



# PC update

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## Australian Government Productivity Commission

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The Productivity Commission is the Australian Government's independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians.

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# The Australian retail industry – structure and performance

A recent Commission report finds that a number of factors, such as changing consumer tastes and technological developments, as well as competition from overseas online retailers, are driving structural change in the retail industry. The key role for government is to ensure that the regulatory environment does not constrain the ability of Australian retailers to respond.

The Australian Government asked the Productivity Commission to undertake an inquiry into the implications of globalisation for the Australian retail industry, and the appropriateness of current policy settings, including, in particular, indirect taxation arrangements for internet transactions. After wide public consultation, the Commission's final report was released in December 2011.

## Recent trends in structure and performance

### Retail sales

The Commission's report notes that retail sales growth has trended down over the past two decades, reflecting both macroeconomic cyclical factors and longer term changes in consumer behaviour. Consumers have been saving more, and spending less on retail goods and more on services such as finance, rent and education. The share of retail spending in overall consumer spending has fallen from over 35 per cent in the early 1980s to just under 30 per cent currently.

### Productivity

Productivity growth in the retail industry over the last two decades has, on average, been similar to that of the rest of the economy, but the *level* of productivity in the retail



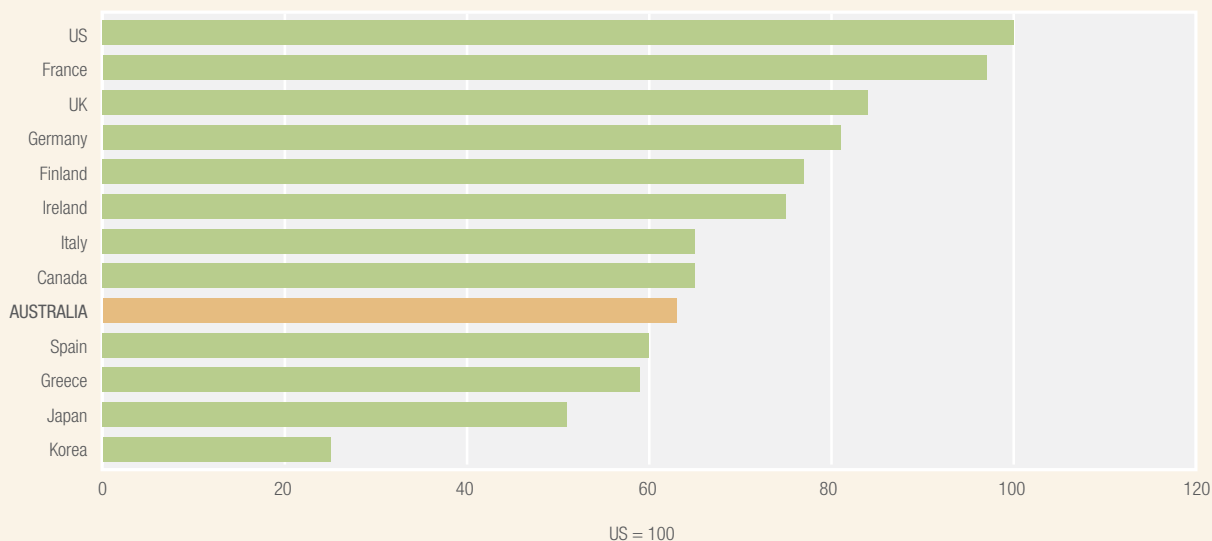
industry remains below that of many other industries and that of the retail industry in most comparable countries (figure 1). And the productivity gap appears to have widened over time. ▶

## A snapshot of the retail industry

- There are almost 140 000 retail businesses in Australia.
- The industry makes a significant contribution to economic output, generating \$53 billion or 4.1 per cent of GDP in 2009-10. However, its share of GDP has been declining slightly over time, reflecting slower growth than in other sectors of the economy.
- The industry is one of Australia's largest employers, with about 1.2 million people, or 10.7 per cent of the total working population, employed in the industry.
- The retail workforce has relatively low skill levels, and is relatively youthful with a high share of females.
- The workforce is characterised by high levels of part-time and casual working arrangements, and high rates of employment turnover.
- The retail industry exhibits great diversity by size of business, region, retail format, competition within sectors, and in the nature of goods sold.

Figure 1 Retail labour productivity, 2007

Gross value added/hour worked US = 100



Source: Productivity Commission 2011, *Economic Structure and Performance of the Australian Retail Industry*, Inquiry Report

### Online retailing

Australia appears to lag a number of comparable countries in the development of online retailing. There are no official statistics of the size of domestic or overseas retail sales to Australian customers. The Commission's best estimate is that online retailing represents 6 per cent of total Australian retail sales – made up of 4 per cent domestic online (\$8.4 billion) and 2 per cent from overseas (\$4.2 billion). Online sales in Australia are projected to grow by between 10 and 15 per cent per annum over the next three years.

### Price differences between Australian and online overseas retailers

A survey undertaken by the Commission found large price differences often existed between the same goods offered online by domestic and overseas retailers. There are a number of reasons for these differences, including notably different cost structures and margins, but an important reason is the practice of international suppliers setting different regional prices. The retail market in Australia has been seen by overseas manufacturers and suppliers as a market that can tolerate higher prices than other regions. Australian consumers are now able to circumvent this practice with many products by directly ordering online or 'parallel importing'. Sometimes consumers can even

import products from overseas retailers more cheaply than Australian retailers can purchase through their established distribution channels. The report recommends that Government should address any anticompetitive behaviour by manufacturers or suppliers inhibiting Australian retailers from purchasing competitively from overseas.

### Indirect taxation arrangements

The current low value threshold (LVT) for imports exempts most imports with a value of less than \$1000 from GST, customs duty, fees and charges, and from the requirement to complete a full import declaration. Submissions received by the Commission during the inquiry indicated concern amongst retailers that the exemption gives overseas online retailers an unfair competitive advantage when selling low value goods to Australian customers and businesses. That is, it operates effectively as a negative tariff on Australian retailers as they are required to charge the GST on their goods while overseas retailers of low value goods are not

As the GST is a broad-based consumption tax, there are strong in-principle grounds for reducing the LVT to a low level to ensure tax neutrality. But the costs of collecting additional revenues, and the loss in consumer surplus from the higher prices for imports, must be balanced against the gains from removing the distortion. ►

## Most international parcels entering Australia are valued at less than \$100

Estimated number and value of international mail parcels entering Australia, 2010-11

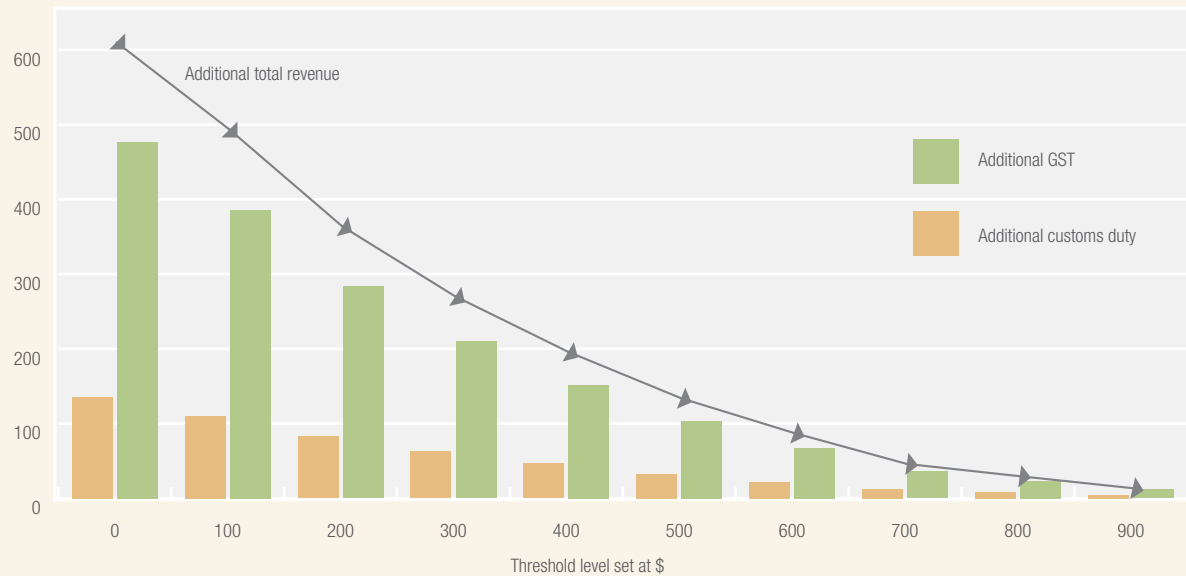
Value range \$	Percentage in range – lower estimate	Percentage in range – upper estimate	Estimated number of parcels in range Millions
0-100	68.59	75.16	34.85
101-200	12.85	12.95	6.26
201-300	4.85	6.11	2.66
301-400	2.45	3.73	1.50
401-500	1.61	2.34	0.96
501-600	1.17	1.18	0.57
601-700	0.88	0.89	0.43
701-800	0.02	0.37	0.09
801-900	0.02	0.26	0.07
901-1000	0.02	0.28	0.07
<b>Total</b>			<b>47.46</b>

Source: Productivity Commission 2011, *Economic Structure and Performance of the Australian Retail Industry*, Inquiry Report

**Figure 2 Estimated additional revenue (excluding collection costs) at lower LVT levels, 2010-11**

### For air cargo and international mail

Additional revenue \$m



Source: Productivity Commission 2011, *Economic Structure and Performance of the Australian Retail Industry*, Inquiry Report

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The low value threshold exemption from GST and other fees and charges should only be lowered if it is cost effective to do so. The costs of raising the additional revenue should be broadly comparable to the costs of raising other taxes. Ideally the efficiency gains from reducing the non-neutrality should outweigh the additional costs of revenue collection.

