



# PC update

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Policy implications of the global financial crisis

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Enhancing water buyback



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How do they compare?

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The role of markets and public policy



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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.

Front cover top photo: © MDBA, Murray River at Nyah, photographer Arthur Mostead

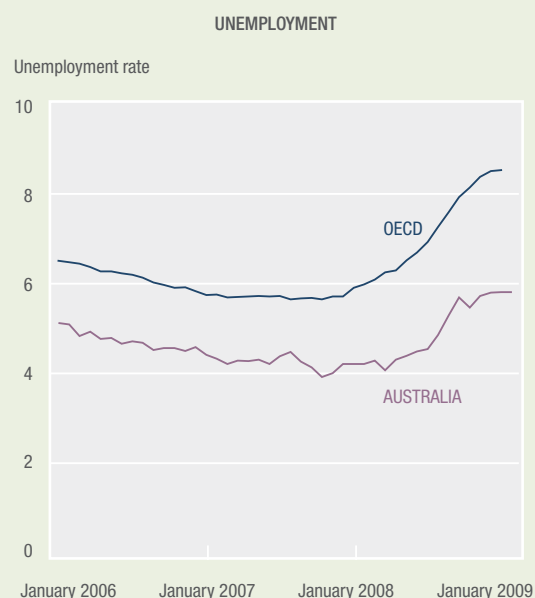
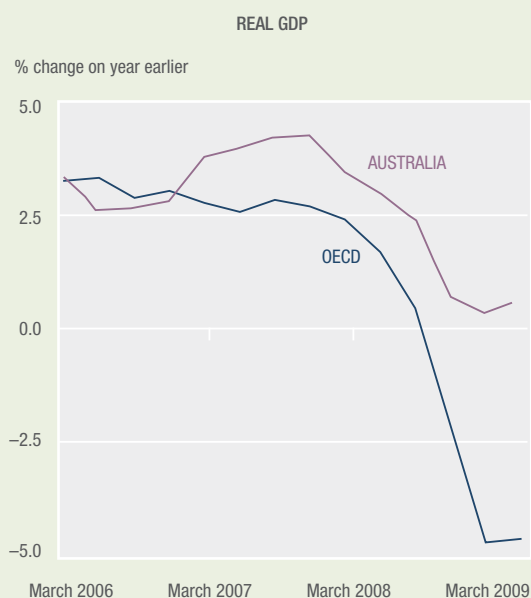
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## Gross domestic product and unemployment



Source: OECD 2009, *Key Short-term Indicators* <http://stats.oecd.org>

the longer run. These estimates highlight the importance of clearly identifying the benefits of any proposed regulatory changes, and establishing that they would outweigh the likely costs of that change.

### Securing future economic growth in Australia

As in the past, factors influencing Australia's future productivity performance will be the key to our prospects for economic growth and higher living standards. The financial crisis and the economic downturn have placed additional emphasis on:

- increasing flexibility in capital and labour markets to remove unnecessary impediments to investment and employment opportunities
- responding to the challenge of a more fiscally constrained environment, with careful attention to the cost-effectiveness of existing expenditure, and efficiency of new expenditure.
- maintaining vigilant policy-evaluation processes.

The Commission's Annual Report highlights three key areas for policy attention:

- targeting spending associated with stimulus measures at projects that provide the greatest payoffs to the community
- gradually removing assistance to specific sectors introduced during the crisis, and reviewing or reforming other areas of industry assistance

### Policy settings for recovery

While short-term measures have been important in stabilising financial markets and improving macroeconomic conditions, to achieve rapid recovery and strong long-term growth, it will be important that governments:

- avoid resorting to policies that erect new barriers to trade, which may amplify the already rapid declines in trade
  - adopt financial regulations and institutional reforms that can strengthen the financial system, while not unduly restricting competition and innovation in financial services
  - progress regulatory, competition and other structural policy reforms that encourage the best use of scarce capital and labour resources, which will boost productivity, national income and government revenue.
- pushing ahead with a range of targeted productivity-enhancing reforms to facilitate recovery and higher levels of future economic growth. ■

Productivity Commission  
Annual Report 2008-09

> Released October 2009

## Recovering water in the Murray-Darling Basin

A Productivity Commission draft report finds that although the Australian Government's buyback of permanent water entitlements has been cost effective, broader strategic issues must be resolved to achieve the Government's objective of managing the Murray-Darling Basin's water resources in the national interest.



(c) MDBA, Murray River at Nyah, photographer Arthur Mostead

Increases in water allocated to irrigation and urban consumption in the Murray-Darling Basin have placed considerable stress on the environment. The Australian Government's agenda for increasing the availability of water for the environment in the Basin includes:

- administrative reallocation through a Basin Plan;
- a \$3.1 billion buyback of water entitlements (the Restoring the Balance program); and
- a \$5.8 billion program for investing in water-saving infrastructure.

The Basin Plan being developed by the Murray-Darling Basin Authority should be finalised in 2011. It will set sustainable diversion limits (SDLs) that will progressively become binding as current state water resource plans expire and are replaced.

The Productivity Commission has been asked to study market-based mechanisms for diversifying the Australian Government's approach to purchasing water for the environment in the Basin. Its draft report was released in December 2009.

The draft report notes that the buyback is occurring before SDLs have been set, meaning that some purchases may be inconsistent with the Basin Plan. Moreover, the Commission has concerns about setting SDLs solely on the basis of environmental considerations, as the

*Water Act 2007* (Cwlth) would seem to require. While these considerations are clearly important, so are the tradeoffs between the benefits from consumptive uses of water and the benefits of using that water for the environment.

