

# Chapter 1

## Executive Summary and Main Conclusions

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### 1.1 Introduction and background

The purpose of this analysis is to examine public sector activities in commercial markets (i.e. activities in competition with private enterprises) and to assess whether existing regulation is sufficient to ensure that public sector commercial activities do not unnecessarily distort competition. The Danish Competition Council has ownership of the analysis, and the Danish Competition and Consumer Authority has prepared the analysis on behalf of the Competition Council.

Thus, when public sector players sell services in competition with private players, they could have a competitive advantage that is associated with the public ownership, for instance in the form of more lenient tax rules or favourable funding opportunities. Moreover, cross-subsidisation from public services to commercial services may entail that the price does not cover the costs of producing the services. This could lead to distortion of competition and compel commercial players – who potentially produce the services more efficiently – to reduce production or leave the market altogether. This, in turn, could lead to a socio-economic loss in the form of higher prices and reduced innovation.

*The main focus of this analysis is on revenue-funded activities and municipal commercial activities.*

In principle, many aspects of public sector activities could be in competition with existing or potential private sector providers. The main focus of this analysis is on 1) revenue-funded activities which may be carried out by government institutions under the authority of the Danish Finance Act (*finansloven*) and by government-funded, self-governing institutions under the authority of other acts and 2) municipal commercial activities under the authority of written legislation or the municipal authority rules, see Box 1.1

The overall scope of these activities is difficult to determine. Government players carry out revenue-funded activities worth approx. DKK 2.4 billion annually. Most of these activities are carried out in commercial markets, mainly within the areas of knowledge services and education. However, no information is available about the total commercial activities of Danish municipalities, and the assessment is that most municipalities do not have a total overview of the scope.

The analysis focuses on three areas: 1) pricing of revenue-funded activities and municipal commercial activities, 2) enforcement of the rules on revenue-funded activities and municipal commercial activities; and 3) the right to carry out revenue-funded activities and municipal commercial activities.

As far as pricing is concerned, the Danish rules do not fully comply with OECD recommendations.<sup>1</sup> Thus, there is no consistent adjustment for the advantages that may be associated with public ownership. As a case in point, Danish authorities etc. are not obliged to include commercial profit in the price of their commercial services. The analysis also finds significant differences in the amount of profit included by government players in their pricing.

The Danish Competition Council recommends that the Danish rules to prevent distortion of competition be clarified and, in particular, that centralised guidelines be prepared to implement the OECD recommendations in this area and ensure that prices are set to a greater extent according to so-called competitive neutrality principles.

Enforcement of the rules on revenue-funded activities and municipal commercial activities is characterised by sets of complex rules, managed in interaction between various authorities, including the State Administration, responsible ministries and the Danish Competition and Consumer Authority. This may weaken compliance. Enterprises are reluctant to complain when faced with unfair competition from revenue-funded activities or municipal commercial activities, and the complaints system is often perceived as opaque and inefficient.

Therefore, the Danish Competition Council recommends that supervision of revenue-funded activities and municipal commercial activities be strengthened and harmonised and that the complaints process and the right to complain be simplified. Among other initiatives, the Competition Council suggests that a centralised, single entry point for complaints be established to process any questions relating to public sector commercial activities that distort competition.

The right to carry out revenue-funded activities and municipal commercial activities is determined politically under the authority of legislation or, as far as the municipal authority rules are concerned, developed based on the practices of the supervisory authorities. Such right may, for instance, be justified by the consideration to avoid wasting assets, whether tangible or intangible, or so-called co-production advantages associated with the fact that the main activities of public institutions could make them especially suited to produce certain consequential services. However, if the price of these services is not set correctly, government players' access to carry out revenue-funded activities could have negative effects on effective competition in the market. Moreover, in some instances, it is difficult to justify activities by waste of assets or other socio-economic considerations.

Therefore, the Danish Competition Council recommends that a committee be appointed to define clearer criteria for the activities that government players should have the right to carry out as revenue-funded activities.

In connection with the analysis, the Danish Competition and Consumer Authority received a number of appeals from commercial players that are faced with unfair competition in areas that cannot be classified as revenue-funded activities or municipal commercial activities; see Appendix 2 in the Danish report.

Thus, a range of fully or partly publicly-funded services are sold (or provided free of charge) in competition with private sector players. These services may resemble revenue-funded

***The analysis focuses on three areas: 1) pricing of revenue-funded activities and municipal commercial activities, 2) enforcement of the rules on revenue-funded activities and municipal commercial activities; and 3) access to carry out revenue-funded activities and municipal commercial activities.***

<sup>1</sup> In terms of correct pricing, the OECD recommends, *inter alia*, that rules be established to ensure tax, regulation and loan neutrality, as well as inclusion of commercial returns. Appendix 1 in the Danish report elaborates on the OECD recommendations, and the difference between the OECD recommendations and the Danish rules can be found in table 1.2

activities or municipal commercial activities, but cannot be classified as such. Examples include GTS institutes (independent Danish research and technology organisations) selling technological advice to enterprises etc., online activities etc. of the DR (the Danish Broadcasting Corporation), the sale of workout services by associations and so on and so forth. These activities may be seen as anti-competitive by private sector players. However, if the activities – and especially their pricing – are authorised under special legislation, the Danish Competition Act (*konkurrenceloven*) does not apply. Thus, such statutory authority reflects political prioritisation of considerations other than the consideration of effective competition in the narrow sense of the word, and if the wish is to ensure more equal conditions of competition in some of these areas, amendments to the specific special legislation are required.

The findings and recommendations of the analysis are elaborated in section 1.2 onwards.

Box 1.1

**Delimitation of the analysis**

The main focus of the analysis is on the revenue-funded activities of government institutions and on municipal commercial activities carried out either in accordance with written legislation or under the municipal authority rules. Through these means, government institutions and municipalities have certain rights to sell goods and services in a commercial market and may thus be operating in direct competition with private sector players. It applies for both revenue-funded activities and municipal commercial activities that the commercial activities must not distort competition with private sector players.