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In 2010-11, around 58 million international parcels valued under the \$1000 threshold arrived in Australia. Because the value of the majority of international parcels is low, significant amounts of tax revenue do not start to be collected until the LVT is also quite low (figure 2). The Commission estimated that with current parcel volumes and processing costs, removal of the LVT would generate revenue of around \$600 million at a cost of over \$2 billion, borne by businesses, consumers and government. Significant reductions in collection costs per parcel are required to generate positive outcomes from any reduction of the LVT. Accordingly, the Commission recommended the establishment of a taskforce charged with investigating approaches to processing low value imported parcels, and with recommending a new process that would deliver significant efficiencies in handling, without creating delivery delays or other compliance difficulties for importers and

#### Planning and zoning regulation can inhibit innovation

Land use regulation that centralises retail activity can be either competition enhancing or competition reducing, depending on how it is designed and implemented by planning authorities. To minimise the anti-competitive effects of zoning, policy makers need to ensure that areas where retailers locate are both sufficiently large (in terms of total retail floor space) and sufficiently broad (in terms of allowable uses) to enable new and innovative firms to enter local markets and existing firms to expand.

A number of overseas studies have examined the impact on the retail industry of some land use regulations that restrict the establishment of new large format stores. These studies suggest that restricting the development of larger stores lowers retail productivity, reduces retail employment and raises consumer prices.

consumers. When an improved international parcels process has been designed, the Government should reassess the extent to which the LVT could be lowered while still remaining cost effective.

#### The regulatory environment impedes competitiveness

The Commission concluded that the LVT exemption is not the main factor affecting the competitiveness of Australian retailers. There are several areas of regulation that serve to reduce industry competitiveness, including regulations that determine where retailers can locate, the nature and format of the stores that can be established, when they can open for business, and their workplace arrangements. These operate to reduce the competitiveness of the industry. Specific restrictions on competition that should be addressed include:

- zoning that unnecessarily reduces land available for particular retail uses
- overly prescriptive local planning rules that inhibit entry of new retailers and retail formats and create unwarranted delay and costs through compliance burdens
- inappropriate protections of existing retail businesses and activity centres through adverse impact tests
- trading hours regulations that restrict the retailers' ability to adapt and compete with online competitors, and provide the convenience that consumers want.

In addition, the Commission's report noted that workplace relations regulations may not provide sufficient workplace flexibility to facilitate the adoption of best practice productivity measures in the retail industry. Two reviews scheduled for 2012 – the review of modern awards to be conducted by Fair Work Australia, and the post implementation review of the Fair Work Act – provide an opportunity to examine the scope for enhancing flexibility and adaptability at the enterprise level.



# The Australian retail industry: the Commission's key recommendations

## Indirect tax arrangements

The Government should establish a taskforce to investigate new approaches to processing low value imported parcels, and recommend a new process that would deliver significant improvements and efficiencies in handling.

When an improved process has been designed, the Australian Government should reassess the extent to which the LVT could be lowered while still remaining cost-effective.

## Planning and zoning regulation

State, territory and local governments should broaden business zoning and significantly reduce prescriptive planning requirements to allow the location of most retail formats in existing business zones.

Governments should not consider the viability of existing businesses at any stage of planning, rezoning or development assessment processes. Impacts of possible future retail locations on existing activity centre viability (but not specific businesses) should only be considered during strategic plan preparation or major review.

State, territory and local governments should facilitate more as-of-right development processes to reduce business uncertainty and remove the scope for gaming by competitors.

## Retail trading hours regulation

Retail trading hours should be fully deregulated in all states (including on public holidays).

## Workplace relations regulation

The Australian Government should, within the context of the current system and consistent with the maintenance of safety net provisions, examine retail employer and employee concerns about the operation of the Fair Work Act. The post-implementation review of the Fair Work Act, which is to commence before 1 January 2012, should provide the appropriate review mechanism.

The review of modern awards by Fair Work Australia, scheduled for 2012, is a further opportunity to address concerns that relate specifically to the operation of relevant retail awards.

## Government's response to the report

In response to the Commission's recommendations, the Government announced the establishment of a Low Value Parcel Processing Taskforce to investigate new approaches to the processing of low value parcels, particularly in the international mail stream. The Taskforce is to produce a final report by July 2012.

The Government also agreed in principle with recommendations on planning and zoning. It noted that the Commission's recommendation concerning trading hours are largely state and territory government responsibilities. The Government encouraged state and territory governments to carefully consider and implement where appropriate the findings of the report. Since the Commission's report was released, several jurisdictions have moved to further liberalise trading hours.

The Government noted the Commission's recommendations regarding workplace relations, and stated that concerns raised in the report may be examined in the course of the post-implementation review of the Fair Work Act to the extent that they fall within the scope of the review. The review was announced in December and is to report by the end of May 2012.

## Economic Structure and Performance of the Australian Retail Industry

- > Productivity Commission Inquiry Report
- > Released December 2011

## Regulation of airport services

A recent Productivity Commission inquiry found that current arrangements for regulatory oversight of airport pricing and service quality should continue, but with some enhancements.



In 1997, the Australian Government began privatising its airports, concluding with the sale of Sydney airport in 2002. Recognising that some airports had significant market power, the privatised capital city airports were subject to price cap regulation and monitoring of their service quality.

In 2002, a Productivity Commission inquiry found that the price control regime risked distorting production decisions and discouraging airport investment. In line with the recommendations of that inquiry, price controls were replaced with light-handed monitoring of aeronautical services at Australia's major airports (see box). A further Commission inquiry in 2006 confirmed that light handed regulation had delivered important benefits, and recommended that the regime continue, with some changes.

In March 2010, the ACCC, on releasing its 2008-09 annual monitoring report, suggested that three major airports might have exercised market power to the detriment of some airport users. These concerns were reiterated in its 2009-10 monitoring report. As well, there has been growing unease about the state of surface transport access to airports, especially the interface between airports' planning and surrounding state and territory planning regimes.

Against this background, in December 2010 the Australian Government asked the Productivity Comm-

ission to examine the effectiveness and efficiency of the economic regulation and service quality monitoring regime for Australia's major airports, and whether new

### Airport monitoring arrangements

The Australian Competition and Consumer Commission (ACCC) monitors and reports annually on the prices and quality of service at Australia's five largest airports. The information gathered by the ACCC enables it to ascertain if airports may have misused their market power. If monitoring indicates that further investigation is required, the Government can direct the ACCC (or another body) to undertake a public inquiry, potentially resulting in the reintroduction of stricter price controls at particular airports.

Separately, at any time, an airport user can apply to the National Competition Council (NCC) for relevant airport services to be 'declared' under Part IIIA of the Competition and Consumer Act. If the declaration criteria are satisfied, the Minister may declare access, providing a right for the parties to negotiate terms and conditions, backed by resort to binding arbitration by the ACCC.



arrangements were needed. After extensive public consultations, including on a draft report, the Commission's final report was released by Government in March 2012.

### Has light-handed regulation been effective?

During the inquiry, the Commission received contradictory views about the performance of light handed regulation. The airports contended that the arrangements are working well, whereas the airlines argued that outcomes are unreasonable. Airport investors consider the current arrangements facilitate necessary investment, as does the Department of Infrastructure and Transport. Other airport users, such as car rental, land transport and logistics firms, object to the airports' tough negotiation stances. And the cost of car parking can also be contentious.