Additionally, the water buyback is taking place before Basin jurisdictions have clarified how the risks of reductions in water availability are to be shared between irrigators and governments, with potential implications for adjustment, and possibly compensation.

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**“The uncertainty surrounding these institutional issues has implications for the efficient conduct of the buyback. Irrigators need to know if they should enter the buyback in the short term, or risk the possible loss of some of their water entitlements, or lower reliability, after the Basin Plan,”** Commissioner Neil Byron

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... continued on page 17 ►

# Australia's gambling industries

The Productivity Commission's draft report on gambling proposed stronger harm minimisation measures, aimed mainly at the use of gaming machines.

Gambling was substantially liberalised in most Australian states and territories in the 1990s, with a consequent surge in gambling expenditure and industry growth. However, community backlash about the adverse impacts on many Australians and their families led to the first independent national public inquiry into gambling, undertaken by the Productivity Commission a decade ago.

Since then, there have been significant changes in the gambling industries and the regulatory environment, with a much greater policy focus on harm minimisation. Yet community and political concerns remain. Accordingly, the Council of Australian Governments asked the Commission to provide an update of its 1999 report, with a focus on problem gambling. The Commission's draft report was released in October. Following further public consultation, the final report will be forwarded to Government at the end of February 2010.



## Who is at risk?

The Commission's draft report notes that gambling is an enjoyable pursuit for many Australians. Government policies should balance the sizeable benefits for recreational gamblers against the significant harm it causes some people. Commission estimates indicate that the number of problem gamblers in Australia is around 125 000, with an estimated 290 000 more gamblers experiencing moderate risk.

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**“Despite progress since our last report 10 years ago, there is considerably more that governments can do to make gaming machines a safer recreational pursuit”,**  
Gary Banks, Chairman, Productivity Commission.

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Gaming machines account for the largest slice of overall gambling expenditure in Australia – around 65 per cent of the total – and account for around 75-80 per cent of problem gambling. The Commission estimates that of those who regularly gamble on gaming machines, 15 per cent are problem gamblers, and an additional 15 per cent are at moderate risk. These two groups account for a sizeable share of industry (and taxation) revenue – problem gamblers alone account for around 40 per cent of total gaming machine spending.

## Online gaming: regulation not prohibition

The provision of online gaming to Australian residents is prohibited by the *Interactive Gambling Act 2001* (IGA). Online wagering on races and sports betting is not restricted. While it is probable that this ban reduced the growth of online gaming, international sites are being increasingly accessed and the ban is likely to be increasingly ineffective as a barrier to online gambling by Australians.

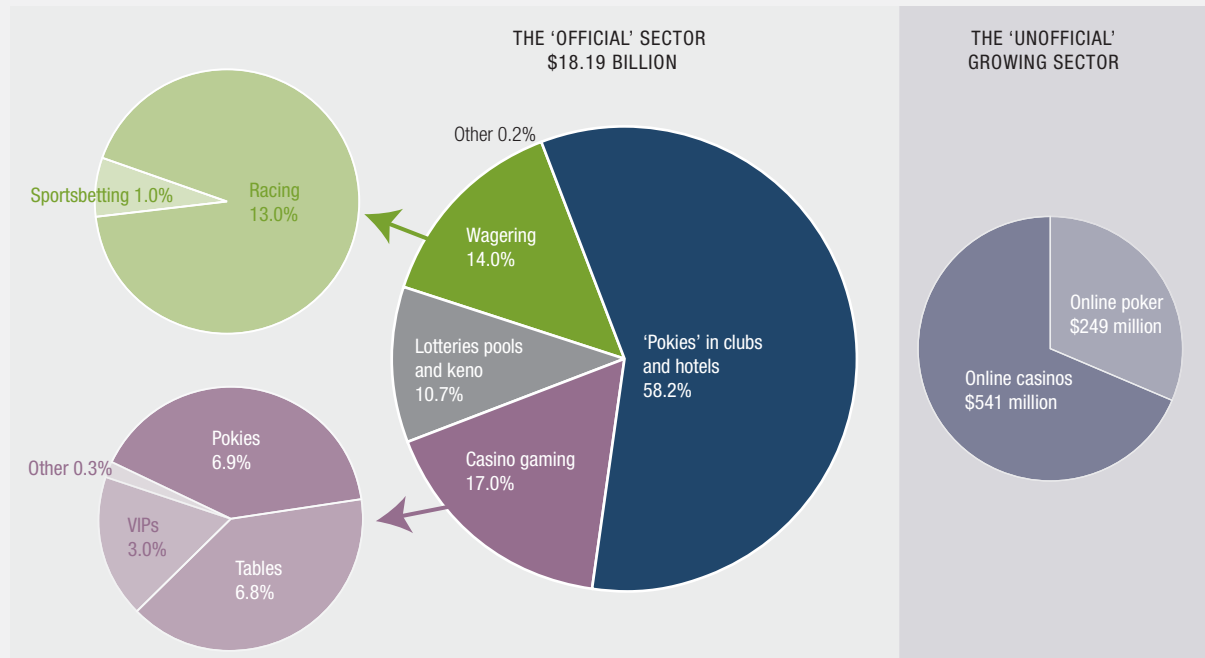
Online gaming poses some risks: its easy access may increase problem gambling; and some offshore sites have poor harm minimisation features and unscrupulous business practices.

In the Commission's view, regulated access – rather than prohibition – would significantly reduce these risks. The draft report recommends repealing the IGA and initiating a process for the managed liberalisation of online gaming, which would include high probity and harm minimisation standards. However, managed liberalisation is not without risk. Ongoing evaluation of the effectiveness of harm minimisation measures and of the regulatory oversight of the online gaming sector would be required.