As already mentioned, the delimitation of the analysis should not be seen to imply that there can be no competitive challenges in areas outside the scope of this analysis.

Thus, a number of services and activities affect competition, through regulation or public sector co-funding, but they cannot be classified as revenue-funded activities or municipal commercial activities.

Examples include the activities of public corporations (DSB (Danish Rail), Post Danmark (Danish postal services), Danske Spil A/S (national lottery) etc.), which operate under private law although they are fully or partly owned by the Danish Government. Government and municipal utilities are not included in the analysis either. The reason is that they are often natural monopolies and are typically operated in corporate form under a 'self-sustaining' regime that reflects their monopoly status.

Non-public corporations, foundations or associations receiving public sector funding, including, for instance, sports associations etc., are not classified as revenue-funded activities or municipal commercial activities either, and consequently the analysis does not go into detail about them. Moreover, the activities of the GTS institutes are not revenue-funded activities, given that they receive direct statutory funding, and special anti-competition rules apply to this area.

Finally, the new Danish Public Procurement Act (*udbudsloven*) took effect on 1 January 2016. The Public Procurement Act establishes the framework for procurement by public contracting entities. The intention of the Public Procurement Act is to ensure optimum utilisation of public funds through effective competition for contracts. Public procurement and the new procurement rules are discussed elsewhere. The Danish Competition and Consumer Authority has issued guidance on the new procurement rules.<sup>2</sup>

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<http://www.kfst.dk/~media/KFST/Publikationer/Dansk/2016/Udbudsloven%20%20vejledning%20om%20udbudsreglerne.pdf>

## 1.2 Scope and nature of revenue-funded activities and municipal commercial activities

Government institutions and self-governing institutions may sell goods and services as revenue-funded activities when authorised to do so under the Finance Act or through other acts. Revenue-funded activities are carried out under special rules in the Danish Ministry of Finance Budget Guidelines (*Budgetvejledning*).

*In 2014, government players carried out revenue-funded activities worth approx. DKK 2.4 billion.*

Government players can carry out various tasks as revenue-funded activities. For instance, course activities, consultancy, education for foreign students, consulting services etc. are provided as revenue-funded activities, often in competition with commercial players. However, revenue-funded activities that are not immediately in competition with commercial enterprises are also carried out, such as For instance, the processing of appeals by the National Board of Industrial Injuries in Denmark against decisions on industrial injury insurance claims.

Under specified conditions, municipal commercial activities can be authorised under the municipal authority rules or special acts. Municipal commercial activities are carried out in a number of different areas. For instance, municipalities sell recycled waste, second-hand clothing, surplus objects (used furniture etc.), Christmas trees, firewood etc. from municipal woods, output from municipal employment workshops and know-how that is a by-product of other municipal tasks.

In addition, municipalities have activities in the form of property letting, the sale of surplus food from municipal kitchens and sales to other municipalities of, for instance, waste disposal services and road operation services, all of which are examples of the sale of excess capacity (i.e. to avoid wasting assets).

### **Revenue-funded activities worth approx. DKK 2.4 billion annually**

In 2014, government players carried out revenue-funded activities worth approx. DKK 2.4 billion. Self-governing institutions, such as universities, recorded total revenue of approx. DKK 1.4 billion from revenue-funded activities in 2014, while institutions under the Finance Act, such as Statistics Denmark, recorded total revenue of approx. DKK 1 billion from revenue-funded activities. For an overview of the revenue of government institutions from revenue-funded activities, broken down by institutions, please see Appendix 3 in the Danish report.

In recent years, the scope of revenue-funded activities under the Danish Government has been on the rise. Since 2011, the revenue from the Danish Government's revenue-funded activities has increased by about 20 per cent, adjusted for inflation.

The total profit from revenue-funded activities has also been increasing. In 2011, public institutions recorded an average commercial profit of 6.6 per cent (DKK 128 million). In 2014, this profit had risen to 9 per cent (DKK 218 million). The significance of revenue-funded activities varies greatly between institutions. For 41 per cent of the government players, revenue-funded activities account for less than 2 per cent of total revenue, while revenue from revenue-funded activities accounts for more than 10 per cent of total revenue for 17 per cent of the public institutions.

### **Danish municipalities do not have a total overview of commercial activities**

Given that there is no requirement to disclose the total commercial activities of the Danish municipalities in the authorised municipal accounting system, information is not available on these activities. Municipal accounting systems do not enable extraction of adequate and fair information. Therefore, the Danish Competition and Consumer Authority has sought to clarify the scope of municipal commercial activities through a questionnaire survey. However, only 38 municipalities responded, 27 of which (71 per cent) stated that they carry out commercial activities. Only 15 municipalities provided an estimate of their total revenue from commercial activities in 2014. In 2014, the total revenue for the 15 municipalities was DKK 88 million.

*Information is not available on total commercial activities of Danish municipalities.*

However, considerable uncertainty surrounds this figure. Danish municipalities do not have a total overview of their commercial activities. With the current accounting systems, it would be resource-intensive for most municipalities to provide a reliable estimate of their revenue from commercial activities, which makes it difficult to gain a total overview of municipal commercial activities.

### **Most revenue-funded activities are carried out in the areas of knowledge services and education**

About 80 per cent of the revenue from revenue-funded activities comes from the areas of education or knowledge services. For institutions authorised under the Finance Act to carry out revenue-funded activities, approx. 60 per cent of the revenue from revenue-funded activities is derived from education and knowledge services. For self-governing institutions, this percentage is higher: close to 100 per cent.

*About 80 per cent of the revenue from revenue-funded activities comes from the areas of education or knowledge.*

A large proportion of the self-governing institutions authorised to carry out revenue-funded activities are under the purview of the Ministry of Higher Education and Science and the Ministry for Children, Education and Gender Equality.

In the area of education and research, the Technical University of Denmark, Aarhus University and the University of Copenhagen, in particular, record high revenue from revenue-funded activities, while, in the area of education, the highest revenue is reported by institutions offering vocational study programmes and production schools.