### The Commission found no evidence that airports have exercised their market power to the detriment of the community.

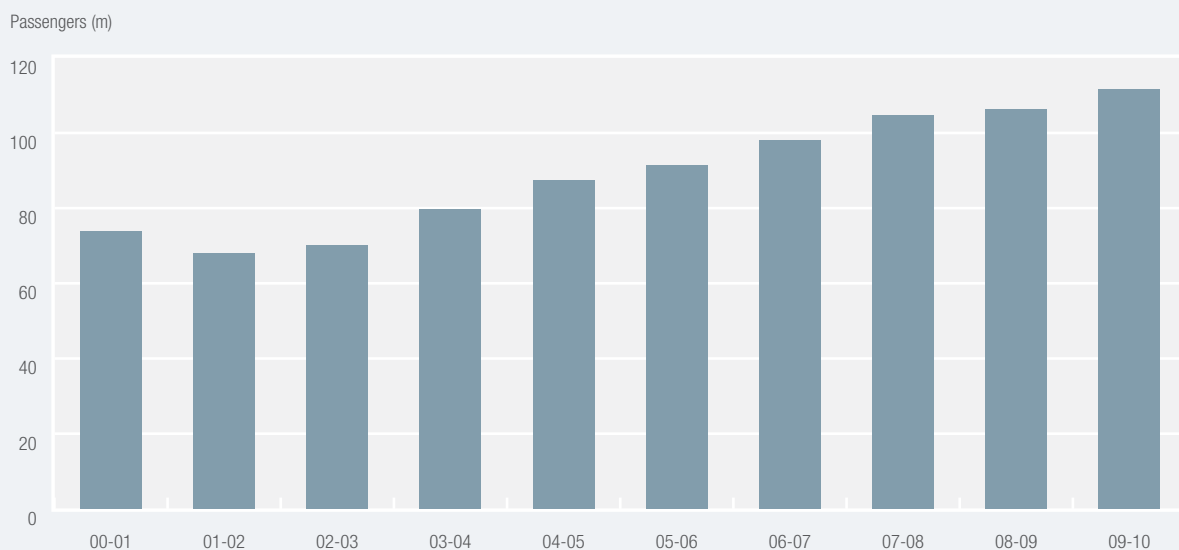
The Commission report found that while some Australian capital city airports possess significant market power, under the light-handed monitoring regime:

- there has been a marked increase in aeronautical investment (figure 2) and airports have not experienced the bottlenecks that have beset other infrastructure areas
- aeronautical charges do not point to the inappropriate exercise of market power
- service quality outcomes overall are 'satisfactory' to 'good', and have trended up in the last two years (figure 3) ▶

### Australia's major airports

- In 2009-10 over 100 million passengers transited through Australia's major airports. Sydney airport serviced almost 35 million passengers, while Melbourne and Brisbane airports serviced 26 million and 19 million passengers, respectively.
- Some of Australia's airport terminals operate under a common user system, whereby all airlines 'share' the facilities provided. In other cases, airlines directly operate their own terminals under lease agreements with the airport.
- In addition to core aviation functions, airports are home to other commercial activities, such as car parking, retail and commercial tenancies.
- From 2009 10 to 2029 30, passenger numbers in Australia are expected to double, with Brisbane, Melbourne and Sydney airports each expected to cater for over 50 million passengers by 2029 30.

Figure 1 Passenger growth at Australia's 10 largest airports



Source: Productivity Commission 2011, *Economic Regulation of Airport Services*

Figure 2: Aeronautical investment has increased since the removal of price caps

Additions to aeronautical tangible non-current assets

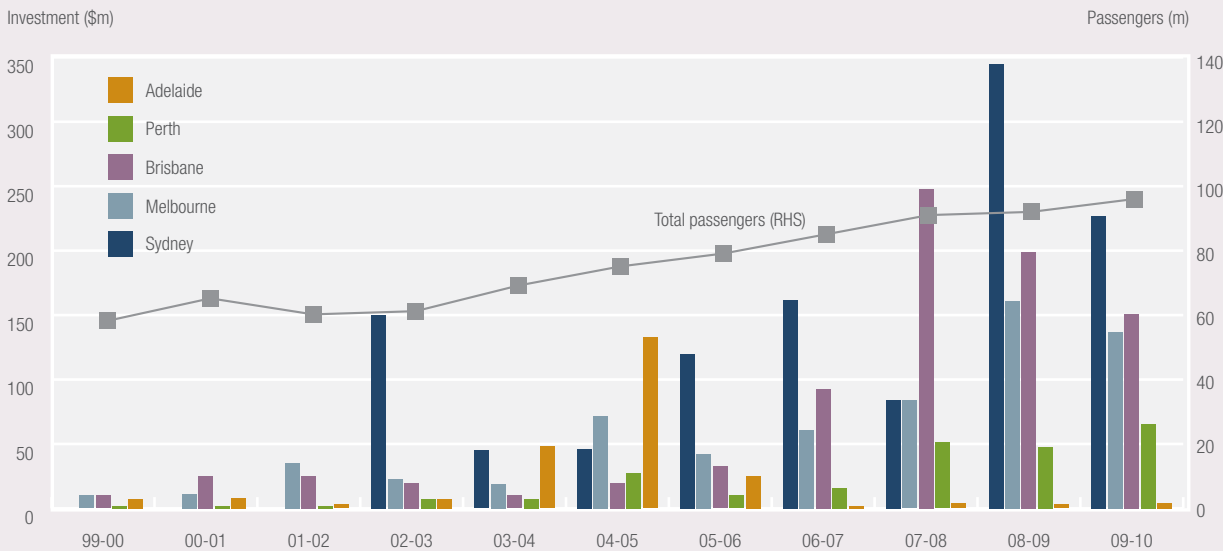
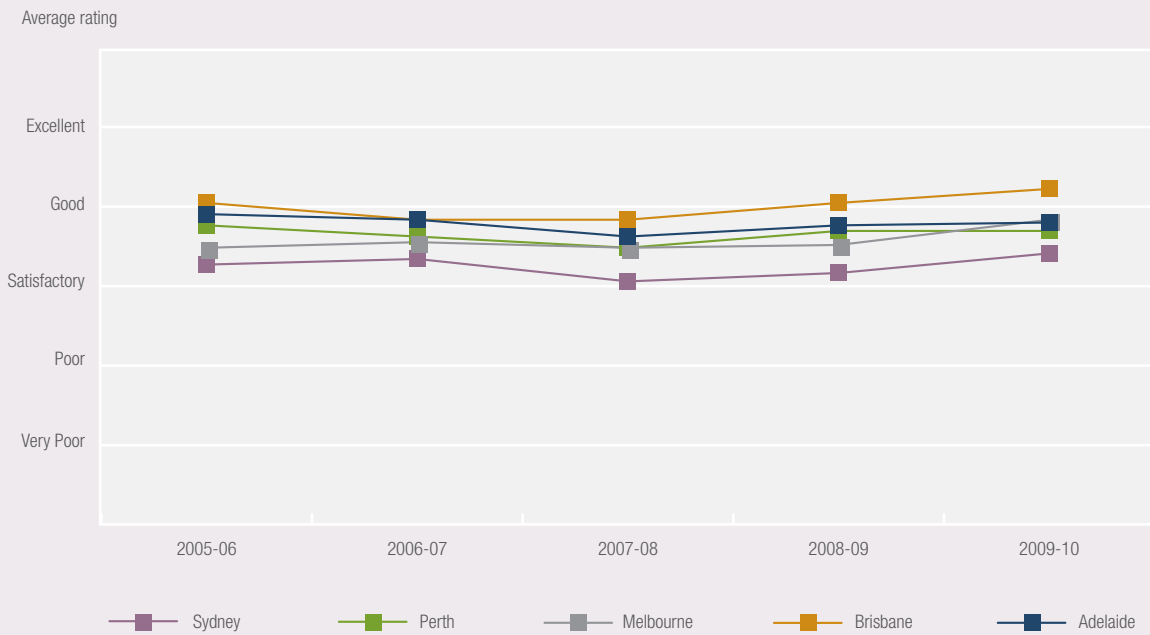


Figure 3: Ratings for service quality are trending up

Overall ratings of airport quality of service



Data sources for charts: see Productivity Commission 2011, *Economic Regulation of Airport Services*.

- Australian airports' aeronautical charges, revenues, costs, profits and investment compare reasonably well with (the mostly non-commercial) overseas airports.

The Commission report also noted that while airlines maintain that airports adopt 'take it or leave it' negotiation stances and that some fail to provide adequate information, no party sought a return to regulatory price setting.

However the report finds that while price monitoring aims to constrain airports from inappropriately exercising any inherent market power, neither the regulator nor Governments have acted when the regulator has raised the possibility that some airports might be exercising market power. Accordingly, the report makes a number of recommendations aimed at enhancing the monitoring approach, including that, if the ACCC finds prima facie evidence that an airport has misused its market power, the airport should be required to 'show cause' why its conduct should not be subject to a 'forensic' price inquiry under Part VIIA of the Competition and Consumer Act.