## Racing and wagering: ensuring long-term viability

Over the last 50 years, the fundamental interrelationship between the racing and wagering industries has been underpinned by funding agreements between the state and territory racing authorities and the Totalisator Agency Boards. However, recent developments, including the growth of corporate bookmakers and betting exchanges, have improved services for consumers, but have also undermined these arrangements, potentially affecting the long-term viability of racing and wagering.

## Gaming machines are the dominant source of gambling revenue



Source: Productivity Commission 2009, *Gambling*, Draft Report.

To overcome these problems, the Commission's draft report recommends the introduction of a national funding model for the racing industry comprising:

- a single levy on wagering operators, on a gross revenue basis, to be paid to the racing industry
- the creation of an independent national body, to set and periodically review the levy in consultation with all relevant stakeholders.

### The Commission's draft report focuses on policies for gaming machines – where most harm arises.

Other findings on racing include that there are grounds for a harmonised tax regime, based on a binding agreement among all jurisdictions; and that there is no compelling rationale for renewing TAB retail exclusivity. ■

#### Gambling

- > Productivity Commission Draft Report released October 2009
- > Contact: Troy Podbury 02 6240 3257
- > Email: [gambling@pc.gov.au](mailto:gambling@pc.gov.au)

#### Reducing harm from gaming machines: selected draft recommendations

Reduce losses by lowering the bet limit to one dollar per button push and by lowering limits on how much cash can be fed into machines at any one time.

Extend shut down periods for gaming rooms in hotels and clubs, and commence them earlier:

Progressively move to a universal pre-commitment system for gaming machines, using technologies that allow all consumers in all venues to set binding limits on their future play.

With effective pre-commitment, many other regulations on gaming machines could be modified, or be removed as they become redundant.

Display more effective warnings and other player information in gaming venues.

Relocate ATMs away from gaming floors, with lower daily cash withdrawal limits.

Enhance support services by improving training for gambling counsellors; broadening funding sources for help services; and developing a nationally consistent and publicly available dataset for gambling support services, including agreed outcome measures.

## Executive remuneration

The Productivity Commission's final report on executive remuneration was released in January.

Commenting on the report's release, Commission Chairman Gary Banks said: 'Substantial feedback was received in response to the Commission's preliminary proposals. Our final recommendations are likely to be more robust and implementable as a result. Most changes are fine-tuning, but some are more significant, including the proposed 'two strikes' rule, which requires boards to submit for re-election where shareholders repeatedly vote against their remuneration decisions.'

Under the Commission's reformulation, shareholders can express their opinion about the company's remuneration policies in the knowledge that a second no vote above 25 per cent would trigger a separate (majority) resolution to spill the board, but not a spill itself. Shareholders' say on pay would be elevated further by the report's recommendation to preclude executives and board members from voting on remuneration reports.

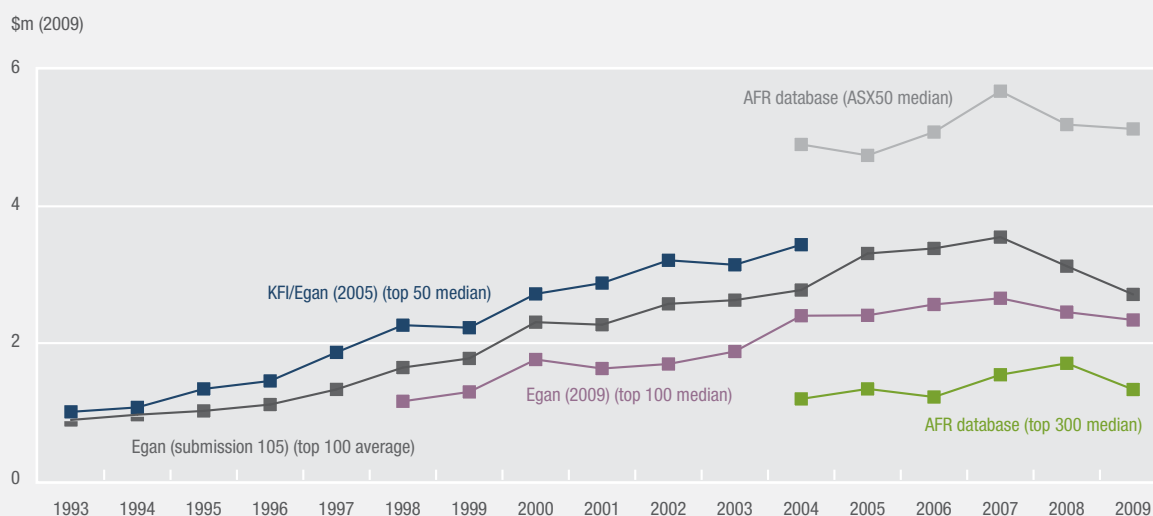
An area of universal agreement is the need to improve the information content and accessibility of remuneration reports. The Commission's recommendations would help shareholders understand what executives are actually being paid and why.

**"The Commission's final recommendations would strengthen board decision-making on executive remuneration by reducing board 'clubbiness', removing potential for conflicts of interest and enhancing accountability for pay outcomes."**

Overall, the Commission found that, despite some problems, there have not been widespread failures in remuneration setting in Australia. Gary Banks described the final reform package as 'a measured and proportionate one. It will not, and should not, stop our top executives from earning high salaries. But it should reduce the scope for anomalies or economically inefficient outcomes, and promote greater trust in corporate Australia.' ■

### The rise and fall of executive pay

Pay for CEOs of the top 100 companies grew most strongly, at 13 per cent real a year, from the mid-90s to 2000, and then increased by around 6 per cent annually in real terms to 2007. Since 2007 average remuneration has fallen by around 16 per cent a year. The rise and decline in executive pay over the 2000s largely reflects increased use of pay structures linked to company performance.