The Agency for Modernisation Ministry of Finance (*Moderniseringsstyrelsen*), the National Social Appeals Board (*Ankestyrelsen*), Statistics Denmark, the Danish Meteorological Institute (*DMI*), the Danish National Centre for Social Research (*SFI*) and the Danish Institute for Local and Regional Government Research (*KORA*) are among the institutions authorised under the Finance Act to carry out revenue-funded activities that have the highest revenue from revenue-funded activities.

Since revenue-funded activities are carried out especially in the areas of education and knowledge services, it is hardly surprising that they are also the areas in which private sector players most often experience conduct that distorts competition from public sector players. The pricing of public services is seen as a particular challenge by private players.

### **Revenue-funded activities are carried out mainly in commercial markets**

An overall distinction can be made between revenue-funded activities carried out in a commercial market and in a monopoly market. For the purpose of this analysis, monopoly markets are defined as markets where, as a result of legislation or regulations, public sector players are the only providers, while commercial markets are defined as markets with actual or potential competition. This distinction is important in a public sector player's pricing of its activities and in the way in which pricing affects competition and dynamics in the market.

*Approx. 70 per cent of all revenue-funded activities are carried out in commercial markets.*

The Danish Competition and Consumer Authority has asked government players to specify whether their revenue-funded activities are carried out in a commercial market or in a monopoly market. The respondents answered that approx. 80 per cent of the total revenue from revenue-funded activities is derived from commercial markets, while the remaining 20-odd per cent comes from monopoly markets. This distribution is based on responses from approx. 30 per cent of the government institutions authorised to carry out revenue-funded activities. However, non-respondents to the survey are estimated to have relatively high sales volumes in monopoly markets. Making a rough allowance for this, approx. 70 per cent of all revenue-funded activities are carried out in commercial markets.

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### 1.3 Pricing of revenue-funded activities and municipal commercial activities

When public sector players carry out activities in commercial markets, competition could be distorted.

*When a public sector player participates in a commercial market, it is vital that the price is set at a certain level to ensure competitive neutrality.*

Pricing in a market depends on a number of factors, including the degree of competition in this market. In a market with intense competition, the commercial return will usually be driven down to an economically appropriate level, i.e. enterprises will recover their costs, while at the same time achieving a suitable return on the capital invested and the risk incurred. If competition is not effective, abnormal profit may be achieved. Thus, the profit margin, and hence the price, will typically be higher. This leads to losses for consumers and typically to a socio-economic loss.

When a public sector player participates in a commercial market, it is vital that the price is set at a certain level to ensure competitive neutrality. Competitive neutrality means that the prices of public services are set to ensure that the public sector player does not gain a competitive advantage as a direct consequence of the public ownership. For instance, consideration should be given to preventing cross-subsidisation between publicly funded activities and commercial activities. This entails, among other things, that the public sector player must include a share of its overheads in the pricing of commercial activities. In addition, competitive neutrality implies that pricing is adjusted to allow for any tax advantages, favourable lending opportunities or less restrictive regulation enjoyed by public sector players. Neutrality also implies that the public sector player includes an appropriate return, i.e. a suitable return on the capital invested.

Competitive neutrality does not prevent public sector players that have a competitive advantage over private enterprises from selling their products more cheaply in the market. For instance, both large public sector players and private sector players may have economies of scale and co-production advantages over small players, rendering them competitive. Such advantages could, for example, be associated with existing knowledge, facilitating more efficient provision of a knowledge-intensive service. This does not violate the principle of competitive neutrality.

Some of the services sold by public sector institutions in competition with private sector players may have positive externalities, i.e. positive effects for others than the buyers of the services. In markets with positive externalities, private provision of the service could lead to under-production seen from a socio-economic perspective. As a case in point, analyses and knowledge published by universities may have such positive externalities. The reason is that the knowledge and insight from such report will benefit not only the buyer but also others – or external parties – that have not paid for the analysis. If this positive externality is not reflected in a price below market price, this would lead to the underproduction of knowledge. Another example is register data collected in connection with regulatory tasks. Such data cannot be collected by private sector players, and the price for using the information (observing appropriate confidentiality) should, in principle, reflect the marginal costs of making data available to users.

To the extent that these services have high positive externalities, allowance for this should be made in the pricing of the services in question. Thus, in some situations, it may be appropriate for the public sector to sell the services at prices lower than production costs or provide the services free of charge. In such situations, the principle of competitive neutrality cannot be upheld, and thus it is not appropriate for the activities to be carried out as revenue-funded activities or municipal commercial activities. In those cases, services should be priced using rules other than those that should be applied to revenue-funded activities.

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### Applicable pricing rules

In the central government area, the rules governing pricing of revenue-funded activities are set out in various guidelines. The overall principles are set out in the Ministry of Finance Budget Guidelines, while more detailed rules are contained in Economic Administrative Guidelines (*Økonomisk Administrative Vejledninger*) of the Agency for Modernisation Ministry of Finance, including Guideline on pricing (*Vejledning om prisfastsættelse*) and Guideline on cost allocation (*Vejledning om omkostningsfordeling*). The Ministry for Children, Education and Gender Equality has a guideline of its own, reflecting the principles of other government guidelines. Similarly, a number of public sector institutions have developed their own guidelines for the performance of revenue-funded activities. The pricing rules of the Budget Guidelines are summarised in Table 1.1.

Table 1.1 Pricing rules

	Competition	Monopoly-like situation	Monopoly
Budget Guidelines	Market price, full cost recovery (possibly including profit)	Full cost recovery, excluding profit	Full cost recovery, excluding profit

In a competitive market, the consideration is to ensure that pricing does not distort competition. In a monopoly market or a monopoly-like market, the consideration is rather to ensure that abnormal profit is not achieved. Thus, the Budget Guidelines state that if an institution holds a monopoly or is in a monopoly-like situation, the price ensuring that costs are recovered is also the cap on the pricing of the service in question. Full cost recovery means that both variable costs and part of the overheads are recovered.