Among other significant findings:

- Access charges and conditions faced by competitors to on-airport car parking are not so high as to impede competition. However information about terms and conditions of access is not transparent.
- Access to airport precincts in most major cities is congested owing to inadequate arterial roads and insufficient mass transit services. Planning and development on federal airport sites is regulated by the Australian Government, whereas the surrounding areas are subject to state, territory and local government laws. Planning development on and around airports has not necessarily been coordinated well.

## The Government's response

The Government's decision, announced on 30 March 2012, agreed in principle with the Commission's recommendations to continue with and improve the light-handed monitoring regime. That decision noted that it is up to the ACCC to give effect to some of the Commission's proposed enhancements. The Government did not support a formal 'show cause' mechanism because it considered that the ACCC already can make a recommendation to the responsible Minister for appropriate action where it has significant concerns as a result of its monitoring program.

## Summary of Commission's key recommendations

### Options for future airport regulation

The ACCC should publicly release a draft monitoring report, and after consultation with monitored airports, subsequently release a final monitoring report.

Where the ACCC, in undertaking its monitoring role, finds prima facie evidence that an airport has misused its market power, the airport should be required to 'show cause' why its conduct should not be subject to a 'forensic' Part VIIA price inquiry. Such a nomination should be contained in the draft monitoring report.

If the ACCC is dissatisfied with the airport's response to a show cause request, it should formally recommend that the Government invoke a Part VIIA inquiry.

- An airport that offered an 'approved' dispute resolution framework with binding arbitration during contract formation would not be subject to such a price inquiry.

### Improving the monitoring regime

Quality of service monitoring should continue until June 2020. However, the ACCC should be asked to review and update the objective criteria by June 2013.

### Airport carparking and ground transport access

Access charges and conditions relating to the supply of car parking should be public and included in monitoring reports. Such transparency would facilitate regulatory action under competition law if an airport acted to impede competition in order to inflate its car park prices or revenues.

### Broader land transport and access issues

A review of the efficacy of recent legislative reforms aimed at better aligning airport planning with state, territory and local government, should be undertaken in 2015.

## Economic Regulation of Airport Services

> Productivity Commission Inquiry Report

> Released 30 March 2012

# Australia's export credit arrangements

The Commission's recent draft report recommends a refocussing of government provided export credits in Australia.

Many governments seek to facilitate trade finance as a means of increasing exports, often establishing officially backed export credit agencies for this purpose. Export credit agencies offer a range of financial products including: loans to exporters or their foreign buyers; guarantees; bonds; and political risk insurance.

In September 2011, the Australian Government asked the Productivity Commission to undertake a public inquiry into arrangements for the provision of export credit through Australia's export credit agency, the Export Finance and Insurance Corporation (EFIC). The Commission was asked to:

- review the rationale for government involvement in the provision of export finance and insurance
- assess EFIC's management of credit and funding risks
- review EFIC's pricing and service arrangements, and assess their impact on incentives for Australian exporters to access private sector providers of export finance and insurance products
- review EFIC's exemption from competitive neutrality policy.

The Commission's economy-wide perspective requires it to identify any market failures potentially warranting intervention, the most appropriate form of such intervention, and to evaluate whether EFIC's activities and governance arrangements align with that form of intervention.

The Commission released a draft report in February 2012. After public consultation, a final inquiry report will be presented to Government in May 2012.

## The Export Finance and Insurance Corporation (EFIC)

EFIC has the following functions under the *Export Finance and Insurance Corporation Act 1991*:

- encourage and facilitate Australian export trade by providing insurance and financial services
- encourage banks and other financial institutions carrying on business in Australia to assist in financing export contracts
- manage the Australian Government's aid-supported loan program
- provide information and advice regarding insurance and financial products available to support Australian exports.

The Australian Government has provided EFIC with a mandate to perform these functions only in circumstances where private sector providers are not able or are unwilling to provide credit and insurance for Australian export transactions, referred to by EFIC as the 'market gap' mandate. EFIC's pricing is not to undercut the private sector when private sector support is present, nor undercut pricing for comparable risks when private support is absent.

EFIC provides its services on a commercial account and manages a national interest account on behalf of the Australian Government. Transactions on the national interest account must be approved by the Minister for Trade, while EFIC is responsible for the approval of its commercial account transactions. EFIC also maintains a treasury operation to facilitate borrowing on domestic and international capital markets to fund its origination activities, to structure Australian dollar and foreign currency cash flows arising from transactions, and to manage EFIC's investment portfolio of capital and reserves.

The Australian Government reported a total contingent liability in relation to EFIC of \$3.4 billion at 30 September 2011. At 30 June 2011, EFIC reported exposures (before provisions) of \$960 million on the commercial account and \$685 million on the national interest account, and equity of \$408 million. EFIC employs around 86 staff.



## A reorientation is required

The Commission's preliminary assessment in its draft report is that a substantial reorientation of EFIC's business is required. At present much of EFIC's activity on the commercial account is focussed on large corporate clients. The draft report proposes that EFIC's objective be refocused to assisting newly exporting small and medium-sized enterprises (SMEs).

The findings of the Commission's draft report include that:

- Not all of EFIC's transactions are priced to earn a commercial rate of return. These transactions are effectively being subsidised by taxpayers.
- The concept of the 'market gap' as used by EFIC to determine the scope of its operations, can cover circumstances where there is no market failure that would warrant government intervention and where support for a transaction would lead to a misallocation of resources in the economy.
- There is no convincing evidence to indicate there are failures in financial markets that impede access to finance for large firms, or for domestic resource-related projects.
- The rationale for EFIC operating a commercial account should be to address the information related failures in financial markets that may impede otherwise commercially viable export transactions.

## A case study: Repeat support for one salt producer?

EFIC has provided a salt producer with more than 20 documentary credit guarantees for its exports to Indonesia since 2009-10. It has not provided any support to other salt exporters.

Australia typically produces more than 10 million tonnes of salt annually. A small number of companies export the majority of this production in bulk from north Western Australia, a large share being exported to South-East Asia, including Indonesia. The vast majority of export transactions, including those to Indonesia, occur without EFIC's support. This suggests there is no inherent difficulty in financing Australian salt exports.

- Those Australian businesses for which assistance with export financing is more likely to be justified are newly exporting SMEs, however, these have not been the main focus of EFIC's operations.

On releasing the draft report, Presiding Commissioner Patricia Scott said: 'Almost all Australian exporters manage without EFIC's assistance. To the extent that market failures may exist because of information problems, these are more likely to affect newly exporting SMEs accessing export finance.' ▶

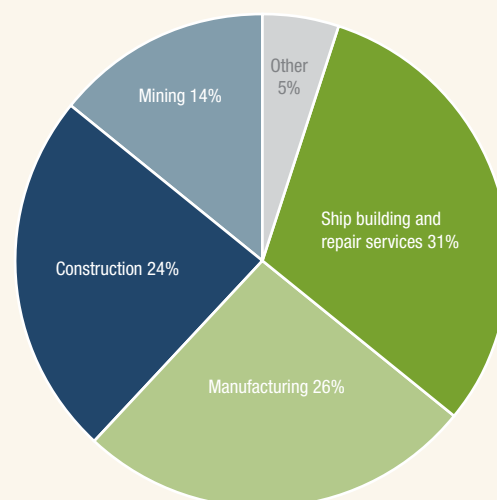
## EFIC's client base

The vast majority of Australia's exports, by both volume and value, take place without EFIC's assistance. In 2009-10 EFIC provided 54 facilities to 41 exporting businesses on the commercial account. In the same financial year, there were about 45 000 exporting businesses in Australia.

At present EFIC's activity on the commercial account is generally focussed on large corporate clients and often repeat customers. More than three quarters of the value of EFIC's business in 2010-11 was with companies with an annual turnover of more than \$150 million. EFIC has recently supported a number of large Australian resource related projects including a coal export terminal, a liquefied natural gas plant and an iron ore rail expansion project.

EFIC's clients operate in a number of different export sectors, including mining, manufacturing, construction and ship building and repair:

## Value of EFIC's commercial account facilities outstanding at 30 June 2011, by sector of exporter



Sources: see Productivity Commission 2012, *Australia's Export Credit Arrangements*, Draft Report, figure 2.1

# Australia's export credit arrangements: the Commission's key draft recommendations

## EFIC's financial management and performance

The pricing of EFIC's commercial account transactions should reflect the full economic cost, including a commercial rate of return on equity, reflecting risk, that is benchmarked against that of appropriately selected private sector providers. Accordingly, EFIC's activity on its commercial account should be subject to competitive neutrality policy.

The size of EFIC's treasury operations should be commensurate with the size and product offering of the origination business it supports. The need for, and the scope of, the treasury function should be subject to regular review by the Treasury and the Department of Finance and Deregulation. This review should include an assessment of EFIC's capital requirements.