Source: Productivity Commission 2009, *Executive Remuneration in Australia*, Final Inquiry Report, Melbourne.



# Executive remuneration

## Key findings and recommendations of the Commission's final report

<b>Board capacities</b>
Any declaration of 'no vacancy' at an AGM to be agreed to by shareholders.
Initiatives by the ASX Corporate Governance Council to improve gender balance on boards strongly endorsed.
<b>Conflicts of interest</b>
On an 'if not, why not' basis: remuneration committees to comprise at least three members, all non-executive directors, with a majority and the chair independent.
For ASX300 companies, executives to be prohibited from sitting on remuneration committees.
Prohibit executives and directors voting their own shares on remuneration reports.
Prohibit executives hedging unvested equity remuneration or vested equity subject to holding locks.
Prohibit executives and directors voting undirected proxies on remuneration reports.
Require proxy holders to cast all their directed proxies on remuneration reports.
<b>Disclosure</b>
Improve information content and accessibility of remuneration reports through: <ul style="list-style-type: none"><li>• a plain English summary of remuneration policies</li><li>• reporting actual remuneration received and total company shareholdings of individuals in the report.</li></ul>
Remuneration disclosures to be confined to key management personnel.
Companies to disclose executive remuneration advisers, who appointed them, who they reported to and the nature of any other work undertaken for the company. ('If not, why not')
For ASX300 companies, advisers on executive pay to be commissioned by, and their advice provided directly to, the board, independent of management.
Institutional investors to voluntarily disclose how they have voted on remuneration reports (and other remuneration-related issues).
<b>Remuneration principles</b>
Remove cessation of employment as the taxation point for deferred equity subject to risk of forfeiture.
<b>Shareholder engagement</b>
'Two strikes and re-election resolution': <ul style="list-style-type: none"><li>• 25 per cent 'no' vote on remuneration report triggers reporting obligation on how concerns addressed</li><li>• subsequent 'no' vote of 25 per cent activates a resolution for elected directors to submit for re-election within 90 days.</li></ul>

## Executive Remuneration in Australia

> Productivity Commission Final Inquiry Report

> Released January 2010

# The performance of Australia's public and private hospital systems

Estimates by the Commission suggest that, at a national level, public and private hospitals have similar average costs and efficiency.



In May 2009 the Australian Government asked the Productivity Commission to examine three aspects of the health care system:

- the relative performance of public and private hospitals, with particular regard to the cost of performing clinically-similar procedures and the rate of hospital-acquired infections
- rates of informed financial consent and out-of-pocket expenses for privately-insured patients in public and private hospitals
- the most appropriate factor for indexing the Medicare Levy Surcharge income thresholds.

On releasing the Commission's final report in December 2009, Commissioner David Kalisch said: 'Comparing the relative performance of hospitals has been challenging. There are major differences within and between public and private hospital systems that make like-for-like comparisons difficult. There are also data limitations, which the Commission has sought to address by drawing on various data sources and incorporating adjustments to make the data more comparable. Future comparisons will be assisted by enhanced data collections for public hospitals already foreshadowed by governments and would be further improved by expanded reporting for private hospitals.'

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**“A multivariate analysis of hospital-level data suggests that the efficiency of public and private hospitals is, on average, similar. However, the output of individual hospitals in both sectors is, on average, estimated to be around 20 per cent below best practice.”**

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Based on available data, the Commission's experimental cost estimates indicate that public and private hospitals have similar overall costs, but there are differences in their composition. Medical and diagnostics costs, and prostheses costs are higher in private hospitals; while general hospital costs and capital costs are higher in public hospitals.

The limited available evidence suggests that private hospitals have lower infection rates than public hospitals, but private hospitals on average treat patients who have a lower risk of infection.

Other indicators presented in the Commission's report show that:

## Public and private hospitals: a snapshot

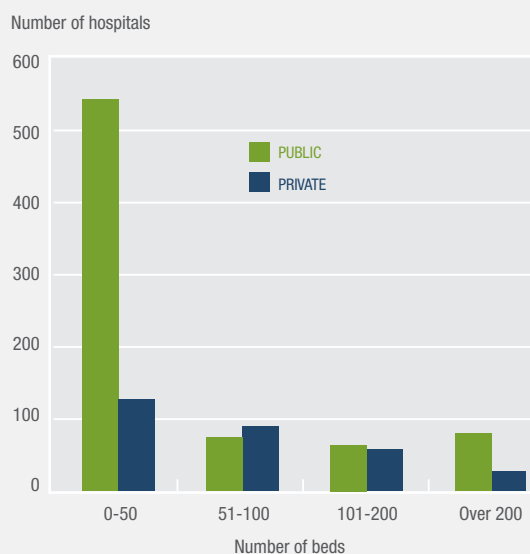
- Health care expenditure comprises about 9 per cent of Australia's GDP, with hospital services accounting for around one-third of this.
- Australia's 768 public hospitals and 556 private hospitals provided 4.7 and 3.1 million episodes of care respectively for admitted patients in 2007-08.
- Private hospitals tend to be concentrated in major cities, whereas public hospitals are more widely distributed (table 1).
- Around half of Australia's hospitals have 50 or fewer beds. Although the concentration of small-scale hospitals is higher in the public sector, there is diversity in hospital sizes in both sectors (figure 1).
- Patients treated in public hospitals are, on average, from lower socioeconomic groups, and have more complex medical conditions.
- Around 14 per cent of patients in public hospitals are treated as private patients. Several state governments have arrangements that allow a small number of public patients to be treated in contracted private hospitals, particularly for elective surgery procedures.
- There is considerable complementarity between public and private hospitals. For example, in 2007-08, public hospitals handled around three-quarters of all medical separations (episodes of care), while private hospitals performed around 60 per cent of all surgeries and nearly 70 per cent of other procedures.
- The boundaries between the two sectors are not clear cut – some public and private hospitals share resources in co-located establishments, a single provider may deliver services in both sectors, and medical staff can work across both sectors.