The Budget Guidelines do not provide an exact definition of a monopoly-like market. If a monopoly-like market describes a situation of potential competition (i.e. a situation in which there are or may come competitive enterprises that are not yet in the market), a price corresponding to the actual costs incurred without any profit margin may cause the public sector player to cut off potential competitors. This may weaken dynamics in the market.

Agency for Modernisation Ministry of Finance's guideline on pricing sets out a number of principles for how to set the price to avoid distorting competition with other market players. Among other things, the guideline specifies that the calculation of costs should be based on full cost allocation. Instructions are also provided on how to handle special types of costs and VAT.

In the municipal area, the overall principles for pricing are governed by the municipal authority rules and special acts. The overall principles are that the public price must reflect the market price and that competition must not be distorted. Moreover, the guideline for cost calculation provides a number of detailed principles for how cost calculations can be made. The guideline specifies that the calculation of costs should be based on full cost allocation. The guideline also sets out principles for how to provide a return on working capital and investment capital and how to handle VAT. The guideline is non-binding.

### Danish rules do not fully comply with OECD recommendations

Today, most countries have sets of rules seeking to ensure that competition between public sector players and commercial players is not distorted. The OECD has produced several reports on this topic and often emphasises that it is important to neutralise any advantages associated with public ownership. Such advantages could be possible public sector tax advantages, favourable lending opportunities given that the risk of default is lower, and possible advantages resulting from less restrictive regulation or lack of public sector incentives to generate a profit etc.

Table 1.2 summarises the key differences between the Danish rules seeking to prevent distortion of competition for government and municipal players, respectively, and the OECD recommendations.

*The Danish rules on pricing do not fully comply with OECD recommendations.*

**Table 1.2 Pricing – OECD recommendations and Danish rules**

OECD recommendations	Government area Budget Guidelines	Municipal area Market price	Municipal area Cost calculation
Separation of activities	Partly	Not comparable	Partly
Inclusion of joint costs	Yes	Not comparable	Yes
Commercial return	Partly	Not comparable	No
Tax neutrality	Partly	Not comparable	Partly
Regulation neutrality	No	Not comparable	No
Loan neutrality	No	Not comparable	No

Source: The Danish Competition and Consumer Authority

The Danish rules on pricing do not fully comply with OECD recommendations. As a case in point, the Danish rules in the government area do not neutralise all tax advantages associated with public ownership, and government players are not required to include a commercial profit when pricing their activities. Thus, although the rules are observed, competition could be distorted.

Application of the principle of market prices in the municipal area could also lead to distortion of competition. Firstly, given that prices in the market may reflect a number of different factors such as differences in products in terms of quality etc., the market price may be difficult to determine in practice. Moreover, there is no relationship between the costs of a municipality and the price based on the market price principle. Thus, the principle could result in goods and services being sold at prices that cover the costs of producing them.

For some goods and services, it may be difficult to meaningfully determine their production costs, and in such cases it may be appropriate to apply a market price principle. Examples include areas such as the sale of used equipment, name rights, letting of advertising space and the sale of real estate.

Non-compliance with the OECD principles could mean that, in some cases, equal conditions are not created and that public sector players will be able to set lower prices than private competitors that produce the services equally effectively.

The OECD mentions that it may be necessary to establish a *de minimis* threshold for commercial activities to be included in the rules. It would be appropriate to establish a system that is less administratively cumbersome for players with a small volume of economic activity than for players with a large volume of economic activity. In this context, a *de minimis* threshold could be applied.

In various contexts, Australia is cited – for instance by the OECD – as a front-runner when it comes to ensuring competitive neutrality. In the 1990s, Australia implemented a number of principles designed to neutralise public sector advantages in various areas. These principles are transparent, and calculation methods have been established in several areas, for instance for the calculation of profits.

In connection with a preliminary consultation procedure, the Danish Competition and Consumer Authority was approached by enterprises that experience anti-competitive pricing in areas that are not revenue-funded activities or municipal commercial activities – including municipal control bids for which the price should also be determined applying competitive neutrality principles. In areas in which the objective is that public sector activities should not distort competition, uniform rules should be applied for how to determine prices.

If the desire is to adopt rules implementing the OECD recommendations for competitive neutrality pricing in Denmark, these rules will have to be integrated with, for instance, section 11a of the Competition Act to ensure consistency between the rules.

Great variety exists between government institutions in terms of inclusion of profit in the price of their revenue-funded activities. Among the 71 respondent government institutions, 21 per cent include a profit of less than three per cent, while one in three institutions include profits of more than 15 per cent. In 2014, government institutions under the Finance Act had an average profit of nine per cent.

Quite a few of the private enterprises in competition with government institutions see the opportunity for government institutions to include low (or no) profit as a key reason why public sector institutions are able to set a price that is lower than that of private sector competitors. In the questionnaire survey, which is not representative, however, approx. 80 per cent of the respondents hold this view. However, there could also be other explanations why private enterprises are not competitive, for instance that the competing public sector institution may have specific economies of scale or co-production advantages.

Based on the analysis of the pricing rules for revenue-funded activities and municipal commercial activities, the Danish Competition Council has listed a number of recommendations, see Box 1.2. The primary aim is for Denmark to comply with the OECD recommendations in the area with a view to protecting against unfair competition from public sector providers that may weaken growth and the financial welfare of Danish consumers.

Box 1.2  
**The Danish Competition Council's recommendations on pricing**

The Danish Competition Council recommends:  
**that the rules to protect against distortion of competition be clarified.**

And more specifically:

- » that, as a main rule, a profit always be included in the of revenue-funded activities sold when the sale is made in a market with competition or potential competition from commercial players
- » that binding rules on pricing be established applying competitive neutrality principles for revenue-funded activities and municipal commercial activities. The rules must:
  - » implement the OECD recommendations in the area, including tax neutrality, regulation neutrality and the inclusion of a fair commercial profit.
  - » establish specific calculation methods and provide operational examples of those methods to achieve maximum transparency.
- » It must be ensured that the administrative costs of compliance are commensurate with the scope of economic activity and the risk of distortion of competition, including that it is assessed whether a *de minimis* threshold should be established for commercial activities falling within the rules.
- » The rules on pricing of public sector commercial activities should apply to all areas in which it is desired to create equal competitive conditions, including public control bids.
  - » Where it is desired to create equal competitive conditions, it should be stipulated in the relevant acts that compliance with the rules is mandatory.