## EFIC's governance arrangements: improving transparency and accountability

The Minister for Trade should table EFIC's corporate plan in Parliament. EFIC should provide quarterly reports to the Minister against the corporate plan, including information on transactions executed in that quarter.

EFIC's Board should establish a performance management framework for assessing its performance, based on a more clearly defined objective under the EFIC Act. Performance should be reported against this framework in EFIC's annual report and corporate plan.

The secrecy and commercial-in-confidence framework under which EFIC operates should only apply to the financial information of its clients. All other information on transactions on the commercial account should be made public.

EFIC's prospective involvement in any transaction with potentially significant environmental and social impacts should be publicly disclosed.

## National interest account

Analysis of national interest account transactions should include an assessment of whether the proposal is the most cost-effective way of achieving the intended outcome.

Information on the performance of national interest account transactions should be publicly reported.

## What future role for EFIC?

EFIC's support for onshore resource projects should cease as there is no clear market failure affecting access to finance for these projects.

Until it is next reviewed, EFIC's role on the commercial account should be limited to demonstrating to the private sector that providing export finance to newly exporting SMEs can be commercially viable.

To improve its demonstration role, EFIC's capacity to engage in repeat transactions with the same client should be restricted. EFIC's commercial account product range should be consistent with its new role.

EFIC should publish information on the transactions it approves on the commercial account, including the name of the firm, price and other terms of provision.

## Australia's Export Credit Arrangements

> Productivity Commission Draft Report, released February 2012

> Contact: Adam Foster 03 9653 2149

> Email: [exportcredit@pc.gov.au](mailto:exportcredit@pc.gov.au)

## Industry assistance in a ‘patchwork economy’

In a recent speech Commission Chairman Gary Banks reflected on the structural tensions arising from the current mining boom, and how government can best respond.

Rising per capita incomes in a country can only be achieved in two ways: by producing more per capita, or by getting higher prices for what is produced. The former route is generally the most enduring or dependable one. But it has been overshadowed in recent years by the dramatic rise in prices received for our mineral exports. The surge in Australia’s terms of trade is estimated to have added some 15 per cent to our (nominal) GDP. It has also contributed to the resilience of Australia’s economy since the global financial crisis

In contrast, the recent productivity picture does not look too promising. While there are indeed reasons to be concerned, close analysis by Commission researchers suggests that at least some of the forces behind the marked productivity slump this century are likely to be temporary.

One significant contributor has been the mining boom itself. Rising export prices, with the prospect of higher profits, have provoked massive flows of new capital and labour into mining, and this has been outstripping measured output growth. This input expansion, while so far ‘unrequited’ in physical output terms (reducing measured productivity) has nevertheless yielded rich financial rewards to mining companies, and to the Australian economy. While non-traded activities and industries supplying the mining juggernaut have done well, trade-exposed industries that are not in its aura have been forced to ‘make way’ by our rising dollar.



Thus, in the midst of plenty, there is some pain. Viewed dispassionately, this is integral to the adjustments needed for Australia to gain maximum benefit from the mining boom. However, most of those on the receiving end understandably don’t see it that way. There have been strident calls for government to support industries under pressure, particularly manufacturing (but also tourism and education services).

**It is timely, therefore, to revisit the question of what role industry assistance should play in our contemporary ‘patchwork’ economy. My message is not that it should have no role at all. Rather, it is that we need to tread warily on selective assistance schemes because of the risk of doing more harm than good to Australia’s productivity and prosperity.**

### Import replacement is a bad idea

At the top of the list of perennially bad policy measures are those that promote Australian industries by reducing imports. I am not just referring to tariffs and other barriers ‘at the border’, since their costs are now well recognised in Australia and few openly advocate a return to them.

### The attractions of ‘anti-dumping’

That said, there has been resurgent interest in the use of ‘anti-dumping’ duties as a WTO-sanctioned form of protection against ‘unfair trade’. The very use of the term ‘dumping’ – coined initially, I suspect, by a linguistically gifted import competitor – connotes something unsavoury. And if it causes (or threatens) ‘injury’ to a local industry, then surely it must reduce Australia’s prosperity?

In fact, shocking as it may sound, neither proposition holds true. There are many legitimate reasons, commercially and economically, why a firm might engage in ‘differential export pricing.’ There may be higher tariffs or less competition at home than abroad. The firm may have a surfeit of stocks with high holding costs. Or it may ▶

need to counter a lack of brand recognition when entering foreign markets. There is nothing inherently 'unfair' about any of these practices. Australian exporters commonly engage in them and have been encouraged to do so by government agencies.

### Local sourcing rules

A form of administered protection that operates well behind the border, and that has had a good run recently in Australia, involves requirements by governments for their own agencies or private firms to purchase goods and services from domestic sources. Local content rules, to the extent that they are successful in diverting purchases from the lowest cost sources internationally, merely reduce a nation's purchasing power. While some local firms may do better, others will do worse as their competitiveness is eroded. Productivity and prosperity are both impaired.

### 'Offshoring'

This same logic applies to Australian-based firms acquiring inputs of services offshore – such as the ubiquitous call centres with those acquired Australian accents that we have all come to know.

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**Airlines, banks, telecommunications companies and other businesses are contracting more of their services inputs overseas. People worry that this is exporting Australian jobs and lowering living standards and employment. But, just as for trade in goods, Australia increasingly sells services abroad where we have an advantage (for example, education and specialised medical care), while buying services abroad where we are not competitive.**

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In 2011, Australia exported in total almost as many services by value as it imported and had a \$4.5 billion surplus in services trade with Asia. Creating barriers to offshoring would undermine domestic businesses and adversely impact on other jobs.

So what is 'good' industry assistance? This is more difficult to assess, since potentially 'good' assistance not only needs to have a sound rationale, but also be implemented through measures that meet their goal without giving rise to costs that exceed the benefits.

### Innovation policies

Perhaps the best illustration of how hard this can be is industry assistance directed at innovation. Although most innovation takes place spontaneously in response to market pressures and opportunities, we know that some innovations that may be socially valuable will not be privately profitable.

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**The challenge for assistance policy is to design measures that encourage innovation that would not otherwise have occurred and that would generate private and spillover returns large enough to exceed the costs of the subsidies.**

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Australia has used a plethora of approaches over the years to stimulate business investment in innovation - perhaps too many, given the uncertainty that continuing policy change poses for business. While its form has changed considerably over time, generic support for business R&D through the tax system has been one of the few constants in the innovation assistance landscape. The R&D tax concession has several major advantages over alternative measures such as direct grants. Businesses, rather than an interposed judge, make the investment decisions, and the incentive applies to many different industries and types of innovation.

The fact that there is a potentially sound rationale for assistance to promote innovation has seen it become popular as a label for many assistance programs that have little to do with encouraging innovation, let alone addressing market failures. For example, all of the major recent structural adjustment packages for declining industries are referred to as 'innovation' programs. However, innovation does not figure much in most of them.

The sizeable financial support still being provided by taxpayers to the automotive and TCF industries, although presented under the innovation banner, mainly comprises what amounts to production subsidies, which are hard to justify on any 'market failure' grounds.



## What about manufacturing?

The adjustment pressures currently experienced by manufacturing – at least those industries not directly benefiting from the mining boom – have been seen by some as a special case for government assistance.

Manufacturing's place in the Australian economy has been in secular decline for the past four decades. As with the decline of agriculture in the 19th century, this trend has been common to all advanced economies. As Reserve Bank analysis has recently demonstrated, the richer the country, the greater the share of services in its total output.

Moreover, the distinction between 'manufacturing' and agriculture, mining and services activities is becoming increasingly tautological rather than conceptual. Considerable transformation occurs in both mining and agriculture, and the sophistication of the machinery, the complexity of processes and the level of labour skills to recover the useful outputs from these industries can be much greater than for many manufacturing operations. Robotics, new metals and remote sensing devices used in mining are at the frontier of technologies.

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**The notion that the mining boom is a 'curse' because it drives up exchange rates misses the point. The mining boom involves sophisticated industries, whose discoveries and activities – and the buoyancy of export demand for those – have greatly increased the buying power of Australian consumers and industries, and produced large income flows.**

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None of this ignores the reality that many enterprises in the manufacturing sector are doing it tough, particularly with the currently high value of the \$A. But there is little support for the proposition that financial struggle is unique to manufacturing. While nearly 30 per cent of manufacturers recorded a loss in 2009-10, the share was 40 per cent for farmers and 53 per cent for miners. And, relative to other industries, manufacturing already gets a lot of government assistance. Net tariff assistance alone was estimated to be around \$6.5 billion in 2009-10, with another \$2 billion or so in various subsidies.

## More productive industry support

The Commission has shown in various studies how the productivity performance of firms is influenced by policy settings in three key areas:

- *incentives* – the external pressures and disciplines on organisations to perform well
- *flexibility* – the scope for organisations to make changes in order to respond to market pressures
- *capabilities* – the human and knowledge capital, as well as the infrastructure and institutions, needed to devise and implement changes effectively.