Table 1: Number of public and private hospitals by region, 2009

Region	Public hospitals	PRIVATE HOSPITALS		
		Day hospitals	Other	Total
Major city	164	233	203	436
Inner regional	205	31	64	95
Outer regional	234	7	18	25
Remote	79	-	-	-
Very remote	81	-	-	-
Unable to be classified	5	-	-	-
Australia	768	271	285	556

Source: Productivity Commission 2009, *Public and Private Hospitals*, Research Report, Canberra

Figure 1: Number of hospitals by sector and bed numbers



- private hospitals have higher labour productivity and shorter lengths of stay than public hospitals, but this is at least partly due to casemix and patient differences between the public and private sectors
- elective surgery in public hospitals is more accessible for disadvantaged socioeconomic groups, but tends to be less timely than in the private sector. The Commission also found that:
- only a small proportion of patients incur out-of-pocket expenses without receiving sufficient prior information to give informed financial consent

- the most appropriate indexation factor for the Medicare Levy Surcharge income thresholds is Average Weekly Ordinary Time Earnings. ■

## Performance of Public and Private Hospital Systems

> Commissioned Study

> Released December 2009

## Markets: how free?

In a recent address to the Whitlam Institute, Commission Chairman Gary Banks discussed the role of markets in the formulation of public policy. Edited highlights of his comments follow.

### What do markets offer?

The recent global financial crisis was seen by many as evidence of fundamental problems with markets. That is understandable. But problems in markets should not be conflated with problems of markets. It's easy to lose sight of the simple function of markets. They are a means of connecting willing buyers and sellers for their mutual benefit. That's all they do. Of course, if they do it well, they achieve a lot.

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**“History tells us that those societies with better functioning markets have been the most successful economically, and often the most successful socially as well.”**

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How rapidly and effectively markets have developed in different countries has depended on the development of institutions and rules to facilitate them, and to reduce the costs of transactions in particular. The key ones are how well property rights are defined; how effectively suppliers compete; how well informed are buyers; and the nature and reach of mechanisms for legal redress when things go wrong.

Through the medium of prices, competitive markets ensure that a country's resources get put to use where they can do the most good – taking account of what value people place on different goods and services, and how much those goods and services cost to produce. Competitive markets also ensure that the ‘better mousetrap’ is appropriately rewarded, in turn providing incentives for innovation and lower-cost production, which underpin the growth process.

Importantly, emerging shortages and surpluses, which are inherent to any economic system, can be signalled automatically in a competitive market through price movements, precipitating spontaneous actions by both buyers and sellers that eventually serve to eliminate them.

For much of the previous century, successive governments imposed policies that impeded competition, distorted prices, constrained business and raised its costs. The fact that we were able to reverse our consequent economic decline was largely due to the structural reforms set in train by the Hawke/Keating Government in the 1980s. Key strands of those reforms were directed at freeing up markets, exposing industry to international competition,

“Gough Whitlam was the first Australian leader to act on the understanding that a freer, more competitive market would facilitate greater economic efficiency and productivity, which would in turn underpin income growth and pay for social programs needed to address inequality and disadvantage. Whitlam also understood that policy reforms to promote efficiency and community wellbeing are often stymied by vocal minorities who stand to lose, while not being adequately appreciated by the much larger section of the community who are the ultimate beneficiaries. He created the Industries Assistance Commission as an institutional counterweight to support reform.”

and allowing prices to perform their proper allocative role, while undertaking reforms to make government infrastructure services more efficient and labour markets more flexible.

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**“Australia itself illustrates how important it is to a country's economic performance to make use of markets in a way that achieves the right balance between freedom and intervention.”**

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### Why do markets have an image problem?

‘If markets are so good, then why do they seem to perform so poorly?’, I can hear some people thinking. There are two features of competitive market processes that I think provide much of the explanation.

One is what has become known as ‘creative destruction’: survival of the economically fittest. Markets go by results. They pay no respect to good intentions and they punish poor economic performance.

Creative destruction is inherent to the growth process. With limited resources, economies are dependent on successful businesses and industries being able to attract people and capital from less successful ones. That seems harsh to most people, especially to those most directly impacted. So we see considerable resistance to the logic of markets, and lobbying by industries for taxpayer support.

The second reason why markets have acquired an image problem reflects the reality that what the market values need not accord with what *society* values, or even with the long-term interests of the economy as a whole. For example, certain kinds of goods and services may not be produced by the market because, while they are socially valuable, firms cannot make a profit from producing them; or some activities may be privately produced, but underprovided.

## Markets cannot do it all

These gaps or deficiencies in market provision involve things that civilized societies care about, like income ‘safety nets’, universal access to healthcare and environmental amenity. It could be said that they have to do with the *productivity of societies*, not just the *productivity of economies*. But we shouldn’t condemn markets for failing to produce them.

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“Markets make an important contribution, but they cannot satisfy every societal goal or need. That’s why we have governments.”

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In addition to establishing institutions to underpin markets, governments need to intervene to influence the behaviour of participants, and they need to provide so-called ‘non-market services’. While many of the latter interventions have been desirable, some have come at a high cost, and some have been motivated by private interests rather than the public interest. Unwinding such arrangements has been the object of the microeconomic reform process since the early 1980s.