#### 1.4 Supervision of revenue-funded activities and municipal commercial activities

##### **Applicable rules and enforcing authorities**

Public sector activities in commercial markets are governed by several sets of rules. At the same time, various authorities supervise these areas.

##### The European Commission

The European Commission enforces member states' compliance with the state aid rules. If a member state has provided state aid without the prior approval of the Commission, the Commission must *in principle demand* that the aid be repaid by the recipient. The EU state aid rules take precedence over other sets of rules.

##### The Danish Competition and Consumer Authority

The Danish Competition and Consumer Authority enforces the rules on aid which distorts competition and may issue orders for the termination or repayment of aid granted from public funds for the benefit of specific types of commercial activities. Thus, under section 11a of the Competition Act, the Danish Competition and Consumer Authority may issue orders when the aid has the direct or indirect object or effect of distorting competition, but only when the aid is not lawful according to other public regulations.

##### Supervision and auditing of government activities

###### *Responsible ministries*

In the central government area, each responsible ministry has overall supervision of the activities under the ministry, including revenue-funded activities. The responsible ministry may issue orders for the termination of a government activity if this activity is not authorised by legislation.

**Public sector activities in commercial markets are governed by several complex sets of rules.**

### *Rigsrevisionen*

*Rigsrevisionen* – the Danish national audit office – is responsible for conducting annual audits of all ministerial areas, including revenue-funded activities. The Auditor General may arrange with the minister concerned that an internal audit body is established under section 9 of the Danish Auditor General Act (*rigsrevisorloven*). *Rigsrevisionen* can then base parts of the audit on the work of the internal audit body.

### Supervision and auditing of municipal activities

#### *Responsible ministries*

The relevant ministry can submit statements on the lawfulness of municipal activities within its area of responsibility. The ministry has the discretion to determine whether there are grounds for submitting such statements.

#### *The State Administration*

The supervision of Danish municipalities and inter-municipal enterprises is conducted by the State Administration (*Statsforvaltningen*), of which the Ministry of Social Affairs and the Interior is the overall supervisory authority.

This supervision is judicial supervision. Thus, the State Administration can only take a position on whether a municipality is acting within the law. This entails that the State Administration cannot take a position on whether a municipal decision is fair or appropriate or on discretionary issues as long as such discretion is exercised within the law.

The State Administration does not conduct supervision to the extent that special appeals or supervisory authorities can take a position on the case in question. The competencies of the State Administration are described in more detail in section 3.5 of the Danish report.

The Danish Competition and Consumer Authority has reviewed the relevant opinions, which are available on the website of the State Administration. During the period from 2004 onwards, the State Administration has issued 10 opinions on municipal commercial activities in relation to the municipal authority rules and in relation to special acts. The State Administration found the municipal activities to be lawful in five of these cases and unlawful in five cases. In four of these cases, the State Administration issued a preliminary opinion on a proposed municipal activity.

*Various authorities supervise revenue-funded activities and municipal commercial activities.*

#### *Municipal auditing*

Municipalities must have their accounts audited by a state-authorized public accountant or a registered public accountant. The municipal auditors must be competent and independent. The audit must cover all areas of accounting under the municipal council. The audit must verify the correctness of the accounts and the compliance of the transactions covered by the financial reporting with the appropriations granted, other decisions by the municipal council, statutes, other regulations, agreements and usual practice.<sup>3</sup>

### Monitoring of politically determined activities with an element of public funding

The public sector performs tasks with an element of public funding. These tasks may be tasks that have been performed by the public sector for several years and may be regarded as 'core tasks' of the public sector, or new tasks that the public sector has not earlier been required to perform. These activities are determined politically by the Danish parliament and are authorized under legislation. In general, these activities will distort competition.

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<sup>3</sup> Consolidated Act No. 769 of 9 June 2015 – the Danish Act on Municipal Administration (*lov om kommunernes styrelse*)

No public sector bodies monitor whether politically determined activities unnecessarily distort competition. The Competition Act does not apply to these areas, given that the activities are authorised under other legislation, and the Competition Act is subordinate to other legislation. It is possible to make a request to the relevant ministry under which the activity belongs, but the ministry is not obligated to respond.

Finally, it is possible to complain to the Danish Parliamentary Ombudsman if a public authority is perceived to have committed errors in case handling. The Ombudsman cannot himself make decisions, but may make criticism of the authority in question and recommend that the case be reopened.

### **Complex sets of rules challenge the effective enforcement of public sector activities in commercial markets**

Thus, various complex sets of rules seek to ensure that competition between public sector players and commercial players is not distorted. These different sets of rules reduce the transparency of the system and may create challenges in ensuring effective enforcement of the rules.

The complex sets of rules and competencies apply, *inter alia*, in relation to section 11a of the Competition Act, which enables the Danish Competition Council to issue orders for the termination or repayment of aid granted from public funds to the benefit of specific forms of business activities.

When receiving such a complaint, the Danish Competition and Consumer Authority must assess according to section 11a(1), of the Competition Act, whether the public aid distorts competition. If the activity is authorised under other legislation, it is exempt from the Competition Act. Under section 11a(2) of the Competition Act, the assessment of legality is performed by the relevant supervisory authority. In several cases, this assessment may coincide with the assessment made by the Danish Competition and Consumer Authority under section 11a(1) of the Competition Act, given that, for instance under the the municipal authority rules, municipalities are obliged to charge the market price for goods and services. The assessment by the Danish Competition and Consumer Authority of whether the aid distorts competition may be included in the assessment by the relevant supervisory authority of legality, but this is not a requirement. In practice, there are examples of supervisory authorities deciding to make this assessment themselves, but also examples of supervisory authorities using the assessment made by the Danish Competition and Consumer Authority. This sharing of responsibilities is inexpedient and may lead to double case processing.