These areas are mutually interactive and all three need to be attended to in a policy framework to enhance industry performance. This has as much if not more to do with reforming existing policies that are shown to detract from performance, as devising new ones.

So which policy areas are likely to be most 'prospective' in promoting flexibility and adaptability? Given the importance of organisational change to innovation and productivity throughout the economy, labour market policies and industrial relations regulation in particular are clearly one important candidate. The taxation system, with its own pervasive effects, including on factor mobility, is another. There is also a range of policies bearing on business start-ups, development approvals and land-use changes that can be significant roadblocks to adjustment. And there is the proliferation of red tape in all jurisdictions that imposes dead weight on firms. I could go on.

## Concluding comment

At the dawn of the 20th century, Australia was the most prosperous country in the world. Our subsequent decline was largely self-inflicted, through policies built on the myth that interests could be protected from the realities of markets. The current boon to our economy and prosperity from burgeoning global demand for our natural resources does not negate the need for us to be productive if we are to remain prosperous into the future. How we handle the structural tensions emanating from our present good fortune will determine whether we have learnt the lessons of our own history.

Edited excerpts from an address by Gary Banks to the Australian Chamber of Commerce and Industry Annual Dinner, November 2011. The full text is available on the Commission's website [www.pc.gov.au](http://www.pc.gov.au) ('Chairman's speeches')

# Report on Government Services 2012

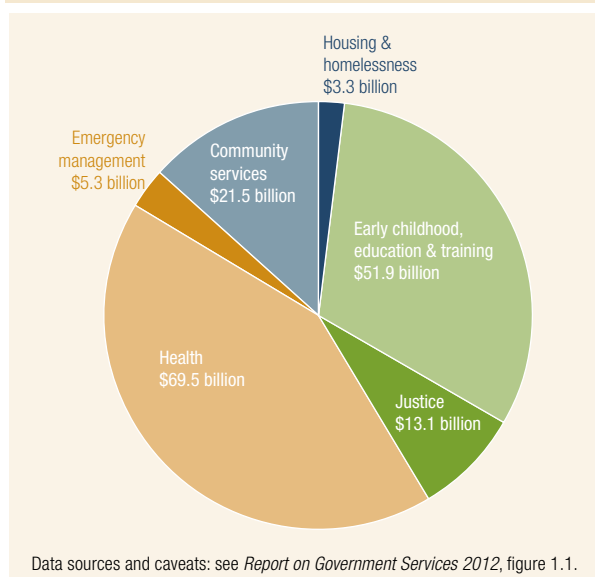
The 2012 Report on Government Services contains comparative data on the equity, efficiency and effectiveness of government services across Australian jurisdictions.

The Report on Government Services promotes awareness about the performance of government services, and helps drive improvements to service delivery and effectiveness. It is produced by a Steering Committee of senior officials from Australian, State and Territory governments for the Council of Australian Governments (COAG). The Steering Committee is chaired by Gary Banks, Chairman of the Productivity Commission.

On the release of the 2012 Report on Government Services, the seventeenth edition of the publication, Gary Banks noted that:

‘Everyone relies on government services at different stages of their lives, and the services in this Report are particularly important for the more disadvantaged members of society. Governments spent over \$164 billion on the services covered in this year’s Report, equivalent to around 12.5 per cent of Australia’s national income.’

## Estimated government recurrent expenditure on services covered by the 2012 RoGS



There are a number of enhancements in this year’s Report, including the introduction of sector summaries in all broad reporting areas, further data quality information, extended time series data for many indicators, and inclusion of brief case studies for selected service areas.

Reporting on the delivery of mainstream services to Indigenous Australians is a priority for the Report. For example, this edition includes additional school education reporting on learning outcomes for recent student cohorts, by Indigenous status.

## Services covered in the 2012 Report on Government Services

### Early childhood, education and training

- Children’s services
- School education
- Vocational education and training

### Justice

- Police services
- Court administration
- Corrective services

### Emergency management

- Fire, road rescue and ambulance

### Health

- Public hospitals
- Primary and community health
- Mental health management

### Community services

- Aged care services
- Services for people with disability
- Protection and support services

### Housing and homelessness

- Public housing and community housing, state owned and managed Indigenous housing and Indigenous community housing
- Homelessness services

# Report on Government Services 2012 – selected indicators

## Primary and community health

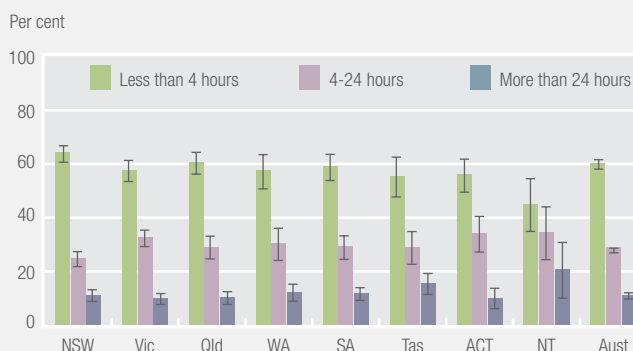
The primary and community health sector is the part of the healthcare system most frequently used by Australians.

- In 2010-11, Australian Government expenditure on general practitioners in Australia was around \$6.4 billion, or \$287 per person.
- Australian Government expenditure on the Pharmaceutical Benefits Scheme was around \$7.3 billion, or \$326 per person, in 2010-11.
- Total expenditure by all governments on community and public health was around \$7.9 billion in 2009-10.

### GP waiting times

Hours waited for urgent treatment by GP, 2010

*An indicator of governments' objective to provide effective access to primary healthcare services*



## School education

- There were 3.5 million full time equivalent school students enrolled in August 2010, in 9468 schools.
- Of these, 69.1 per cent of primary students and 60.7 per cent of secondary students were educated in government schools.
- Recurrent expenditure by Australian, State and Territory governments on school education in 2009-10 was \$41.8 billion, of which \$32.9 billion was spent on government schools.

### Proportion of year 3 students achieving at or above the reading, writing and numeracy national minimum standard, 2010

*An indicator of governments' objective that all students should attain a range of skills, including numeracy and English literacy, such that every student should be able to read, write, spell and communicate at an appropriate level*

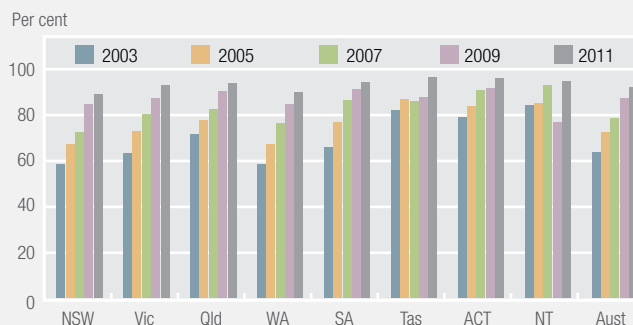


## Aged care services

- Total government expenditure reported on aged care services in 2010-11 was \$12.2 billion. This included residential care services (\$8.1 billion) and community care services (\$3.4 billion).
- In June 2011, there were 182 302 operational places (excluding flexible care) in residential care facilities (83 963 in predominately high care services, 3975 in predominately low care services and 94 364 in services with a mixture of high and low care).

### Proportion of residents who changed from low care to high care and remained in the same aged care service, June

*An indicator of governments' objective to facilitate 'ageing in place'*



Data sources and caveats for these charts are available from the website for the Review of Government Service Provision [www.pc.gov.au/gsp/rogs/2012](http://www.pc.gov.au/gsp/rogs/2012)

## Report on Government Services 2012

> Released January 2012 > <http://www.pc.gov.au/gsp>

> Contact: Lawrence McDonald 03 9653 2178 [lmcdonald@pc.gov.au](mailto:lmcdonald@pc.gov.au)

# Influences on labour market outcomes for Indigenous people

A range of factors potentially influencing Indigenous people's participation in the labour market are analysed in a recent Staff Working Paper.

Halving the gap in employment outcomes between Indigenous and non-Indigenous Australians is a key target of the National Indigenous Reform Agenda, developed under COAG to address Indigenous disadvantage. A recent Commission Staff Working Paper examines certain factors that can influence Indigenous labour market outcomes.

Patterns of disadvantage can vary by demographic group. For example, labour market outcomes vary significantly between men and women, as women tend to take on more unpaid child rearing and other unpaid caring work that benefits the community. Outcomes can also vary according to factors such as a person's age, education, health and location. And personal characteristics, such as ability, motivation and preferences, may also influence outcomes.

The Staff Working Paper develops a framework for analysing the strength of relationships between labour market outcomes and various personal characteristics of potential interest to policy makers, while controlling for other factors.