## Implications for regulatory ‘balance’

Unless you are operating in a perfect market with social and private valuations and effects coinciding, and complete information for all, there may be a case for government intervention. But how much and what kind will depend crucially on the particular market and the costs of the intervention. For example, the degree of intervention that the Commission has proposed for gambling differs greatly from what we have proposed for executive remuneration.

Interventions that can target the source of a problem without unwanted side effects will generally be superior, and give greater confidence of achieving a net benefit to the community over the longer term. In the case of gambling,

we calibrated the measures to have impacts mainly on problem gamblers. In the case of executive remuneration, a number of the recommendations that we made essentially involve codifying what already is accepted as best practice, and undertaken by the best firms.

Sometimes markets give rise to social costs, but no intervention can be found that would reduce them without giving rise to greater costs. In those situations, although it can be politically hard to resist, ‘no action’ is the most appropriate course.

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“Knowing whether and how to intervene so as to do good, or at least not to do harm, is rarely straightforward. Getting this right demands good analysis and good evidence, which must include consultation with those likely to be affected. So it also requires good process.”

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The Commission has never had an inquiry where its final recommendations to government haven’t benefited from the exposure of a draft report to feedback from the community. The law of unintended consequences holds most firmly when consultation is weakest. And the risks are generally highest when making ad hoc or piecemeal changes to an *interactive* system – which is the essence of a market.

The global financial crisis has revealed weaknesses in financial markets, especially overseas, which call for action. But any regulatory interventions need to be carefully designed to address the sources of problems and not give rise to collateral damage on innovation and productivity, and the benefits that flow from them.

In summary, markets cannot satisfy all policy goals and need to be complemented by government intervention that either ‘fills the gaps’, or influences the behaviour of market participants to align private and public interests. Getting this right is hard, but evidence, analysis and ‘learning by doing’ are essential to finding the right balance. ■

### Markets: how free?

> Edited highlights of a speech by Gary Banks AO, to the *Governing the Economy Symposium*, convened by the Whitlam Institute, Sydney

> 30 November 2009

# Wheat export marketing arrangements

The Australian Government has asked the Commission to examine the operation and effectiveness of the current wheat export marketing arrangements.

The Wheat Export Marketing Act came into effect on 1 July 2008. Under the Act, a new regulator – Wheat Exports Australia (WEA) – was established to formulate and administer the Wheat Export Accreditation Scheme. WEA replaced arrangements that followed the removal of the AWB monopoly over wheat exports.

The purpose of the accreditation scheme is to ensure that companies that are bulk wheat exporters are ‘fit and proper’ to export wheat from Australia. Accreditation by WEA is intended to promote competition and choice in marketing for growers while providing them with some comfort that a bulk wheat exporter will not default on its liabilities (although no guarantees are provided).

The Wheat Export Marketing Act also aims to ensure that wheat exporters who operate port terminal facilities cannot use access to their facilities to inhibit competition from rival exporters. Under the Act, to obtain wheat export accreditation, bulk wheat exporters providing port terminal services must satisfy an ‘access test’ in respect of their port facilities.

The Commission is examining the operation of the Wheat Export Marketing Act and the Wheat Export Accreditation Scheme. An Issues Paper was released in October 2009 outlining the matters to be considered by the Commission. These include:

- the effectiveness of the arrangements in meeting the objectives of the Act, including the role of WEA
- the suitability of the eligibility criteria for accreditation of exporters
- the appropriate level of assessment of each applicant for accreditation by WEA against these eligibility criteria
- the appropriateness of the access test requirements for accreditation of port operators as exporters
- the effectiveness of, and level of competition in, the transport and storage supply chain for wheat
- the availability and transparency of market information.

The Commission conducted its first round of public consultations for the inquiry in November and December 2009. A draft inquiry report will be released in March 2010, followed by further public consultation. The final report will be presented to the Australian Government by 1 July 2010. ■

## Wheat Export Marketing Arrangements

- > Productivity Commission Issues Paper
- > Released October 2009
- > Contact: John Salerian 03 9653 2190
- > Email: wheatexport@pc.gov.au

## New Commissioned projects

The Australian Government has requested that the Productivity Commission undertake two new projects:

- *The impact of bilateral and regional trade agreements* – an issues paper for this study was released in December 2009. Initial submissions are due by 1 March 2010, a draft report will be released in June, and the final report will be sent to Government by 27 November 2010.

- *Rural research and development corporations* – this 12-month inquiry was announced in mid-February. The Terms of Reference for the inquiry can be downloaded from the Commission’s website. More information about the inquiry will be posted on the website as it becomes available.

## Forthcoming inquiries

The Australian Government has announced that it will shortly provide references to the Productivity Commission for two new projects:

- *Disability care and support*: The Commission will investigate the feasibility of new approaches for funding and delivering long-term disability care and support.

- *Aged care* – the Commission will undertake a public inquiry into the needs of Australia’s aged persons for the next 20 years including appropriate standards and funding arrangements.

# Economic impacts of the EU Common Agricultural Policy

A recent Commission Staff Working Paper, based on collaborative research with Groupe d'Economie de Mondiale in Paris, estimates that the Common Agricultural Policy reduces GDP in the European Union, and lowers overall global welfare by about US\$45 billion.

The Common Agricultural Policy (CAP) of the European Union has undergone significant reform since the early 1990s, with the aim of improving its market orientation. There is an increasing focus on breaking the link between direct income payments and production decisions – so called 'decoupling'.

Expenditure on the CAP accounts for about 46 per cent of total EU budgetary expenditure, or over 50 billion a year. The majority of expenditure is in the form of direct income payments to farmers. Expenditure also includes market price support and rural development programs. These measures are bolstered by various border protection measures including import duties and other non-tariff barriers.

