate law's binary distinction between for-profit corporations, which are organized to maximize shareholder wealth, and nonprofit organizations, which are organized exclusively for charitable purposes.[55]

At the broad policy level, what is attractive about social enterprise from the perspective of its supporters is precisely the capacity to combine in one legal entity the making of profit, a financial return on investment and the pursuit of non-commercial social or environmental objectives. Different jurisdictions have chosen distinct pathways to achieve this. Broadly speaking, the UK and Canada have chosen to enact substantive constraints on internal corporate governance, monitored by a newly created government regulator. The US model is based on externally-focused reporting, transparency and disclosure, monitored by contestable third-party audit. European jurisdictions such as Italy have enacted legislation to support social cooperatives, with shared ownership and multi-stakeholder ownership at the core of their governance.[56]

A little more detail about these models is provided below. Here we merely stress that the policy salience of social enterprise rests on its hybrid status, and its commitment to demonstrating the social value generated, which allies it to the public interest commitments acknowledged as important by competitive neutrality. Viewed as an alternative to both state and private enterprise, social enterprise policy seeks to bridge the disadvantages of both, aspiring in ideal form to address the political contest over 'state vs market', which often

55 Rene Kathawala and Tal Hacohen, 'The Case for Pro Bono Support of Social Enterprises', *New York Law Journal* (online), 9 September 2015 <http://www.newyorklawjournal.com/id=1202736623893/The-Case-for-Pro-Bono-Support-of-Social-Enterprises>.

56 Bronwen Morgan, 'Transcending the Corporation: Social Enterprise, Cooperatives and Commons-Based Governance' in Charles R T O'Kelley, Justin O'Brien and Thomas Clarke (eds), *Oxford Handbook of the Corporation* (Oxford University Press, forthcoming).

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circulates around positions that charge state-owned business with performing poorly on efficiency and competition dimensions, while private enterprise fails to give sufficient priority to social and environmental objectives. From this perspective, for example, social procurement of service delivery that gives priority to social enterprises is attractive.[57] But this approach would cut directly across the preference of competitive neutrality policy to separate commercial and non-commercial objectives. There is a fundamental ill fit, flowing from the analytical separation of 'economic' and 'non-economic' objectives implicitly underpinning competitive neutrality policy, and its related theoretical preference for maximising social outcomes either via aggregate consumer welfare or via targeted distribution only when premised on transparent and costed public justification.

The challenge from the perspective of two different social enterprise legal model types

It is helpful to explore this ill fit in more detail, taking into account the varying emphasis of the two key strands of social enterprise models: those that focus on the production of social impact or social outcomes, and those that rest on shared ownership and multi-stakeholder governance.

Social impact/outcome models

For the broad-brush purposes of this exploratory analysis, both the UK and US approaches to social enterprise are premised on the salience of social outcomes. UK Community Interest Companies ('CICs') combine a company limited by shares that can issue capped dividends, paid directors, a mandatory 'asset lock' and explicit commitment to a named 'community interest' which is monitored by a CIC regulator. US benefit corporations are legislatively backed to create general public benefit in addition to financial return, and report on the outcomes to accredited third parties in a contestable market for certification. Although Australia does not have a distinct social enterprise legal model, a recent Treasury discussion paper on social impact investing raises the question of whether such a model would facilitate the combined pursuit of both social impact and financial return.[58]

A number of considerations raised in the paper are consonant with the emphasis in competitive neutrality regimes on transparent, fully costed and analytically separate social objectives, like CSOs. As the Treasury paper notes, '[s]ocial impact investments are investments made with the intention of generating measurable social and/or environmental outcomes in addition to financial return'.[59] Two of the four core principles guiding their use are 'deliverable and relevant social outcome' and 'robust outcomes-based measurement and evaluation'.[60] Moreover, the third, value for money, rests in part on a weighing-up of the benefits and the costs of the approach from the perspective of the Australian Government, suggesting that a broad form of

57 This is increasingly popular in Queensland: Barraket, Mason and Blain, above n 53; and more recently in Victoria: Victorian Government, *Social Enterprise Strategy* (2017).
58 Australian Treasury, *Social Impact Investing*, Discussion Paper (2017) 18, 20.
59 Ibid 8.
60 Ibid 18, 20.

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public benefit assessment underpins final policy decisions in this area as it does with the *Competition Principles Agreement*.

Despite the conceptual similarities noted here, there are still considerable challenges that exist in linking the kinds of processes noted above with the policy objectives of competitive neutrality. These challenges are twofold. First, there are technical challenges of measurement and data. It is challenging to articulate and agree to social outcome measures in many instances. This is a particularly acute difficulty of applying competitive neutrality policy in the human services sector, especially in relation to CSOs, as acknowledged by the *Harper Review*. The difficulty with CSOs in human service is that it is very challenging to specify the benefits of, for example, human interaction in aged-care services, much less the methods for identifying the cost. Even with agreed outcomes and methods, there is a lack of accessible, high quality data to measure outcomes to determine success (and payment) for particular social impact investment projects and frequently there are extended timeframes involved in the emergence of relevant social outcomes.