Moreover, the Danish Competition and Consumer Authority applies the market economy investor principle in the assessment of aid, while the State Administration and the responsible ministries apply other methods. It is also inexpedient that the same principle is not applied in the assessment of uniform issues. Moreover, the responsible ministry and the State Administration may not have the resources to conduct an in-depth assessment of the aspects of the case. The sharing of responsibilities could also present other challenges, for instance in the central government area where, on the one hand, the responsible ministry makes the decision to initiate the activity and, on the other, is responsible for assessing the legality of the activity if it is approached by commercial players.

Over the years, there have been few cases regarding public sector commercial activities which have distorted competition, see Box 1.3. The limited number of cases reflects that few of the requests received could justify an actual case in the assessment of the Danish Competition and Consumer Authority. This should be seen, *inter alia*, in the context that, in practice, the Danish Competition Council does not consider cases on aid which distorts competition if such aid is lawful under other legislation or if the aid affects trade with other EU member states.

*Complex sets of rules challenge the effective enforcement of public sector activities in commercial markets.*

Box 1.3  
**Few cases on aid which distorts competition**

Since October 2000 when the introduction of section 11a empowered the Danish Competition Authority to issue orders on activities receiving public aid, the Authority has decided 12 cases on aid which distorts competition.

Of these 12 cases, only five were about public sector commercial activities. All of these five cases involved aid which distorted competition in the form of indirect aid, such as cross-subsidisation, exemption from duties, lenient tax rules, guarantees etc.

In two of the five cases, the Danish Competition Council ordered the public sector player to terminate the aid. In the three other cases, the aid was either lawful under other legislation, or the aid was granted in a monopoly market with no competing players.

At the same time, this analysis suggests that enterprises competing with public sector players are reluctant to complain. In the questionnaire survey, a relatively large proportion of the respondent enterprises assess that they have had a reason to complain about a public sector player without doing so. The explanation given by the enterprises is fear of 'getting into hot water' with the public sector player, which is a competitor in one field but may be a customer in another. Moreover, the enterprises assess that the financial resources associated with a complaints process are not commensurate with the potential gain; and in many cases, the enterprises do not feel confident that a complaint will bring about a change of the situation.

The respondents also experience that it is unclear where to complain. Thus, just over one-fourth of the respondent private enterprises facing competition from public sector players do not know how to proceed if they suspect that the nature and scope of the public sector activity are inconsistent with the statute under which the activity in question is authorised.

At the same time, a majority of the respondent enterprises facing competition from a public sector player find the rules opaque and inadequate. This applies both to the central government area and the municipal area.

However, it is important to note that the questionnaire survey targets only enterprises facing competition from public sector institutions. As the questionnaire survey is not representative, it is thus not possible to draw any final conclusions based on the survey.

### **Supervision and auditing of revenue-funded activities**

Each responsible ministry holds responsibility for supervising the revenue-funded activities of government institutions. The audit is planned based on materiality and risk and does not form part of the supervision. *Rigsrevisionen* – the Danish national audit office – performs financial auditing assessing whether prices are set correctly, whether correct cost allocation has been made, whether pre- and post-calculations have been performed and whether business procedures and controls are in place to support correct administration and financial reporting.

The auditors also perform legal compliance auditing to assess whether government institutions have acted within their powers to carry out revenue-funded activities. Finally, the auditors assess whether the institution meets requirements of economy, efficiency and effectiveness.

*Rigsrevisionen* focuses its audit on key areas of risk. This means that not all revenue-funded activities are audited annually; only activities identified as key areas of risk are subject to annual audits. To clarify this area, the Danish Competition and Consumer Authority requested *Rigsrevisionen* to provide information on the number of control surveys in which *Rigsrevisionen* had examined issues related to revenue-funded activities and the number of instances in which *Rigsrevisionen* had expressed criticism of issues related to compliance with the rules for revenue-funded activities. As *Rigsrevisionen* does not keep separate records on

*Rigsrevisionen focuses its audit on key areas of risk.*

*Revenue-funded activities account for a relatively small proportion of the total revenue of the institutions.*

cases and issues related to revenue-funded activities, *Rigsrevisionen* was not able to provide exhaustive information in this respect. *Rigsrevisionen* referred to the annual publication *Report to the Public Accounts Committee of the Danish Parliament on the Audit of the Public Accounts* in which major cases are mentioned.

The publication shows that 2013 saw one case concerning non-compliance with the rules governing revenue-funded activities, while 2014 saw three cases. The limited number of cases could reflect that only major cases are published in the report, that compliance with the rules governing revenue-funded activities presents no special challenges, or that this area may not be seen as significant from an auditor's point of view, given that revenue-funded activities usually account for a relatively small proportion of the total revenue of the institutions. The consideration of effective competition and well-functioning markets does not directly play any independent role in the planning of the audit work.

At the same time, the requirements made by each responsible ministry for the internal auditors' review of the institutions' accounts may differ.

Based on the analysis of the enforcement of the rules and the complaints system, the Danish Competition Council has listed a number of recommendations for this area see Box 1.4. The main aims are to streamline and simplify the complaints process and to strengthen supervision and auditing of revenue-funded activities.

#### Box 1.4

#### Recommendations of the Danish Competition Council on the complaints process and supervision

The Danish Competition Council recommends:

**that the complaints process be strengthened, equalised and made more transparent.**

And more specifically:

- » that a centralised, single entry point for complaints be established to pass on complaints regarding public sector commercial activities which distort competition and public aid which distorts competition to the relevant supervising authority.
- » that it be specified in the relevant legislation that the relevant supervisory authority must be obliged to obtain an assessment from the competition authority when the legality assessment contains a market assessment, including a pricing assessment.
- » that the competition authority's market assessment, including the pricing assessment, be binding on the relevant authority's assessment.
- » The entry point for complaints is to provide guidance to enterprises on the complaints process and to take annual stock of ongoing and completed cases.