According to the modelling results presented in the paper, the effects of the CAP include:

- higher output of the farm and food processing sectors in the European Union, of about 8 and 6 per cent respectively
- lower output of the EU manufacturing and services sectors
- lower GDP in the European Union of about 0.3 per cent, or US\$52 billion.

## Modelling approach

In the Commission paper, the economic impacts of the CAP are evaluated using a computable general equilibrium (CGE) modelling framework. The Global Trade Analysis Project (GTAP) comparative static CGE model is used, together with the latest version of the GTAP database (version 7), which has a base year of 2004.

To evaluate the impact of the current regime on economic outcomes, a counterfactual scenario is modelled, where elements of the CAP are removed.

Although the components of the CAP are interdependent, the main components have been modelled separately in order to interpret better their roles and contributions to the overall effects of the CAP. The effects of three major components of the CAP – direct income payments, export subsidies, and border protection – are analysed.

The modelling results provide an indication of the aggregate allocative efficiency and welfare effects, along with sectoral effects – both within and outside agriculture – on the European Union and on other parts of the world.



The additional farm and food output in the European Union is estimated to depress world prices for these goods by between 1 and 4 per cent. World prices for manufactured goods and services increase. These price movements induce a contraction in agriculture and food processing in non-EU regions, and an expansion in the manufacturing and services sectors. Some of the largest contractions occur in the livestock sectors in Latin America (12.7 per cent) and Australia-New Zealand (4.9 per cent) and in the food processing sectors in most regions.

The estimated net effect of the CAP is to reduce global welfare by about US\$45 billion, with a cost to the European Union of US\$30 billion. The largest contributor to this welfare loss is the border protection component of the CAP.

However, the paper's authors note that important caveats apply to the modelling results. The estimates are sensitive to parameter choices, specific model features, and the structure of the database. The results should be interpreted as indicative only of the magnitude of the economic impacts of the CAP. ■

## Modelling the Effects of the EU Common Agricultural Policy

> Productivity Commission Staff Working Paper

> Released December 2009

## Benchmarking food safety regulation

Opportunities for all jurisdictions to improve food safety regulation and its enforcement, and thus to reduce burdens on business and overall community costs, are identified in a new Commission research report.

As part of the National Reform Agenda, COAG agreed to benchmark and report on the regulatory burden across all levels of government, with the aim of identifying unnecessary compliance costs, enhancing regulatory consistency across jurisdictions and reducing regulatory duplication and overlap. The Commission report, *Performance Benchmarking of Australian and New Zealand Business Regulation: Food Safety*, part of a series of reports requested by COAG, presents indicators of regulatory burdens associated with food safety regulatory regimes across Australian jurisdictions and New Zealand.

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**“There are encouraging signs that regulatory agencies generally use a tailored and measured approach, assisting businesses to comply. Yet unnecessary compliance burdens remain in a number of areas.”**

Associate Commissioner Paul Coghlan

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Historically, food regulations have been enacted by state and territory governments leading to significant differences in food regulations among the jurisdictions. Over the last three decades, there has been a series of reforms aimed at unifying the food regulatory system. Additionally, the

Australia New Zealand Food Standards (ANZFS) Code was established in 1995.

Areas which result in differences in regulatory burdens across jurisdictions, include:

- some regulatory requirements in excess of national standards
- slow progress in developing national standards under the ANZFS Code for primary production and processing
- inconsistencies across jurisdictions on the assessment of risks of particular foods
- inconsistencies across Australian local councils and across New Zealand territorial authorities in the fees charged, intensity of inspection and auditing, and level of transparency
- processes for registering and specifying maximum residue limits of chemicals, which are more streamlined and timely in New Zealand than in Australia
- higher costs and regulatory duplication for Australian food exporters compared to the regulation of New Zealand food exporters. ■

### Performance Benchmarking of Australian and New Zealand Business Regulation: Food Safety

> Productivity Commission Research Report

> Released December 2009

## 2009 Richard Snape Lecture

The Commission’s annual Richard Snape Lecture was presented by Professor Yu Yongding from the Chinese Academy of Social Sciences (Beijing) on 25 November in Melbourne.

In an address titled ‘China’s Policy Responses to the Global Financial Crisis’ Professor Yu described how the Chinese Government’s stimulus package and expansionary monetary policy succeeded in arresting falls in China’s economic growth resulting from the global financial crisis. He also identified potential threats to the sustainability of China’s economic recovery, and emphasised the need to



Professor Yu with Commission Chairman Gary Banks.

tackle underlying structural problems to ensure solid foundations for future growth. Copies of Professor Yu’s speech are available from the Commission’s website. ■



## Recovering water in the Murray-Darling Basin

...continued from page 5

### Enhancing the water buyback

The Restoring the Balance program uses an open tender process as the main mechanism for purchasing water entitlements.

The draft report found that while a tender process for purchasing permanent entitlements is an efficient mechanism in the absence of water markets, where there are active water markets, buying directly 'on the market' has a number of advantages over tenders, including the potential to reduce transaction costs for both buyers and sellers.

The draft report argues that restricting the buyback to purchasing water entitlements, rather than a range of water products, is likely to reduce the effectiveness and efficiency of the program. Other products could also be acquired including, for example, seasonal water allocations (the specific volume of water allocated to water entitlements in a given water accounting period).

The draft report also argues that the Restoring the Balance program should not be compromised by targeting for other distributional, system rationalisation, and/or salinity mitigation objectives.