Using multivariate regression analysis and data from 2008 National Aboriginal and Torres Strait Islander Social Survey (NATSISS), the paper builds on an earlier model presented in *Overcoming Indigenous Disadvantage: Key Indicators 2011*. The analysis includes variables representing social and cultural factors – which can act as proxies for unobserved personal characteristics – to obtain insight into the effects of such individual characteristics on labour market outcomes.

The analysis examines the marginal effects of a number of variables on the following outcomes: 'mainstream employment', 'unemployment', 'participation in Community Development Employment Projects (CDEP)', and 'not in the labour force'. Variables covered include gender, age, family structure and household characteristics, location, health and disability, skills and knowledge, contact with the criminal justice system, and social and cultural environment.

The authors note, however, that modelling the link between labour market outcomes and these factors has a number of limitations, and results should be interpreted as 'associations' rather than estimates of cause and effect. The findings may inform further research in terms of other areas of study, modelling approaches and data collection.

## Summary of key findings

### Educational attainment

- There are statistically significant associations between education and labour market outcomes for Indigenous Australians.
- However, the results indicate that higher levels of education have different outcomes for Indigenous women and men.
- For women, attainment of year 10 or above is associated with a higher probability of employment and labour force participation (LFP), whereas this is less evident for men.

### Health and disability

- There are statistically significant associations between physical and mental health, and employment and LFP. There are also statistically significant (negative) associations between severe or profound disability and employment and LFP.
- Results confirm findings from previous research that other human capital factors, such as good health, are positively associated with Indigenous employment and LFP.

### Contact with the criminal justice system

- Arrest and imprisonment were found to be negatively associated with Indigenous employment and LFP. A history of arrest was found to have a larger negative association with employment for women compared with men.

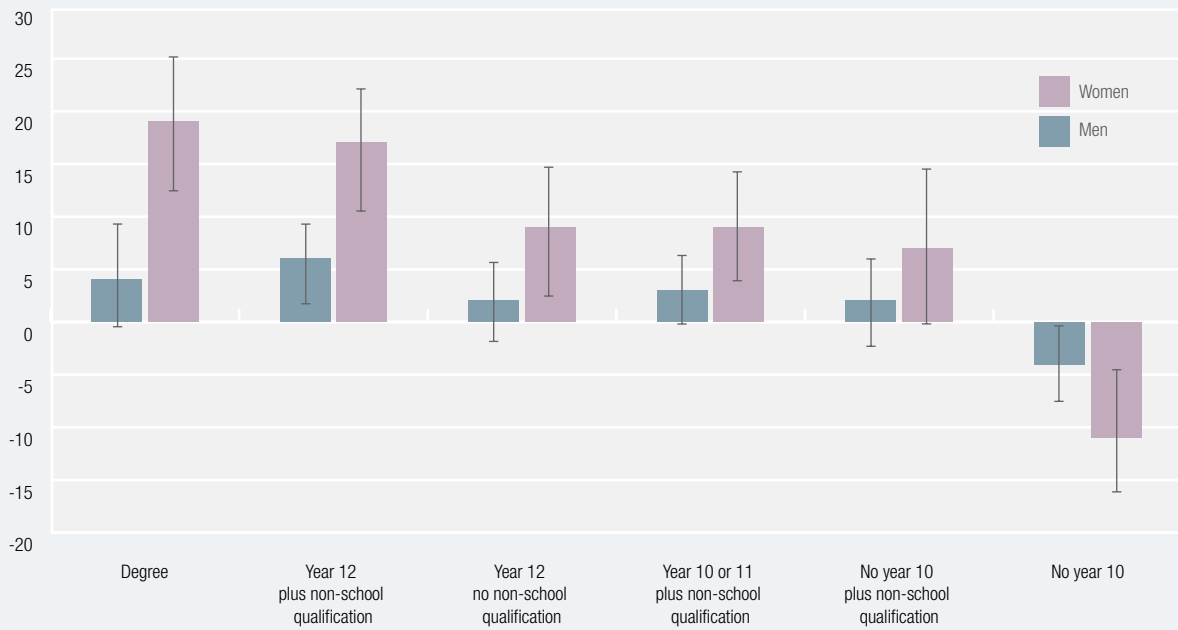
### Cultural and social engagement

- The cultural and social engagement factors were found to have statistically significant associations with Indigenous labour market outcomes for women, but not for men.
- For women there were positive associations between employment and LFP, and engagement in social cultural events and the provision of support outside the household. For women there were negative associations between participation in traditional cultural activities (such as hunting and traditional arts and crafts) and employment.
- For men, the equivalent associations were weak.