These technical difficulties are supplemented by the fact that a different 'implicit baseline' underpins the notion of social enterprise, in relation to which it is difficult to even apply the question of 'competitive advantage or disadvantage of social enterprise enjoyed because of their ownership and unique structure'. Under the framework of competitive neutrality, analysis is likely to focus on whether the 'social' aspects of social enterprise can be seen as a potential competitive neutrality disadvantage — but this question implies a benchmark that is only muddily conceptualised when social enterprise is involved. It cannot be asked with an implied baseline of commercial for-profit business, or an assessment of disadvantage relative to how the enterprise might operate if doing so purely for profit — because the whole *raison d'être* of social enterprise is *not* to function in this way. At the same time, the notion expressed in the Treasury paper that key benefits include cash savings and avoided future costs for government[61] illustrates that the government aspires to benefit from efficiencies flowing from social impact investment, while ensuring that social outcomes are still produced. The equal valuation of both economic and social outcomes here makes political sense but is difficult to operationalise in terms of the conceptual framework of competitive neutrality discussed in Part I. This reinforces the artificial separation of commercial and non-commercial dimensions of enterprise discussed earlier, and is arguably likely to drive a focus on cost-benefit analysis becoming the default approach to determination of competitive neutrality matters.

It is perhaps not surprising that the transaction and due diligence costs of operationalising social impact assessment are very high when compared to the scale of existing social enterprises and the expected rates of financial return. These barriers, as well as the technical challenges noted above, are all acknowledged both in broader debates over social enterprise, and in the Treasury discussion paper itself, which explicitly notes that the social impact assessment model is not suitable for all models of social enterprise or for promoting positive social outcomes.[62] This brings us to the second main

61 Ibid 19.
62 Ibid 9.

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model of social enterprise, which is grounded in multi-stakeholder ownership.

Multi-stakeholder focus

Given the limits noted above of trying to measure social outcomes as separate elements of enterprises seeking to blend social and economic objectives, multi-stakeholder-owned models of social enterprise provide an alternative approach to the broad policy issue. However, they do so in ways that are even less consistent with the framework of competitive neutrality regimes. Most strikingly, multi-stakeholder models are premised far less on public transparent articulation of their social objectives in externally measurable ways. In particular, their governance structures are ill-adapted to specifying these as separate from the economic interests of the enterprise. Rather, social and economic objectives are integrated in the consideration of multiple member interests articulated through voice, deliberation and shared ownership within internal corporate governance.

Within multi-stakeholder-owned social enterprise, then, social objectives become more of a question of managerial discretion, discretion that is constrained by the structural design of an entity that is more overtly attuned to multiple stakeholder and member interests than standard company forms. This moves away altogether from implicit baselines that prioritise competitive efficiency. Instead, a qualitatively different approach to economic development emerges as salient: one that conceptualises economic endeavours as always already embedded in political and social dimensions. It is a perspective that moves quickly beyond the scope of this article. Peter North,[63] for example, argues that we need to develop asset-based community development, diverse economies and solidarity economy approaches which prioritise economic democracy, while Graham Thompson and Simon Teasdale[64] argue that social enterprise regulatory frameworks should seek to institutionalise associative democracy in ways that current UK social enterprises fall short of. These are qualitatively and conceptually different trajectories of argument from those that underpin competitive neutrality regimes. If the challenge of social enterprise to the implicit conceptual and analytical underpinnings of competitive neutrality is taken seriously, it opens up the possibility of entering into these broader arguments, which are important responses to the increasingly untenable separation of economic issues from their social, political and environmental consequences.

IV Conclusion

The challenge of social enterprise for competitive neutrality has two horns. In a legal form that prioritises social impacts, social enterprise is reasonably consistent with competitive neutrality policy but faces technical implementation challenges. In a legal form that prioritises multi-stakeholder ownership, social enterprise has profound systemic implications for existing shared commitments to current models of economic development. Hence upon these two horns rests, as the metaphor implies, a dilemma, one more

63 Peter North, 'Local Economies of Brexit' (2017) 32 *Local Economy* 204, 211–14.

64 Graham Smith and Simon Teasdale, 'Associative Democracy and the Social Economy: Exploring the Regulatory Challenge' (2012) 41 *Economy and Society* 151, 167–8.

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political than technical. The choice of which of these paths to develop is at the heart of debates over the future trajectories of social enterprise, and this encounter with competitive neutrality policy demonstrates the challenge thereby posed. Responding to this challenge will clarify the full potential of current innovations in legal structures for social enterprise[65] to enhance opportunities for social enterprise to grow and strengthen. It is important, therefore, to raise the question of whether competitive neutrality might be acting as a barrier to the ability of social enterprise to respond to rising political and consumer demand for more sustainable business models.

65 Morgan, above n 47.