**that it be considered whether to strengthen supervision of the revenue-funded activities of government institutions**

And more specifically:

- » whether the auditing of revenue-funded activities should be strengthened.
- » whether the supervision of revenue-funded activities should be strengthened.

The competition authority should continue to prioritise cases of special significance to competition, including deciding whether there are sufficient grounds for issuing a binding opinion, examining or making a decision in a case, see section 15 of the Competition Act.

## 1.5 Access to carry out revenue-funded activities and municipal commercial activities

The access of public sector players to carry out revenue-funded activities or municipal commercial activities is subject to statutory authority. Today, the authority to carry out revenue-funded activities and municipal commercial activities, respectively, is subject to different acts.

### Applicable rules

The Finance Act and other acts provide a statutory basis to central government players for carrying out revenue-funded activities

Revenue-funded activities by the central government can be carried out under the authority of the Finance Act or other acts. Self-governing institutions carrying out revenue-funded activities may be authorised under the Finance Act or under other acts, for instance the Danish Act on Production Schools (*lov om produktionsskoler*).

The Danish Ministry of Finance Budget Guidelines list a number of conditions for revenue-funded activities which must be met in order for authority to be granted:

*Activities that are carried out as revenue-funded activities must be a natural extension of the regular activities of the institution.*

- » There must be no obligation for the group of buyers to buy the goods or services in question
- » The institution must be able to separate the production of goods or services that are intended to be carried out as revenue-funded activities from the other tasks of the institution
- » The revenue-funded activities must be a natural extension of the regular activities of the institution.

Under the rules, staff may be employed for revenue-funded activities as long as the revenue from the revenue-funded activities can cover all costs, including staff costs.

Revenue-funded activities may be carried out as long as these conditions are met, including that the activities must be a natural extension of the regular activities of the institution. This authority is relatively broad, enabling the implementation of activities that are not necessarily supported by relevant socio-economic considerations. This applies, in particular, if service prices are not set applying competitive neutrality principles, and should be seen in the context that central government players are able to employ staff to carry out revenue-funded activities. This opportunity is not available for municipal commercial activities the municipal authority rules.

The municipal authority rules provide a statutory basis for carrying out municipal commercial activities

It is generally assumed that, in principle, municipalities cannot carry out commercial activities without statutory authority. The reason is that operating a business for profit is not a municipal task. Thus, under ordinary principles of municipal law for municipal tasks, the so-called municipal authority rules, it is, in principle, not a municipal task to carry out commercial activities, including trade, craft and industry and financial activities.

However, it is assumed in the practice of municipal supervisory authorities and in the legal literature that, as a modification of the principle, a municipality has the general right to provide itself with goods and services for use in the performance of its statutory tasks and tasks under the municipal authority rules. This right is justified by the municipality's obligation to use its resources responsibly, and there are no limits to the nature of goods and services that can be produced by a municipality for its own use. It follows from the above that municipalities are not under any obligation to have private sector providers perform a task just because private sector providers are suited to the task or because private sector providers can perform the task more cheaply.

It is assumed that, under certain conditions, a municipality may lawfully utilise excess capacity – to avoid wasting assets – and thus perform tasks that are not usually municipal tasks. Under the practice of municipal supervisory authorities, one condition for the utilisation of excess capacity is that the task in hand is not sized for the purpose of achieving the possibility of performing tasks that are not usually municipal tasks, another is that – due to the performance of the municipal task – the excess capacity cannot be eliminated. When determining whether a municipality can lawfully sell excess capacity, the municipal supervisory authorities also consider, as part of their practice, whether the task is already performed in a reasonable manner by private business operators. Moreover, it is assumed that, in order to avoid wasting assets, municipalities can lawfully sell any by-products, including know-how, from municipal activities. However, it is a condition that those products are the result of municipal activities with another main purpose. To some minor extent, the by-product can be processed to the extent necessary to sell the product, but such processing must not be on a scale resembling new independent production. In the assessment of whether the above conditions for municipal activities are met, the consideration of avoiding inflicting competition on the private corporate sector carries considerable weight. Where appropriate, sales will be made at the market price.

**Municipalities' right to carry out commercial activities under the municipal authority rules are, in some cases, justified by the consideration of avoiding waste of assets.**

The right of municipalities to carry out commercial activities under the municipal authority rules is limited and, in general, justified by the consideration of avoiding waste of assets. Thus, in principle, the right is clearly delimited from the right of central government players to carry out revenue-funded activities, which may, *inter alia*, be a natural extension of the regular activities of the institution. On the other hand, this right may be difficult to enforce consistently in practice, given that several of the factors in the supervisory authority's assessment are not firmly defined, see above. As a case in point, a by-product may be processed to *some extent*.

It should be noted that the right of municipalities to perform tasks must initially be assessed according to written legislation and subsequently according to the municipal authority rules.

#### Other acts may also provide a statutory basis for municipal commercial activities

Over time, a number of acts have been adopted which give municipalities the right to carry out commercial activities in areas not authorised by the municipal authority rules. As examples, municipalities mention the Danish Act on Industrial Promotion (*lov om erhvervsfremme*), the Danish Act on Municipalities' and Regions' Use of Real Estate and Fixtures and Fittings for Advertising on Behalf of Others (the Danish Advertising Act) (*lov om kommuners og regioners anvendelse af fast ejendom og løsøre til brug for reklamering for andre (reklameloven)*), the Danish Act on Public Roads (*lov om offentlige veje*), the Danish Harbour Act (*havneloven*), the Danish Civil Aviation Act (*luftfartsloven*), the Danish District Cooling Act (*lov om fjernkøling*), the Danish Heat Supply Act (*varmeforsyningsloven*), the Danish Electricity Supply Act (*lov om elforsyning*), Danish employment legislation, the Danish Act on Municipalities' and Regions' Performance of Tasks for Other Public Authorities and Municipalities' and Regions' Participation in Public Limited Companies (*lov om kommuners og regioners udførelse af opgaver for andre offentlige myndigheder og kommuners og regioners deltagelse i aktieselskaber*) etc. The socio-economic considerations underlying the written statutes are very diverse, and there is no complete overview of all statutes enabling municipalities to carry out commercial activities.