## Marginal effects of education, Indigenous people, 2008

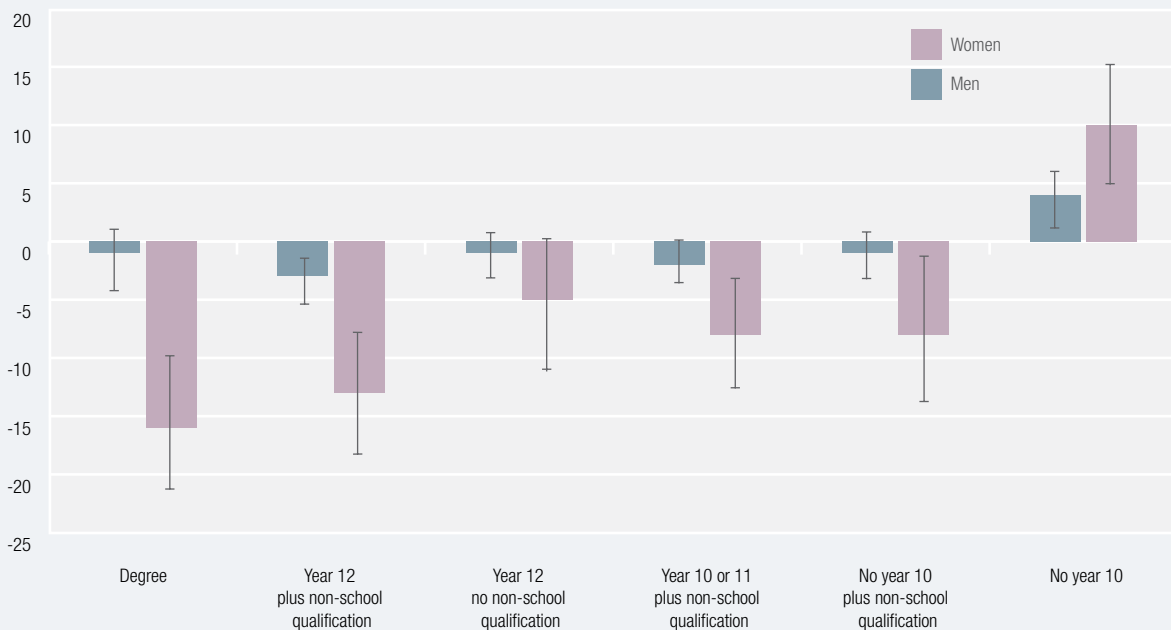
### Employed

Percentage point change



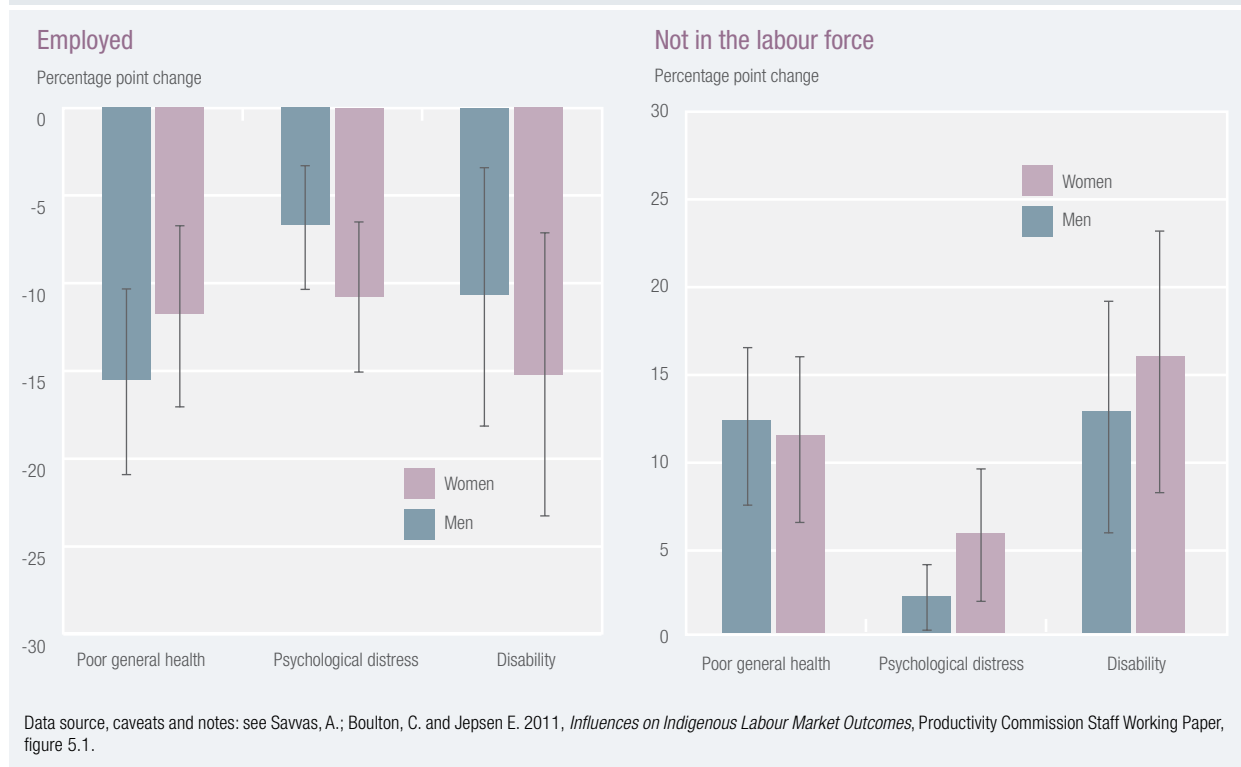
### Not in the labour force

Percentage point change



Data source, caveats and notes: see Savvas, A.; Boulton, C. and Jepsen E. 2011, *Influences on Indigenous Labour Market Outcomes*, Productivity Commission Staff Working Paper, table 5.2.

## Marginal effects of health and disability indicators, Indigenous people, 2008



## Marginal effects of selected social and cultural factors, Indigenous people, 2008

Percentage point change in predicted probability

Explanatory variable	Explanatory variable unit	Men		Women	
		Employed	Not in the labour force	Employed	Not in the labour force
Does not provide support outside household	Binary	-3*	2*	-10***	10***
Lives in a multifamily household	Binary	-6***	4**	-6**	6**
Provides unpaid child care	Binary	-2	-0.3	-7***	4*
Participation in traditional cultural activities	Binary	0.2	0.5	-7**	3
Participation in social cultural events	Binary	1	-2**	10***	-8***

\*\*\* = significant at 1 per cent level; \*\* = significant at 5 per cent level; \* = significant at 10 per cent level. No stars indicate that the variable is not statistically significant.

Data source, caveats and notes: see Savvas, A.; Boulton, C. and Jepsen E. 2011, *Influences on Indigenous Labour Market Outcomes*, Productivity Commission Staff Working Paper, table 5.2.

## Influences on Indigenous Labour Market Outcomes

- > Savvas, A.; Boulton, C. and Jepsen, E.
- > Productivity Commission Staff Working Paper
- > Released December 2011

# Commission News

## New inquiries and commissioned studies

### Strengthening Economic Relations between Australia and New Zealand

Following a meeting of Prime Ministers, the Australian and New Zealand Productivity Commissions have been asked to jointly study the options for further reforms that would increase economic integration and improve economic outcomes for Australia and New Zealand.

### Default Superannuation Funds in Modern Awards

The purpose of this inquiry is to design transparent and objective criteria for the selection and ongoing assessment of superannuation funds eligible for nomination as default funds in modern awards.

### Electricity Network Regulation

A public inquiry into the use of benchmarking as a means of achieving the efficient delivery of electricity network services and infrastructure; and the effectiveness of regulatory arrangements for interconnectors.

### Regulatory Impact Analysis: Benchmarking

The Productivity Commission has been asked to undertake a benchmarking study into regulatory impact analysis (RIA) processes. In undertaking this study, the Commission will

benchmark the efficiency and quality of Commonwealth, state and territory, and COAG RIA processes.

*Details of all current Commission projects appear on page 24 and are available at [www.pc.gov.au](http://www.pc.gov.au)*

### Carbon policy assistance reviews

Under the Australian Government's Clean Energy Future Package, the Productivity Commission has been assigned a range of tasks. Specifically, the Commission is required to quantify mitigation policies in other countries; review assistance provided under the Jobs and Competitiveness Program; conduct assessments of impacts of the carbon pricing mechanism on particular industries; review fuel excise arrangements; review the impact of carbon pricing on the competitiveness of the Australian steel industry; and conduct reviews of the effects on companies producing steel of possible cost pass through by coal suppliers.

In December 2011, the Commission released a consultation paper *Carbon Policy Assistance Reviews: the Commission's Tasks*. The paper outlines and discusses the nature of the tasks assigned to the Commission.

## Recent releases

### May 2012

**Impacts of COAG Reforms: Business Regulation and VET**

*Research Report (3 vols)*

**Schools Workforce**

*Research Report*

### April 2012

**Barriers to Effective Climate Change Adaptation**

*Draft Inquiry Report*

**Report on Government Services 2012: Indigenous Compendium**

*Steering Committee for the Review of Government Service Provision*

**Australia's Productivity Growth Slump: Signs of Crisis, Adjustment or Both?**

*Visiting Researcher Paper*

**PETNET Australia**  
**Australian Government competitive Complaints Office**  
*Investigation No. 15*

**Strengthening Economic Relations between Australia and New Zealand**  
*Issues Paper*

**Productivity in Electricity, Gas and Water**  
*Staff Working Paper*

**Business Regulation Benchmarking: Role of Local Government as Regulator**  
*Draft Research Report*

### March 2012

**Economic Regulation of Airport Services**  
*Inquiry Report*

**Regulatory Impact Analysis: Benchmarking**  
*Issues Paper*

### February 2012

**Default Superannuation Funds in Modern Awards**  
*Issues Paper*

**Electricity Network Regulation**  
*Issues Paper*

**Australia's Export Credit Arrangements**  
*Draft Inquiry Report*

All publications can be downloaded from the Commission's website [www.pc.gov.au](http://www.pc.gov.au)

# Current commissioned projects

15 May 2012

## Australia-New Zealand Economic Relations – *Joint Study with New Zealand Productivity Commission*

Issues paper released April 2012.

Draft report September 2012.

Final report December 2012.

Contact: Jane Melanie (02) 6240 3380

Email: transtasmanreview@pc.gov.au

[www.pc.gov.au/projects/study/australia-new-zealand](http://www.pc.gov.au/projects/study/australia-new-zealand)

## Default Superannuation Funds in Modern Awards – *Public Inquiry*

Issues paper released February 2012.

Draft report June 2012.

Final report to Government October 2012.

Contact: Imogen Curtis (03) 9653 2116

Email: default.super@pc.gov.au

[www.pc.gov.au/projects/inquiry/default-super](http://www.pc.gov.au/projects/inquiry/default-super)

## Electricity Network Regulation – *Public Inquiry*

Issues paper released February 2012.

Draft report September/October 2012.

Final report to Government April 2013.

Contact: Michelle Osborne (02) 6240 3354

Email: electricity@pc.gov.au

[www.pc.gov.au/projects/inquiry/electricity](http://www.pc.gov.au/projects/inquiry/electricity)

## Barriers to Effective Climate Change Adaptation – *Public Inquiry*

Issues paper released October 2011.

Draft report released April 2012.

Final report to Government September 2012.

Contact: Anthea Long (03) 9653 2162

Email: climate-adaptation@pc.gov.au

[www.pc.gov.au/projects/inquiry/climate-change-adaptation](http://www.pc.gov.au/projects/inquiry/climate-change-adaptation)

## Australia's Export Credit Arrangements – *Public Inquiry*

Issues paper released October 2011.

Draft report released February 2012.

Final report to Government May 2012.

Contact: Alex Maevsky (03) 9653 2230

Email: exportcredit@pc.gov.au

[www.pc.gov.au/projects/inquiry/export-credit](http://www.pc.gov.au/projects/inquiry/export-credit)

## Business Regulation Benchmarking: Role of Local Government as Regulator – *Commissioned Study*

Issues paper released September 2011.

Draft report released April 2012.

Final report to Government July 2012.

Contact: Sue Holmes (02) 6240 3351

Email: localgov@pc.gov.au

[www.pc.gov.au/projects/study/regulationbenchmarking/localgov](http://www.pc.gov.au/projects/study/regulationbenchmarking/localgov)

## Regulatory Impact Analysis: Benchmarking – *Commissioned Study*

Issues paper released March 2012.

Draft report August 2012.

Final report to Government November 2012.

Contact: Rod Bogaards (02) 6240 3208

Email: ria.benchmarking@pc.gov.au

[www.pc.gov.au/projects/study/ria-benchmarking](http://www.pc.gov.au/projects/study/ria-benchmarking)

Log on to the Commission's website [www.pc.gov.au](http://www.pc.gov.au) for full details of all current projects.