#### Acts providing a statutory basis for activities with an element of public funding

In addition to revenue-funded activities and municipal commercial activities, politicians may decide to initiate activities that have an element of public funding. Examples are tasks that have been performed by the public sector for several years and may be regarded as 'core tasks' of the public sector, or new tasks that the public sector has not earlier been required to perform. These activities will be subject to statutory authority – for example the Finance Act – and will be performed either free of charge or with an element of public funding. The rationale

behind the right to perform these activities is often found in various political and socio-economic considerations.

Since, in principle, activities that are provided free of charge or subsidised distort competition and since such activities are not subject to regular supervision, it is essential that politicians balance the various considerations against the weakening of competitive conditions and the financial welfare of Danish consumers that could result from those activities.

### **Various considerations underlying the right to perform revenue-funded activities and municipal commercial activities**

Various socio-economic considerations may justify revenue-funded activities and municipal commercial activities, but the objective of avoiding waste of assets, both tangible and intangible, is particularly important.

In relation to the municipal authority rules, the objective is often to avoid wasting tangible assets, for instance through the possibility of selling firewood after the felling of trees in a municipal wood. There are a number of other underlying socio-economic considerations, such as the considerations of growth and entrepreneurship, of other legislation which provides the statutory basis for municipalities to carry out commercial activities.

In the area of education and knowledge, it may be desired to avoid wasting intangible assets. Public sector players may accumulate special knowledge in connection with their publicly funded activities, for instance knowledge related to university research. It may be in the interests of society to allow this knowledge to be purchased by potential stakeholders.

Moreover, public sector players may have co-production advantages obtained as a result of publicly authorised activities. This means that the public sector player is able to provide consequential services at relatively low costs. Co-production advantages are not directly associated with the public ownership (private sector players may have similar advantages), and the pricing of the consequential service should not be adjusted to reflect these advantages. Thus, the calculation of a 'competitive neutral' price should not take these advantages into account, given that it is in the interests of society that goods and services are produced as cheaply as possible.

It is for the politicians to decide what activities that public sector players should have the right to carry out in commercial markets – provided that the activities are authorised under legislation – including what activities to carry out as revenue-funded activities or municipal commercial activities.

The positive externalities of avoiding waste of tangible and intangible assets should be balanced against the negative externalities of the possible distortion of competition, including the risk that the presence of public sector players in a market will have negative derived socio-economic effects by barring potential commercial players from the market or forcing existing effective commercial players out of the market.

Even if it were possible to ensure full competitive neutrality, it would be relevant to assess the short-term and long-term effects on competition and welfare of allowing public sector players access to a market. The very presence of public sector players may reduce competition, for instance by barring potential private players from the market. At the same time, public sector players may be more effective than private players due to their economies of scale and co-production advantages that may be obtained through their tax-funded activities. As a result, public sector players may oust private sector players to the effect that, in the long term, the public sector player becomes the only provider in a specific area, which will weaken competition. Thus, public sector economies of scale and co-production advantages may lead to lower prices in the short term, while the absence of competition may lead to higher prices and less innovation in the long term.

*Various socio-economic considerations may justify revenue-funded activities and municipal commercial activities, but the objective of avoiding waste of assets, both tangible and intangible, is particularly important.*

### **Public sector activities with an element of public funding will distort competition**

In addition to granting the right to perform revenue-funded activities and municipal commercial activities, politicians may decide to initiate activities that are provided free of charge or with an element of public funding.

When politicians decide to initiate activities in commercial markets with an element of public funding, it is not possible to ensure competitive neutrality between public sector players and private sector players (unless the private sector players also gain access to public funding).

Usually, the arguments advanced in favour of these activities are based on allocation policy considerations or are associated with special positive externalities of the services. Another argument is that they may, for instance, help to correct other market errors. In these cases, it may well be argued that the public sector should fund the activities, but this does not necessarily mean that public sector players should produce the services. Public sector players should produce services only if they are able to do so more effectively than private sector players. In order to test whether this is the case, the public authority may put the task out to tender and possibly prepare a control bid, i.e. a bid under which the authority performs the task itself. In this context, fair competition requires that the price of the control bid is calculated in accordance with competitive neutrality principles.

When public sector activities are authorised in commercial markets, the socio-economic considerations underlying the public performance of the task should be balanced against competitive considerations and the derived effects on innovation and the financial welfare of consumers.

The Danish Competition Council recommends that clearer criteria be defined for activities that may be carried out as revenue-funded activities, see Box 1.5.

#### **Box 1.5 Recommendation of the Danish Competition Council on rights**

The Danish Competition Council recommends:

that a committee be appointed to define clear criteria for the activities that government players should have the right to carry out as revenue-funded activities.

- » The committee may also consider including the municipal area and defining criteria for municipal commercial activities.

For the committee's work of defining clear criteria, the Danish Competition Council recommends:

- » that the committee include the consideration of socio-economic gains, including the access to unique knowledge or co-production advantages that may be enjoyed by central government players.
- » that the committee include the potentially damaging effect of public sector players' access to commercial markets in the form of distortion of competition, including the risk that the co-production advantages of public sector players may create unnecessary public monopolies.
- » that the market to which access is being considered, be clarified, including the supply from existing private players.
- » that the committee examine whether the phrase of 'a natural extension of the regular activities of the institution' in the Danish Ministry of Finance Budget Guidelines can and should be clarified.

The Danish Competition Council will conduct annual follow-ups on the implementation of the Council's recommendations and will, in this connection, assess whether additional measures are required.