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**The Commission also found that impediments to water trading imposed by state governments are adversely affecting the buyback and should be removed as soon as possible.**

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### Recovering water through irrigation infrastructure investment

The Commission concluded that subsidising the cost of investing in water-saving infrastructure is not generally a cost-effective way of obtaining water for the environment, nor is it likely to be the best way of sustaining irrigation communities, or assisting their transition to a future with less water. Infrastructure investment projects should only be undertaken where the price paid for recovered water is similar to the price paid through the buyback.

The Commission's final report will be presented to Government by 24 March 2010. Stakeholder consultation on the draft report will occur in January and February 2010. To facilitate discussion of the report's draft recommendations, a blog has been set up on the Commission's website: [www.blog.pc.gov.au](http://www.blog.pc.gov.au). The Commission encourages stakeholders to participate in the blog. ■

### Key draft recommendations and findings

Purchasing water products from willing sellers is generally the most effective and efficient means of acquiring water, where governments are liable for the cost of recovering water for the environment.

The Australian Government should adopt a portfolio approach to purchasing water products, and not focus solely on permanent water entitlements.

Where active water markets exist, water should be acquired directly from those markets, rather than through tender processes.

All Basin jurisdictions should clarify, as soon as possible, how the risk assignment provisions set out in the National Water Initiative, as amended in the *Water Act 2007 (Cwlth)*, will apply to the reductions in water availability that are likely under the Basin Plan.

In setting SDLs, factors such as community preferences, the opportunity cost of water, and other determinants of environmental outcomes (such as land management), should be taken into account.

Rigorous approval processes should be applied to all projects under the Sustainable Rural Water Use and Infrastructure program. Projects should generally only be approved where the cost per megalitre for water entitlements recovered is similar to the market price. Premiums above this price should only be paid in exceptional circumstances.

The 4 per cent limit on out-of-area trade of water entitlements should be eliminated as soon as possible, rather than phased out by 2014 as currently scheduled. Limits on the amount of entitlements that can be sold to the Commonwealth through the buyback should also be eliminated.

### Market Mechanisms for Recovering Water in the Murray-Darling Basin

- > Commissioned Study
- > Draft Report released December 2009
- > Contact: Rick Baker 03 9653 2146
- > Email: [water\\_recovery@pc.gov.au](mailto:water_recovery@pc.gov.au)

## Commission news

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### Back to the future: Restoring Australia's productivity growth

In an address to the Melbourne Institute/*Australian Economic and Social Outlook Conference* in November 2009, Commission Chairman Gary Banks emphasised the need for appropriate policy interventions to underpin sustainable economic recovery and Australia's long-term growth. 'The recent unprecedented fiscal expansion and associated debt add to the pre-existing imperatives for higher productivity growth arising from demographic ageing, increasing globalisation and the costs of achieving greenhouse gas abatement and other sustainability goals.' Drawing on the Commission's Annual Report (see page 10), he identified three priority areas for attention in the short term:

- removing or reforming 'unproductive' industry assistance
- removing regulatory burdens and distortions and avoiding adding new ones
- rethinking approaches to infrastructure investment.

*Copies of the speech are available on the Commission's website.* ■

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### Utilising social science research

The Productivity Commission is a research partner in a new Australian Research Council Linkage project titled 'The utilisation of social science research in policy development and program review'. The aim of the project is to identify factors affecting the success of evidence-based decision making by examining the utilisation of social research within federal and state government agencies. The project will be conducted over the period 2010 to 2012 in collaboration with Professor Brian Head and other researchers at the University of Queensland and a range of other government organisations. ■

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### Regulatory burdens on business and consumer services

In the fourth year of its rolling review of regulatory burdens on business, the Commission is focussing on regulations that impact on the business and consumer service industries, including financial and insurance services, accommodation and food services, hiring, real estate, professional and personal services, arts and recreation, and repair and maintenance services.

The aim of the review is to identify regulation that is unnecessarily burdensome, complex or redundant, or that duplicates regulations or the role of regulatory bodies,

### Industry visits – Inquiry into wheat export marketing arrangements



Inquiry team members Catherine Costa and John Salerian at the bulk wheat export facility at Kwinana port terminal in Western Australia



Commissioner Angela MacRae on a visit to wheat growers in the Wimmera district of Victoria.

including in other jurisdictions. The Commission will identify areas for reform which have the potential to deliver the greatest productivity gains to the economy as a whole.

An issues paper, outlining matters on which the Commission is seeking information and feedback, was released in December 2009. A draft report will be released in June 2010 and the final report will be delivered to Government in August 2010. More information about the study is available on the Commission's website. ■

## Recent releases

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

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### January 2010

**Report on Government Services 2010  
(2 vols)**

*Steering Committee for the Review of  
Government Service Provision*

**Performance Benchmarking of  
Australian and New Zealand Business  
Regulation: Food Safety**

*Research Report*

**Work Choices of Married Women:  
Drivers of Change**

*Visiting Researcher Paper*

**Executive Remuneration in Australia**

*Final Inquiry Report*

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### December 2009

**Performance Benchmarking of  
Australian and New Zealand  
Business Legislation: Food Safety**

*Research Report*

**Bilateral and Regional Trade  
Agreements**

*Issues Paper*

**Public and Private Hospitals**

*Research Report*

**Market Mechanisms for Recovering  
Water in the Murray-Darling Basin**

*Draft Research Report*

**Modelling the Effects of the EU  
Common Agricultural Policy**

*Staff Working Paper*

**Annual Review of Regulatory Burdens  
on Business: Business and Consumer  
Services**

*Issues Paper*

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### November 2009

**Markets: how free?**

*Chairman's speech*

**China's Policy Responses to the  
Global Financial Crisis**

*Richard Snape Lecture 2009*

**Back to the Future: Restoring  
Australia's Productivity Growth**

*Chairman's Speech*

**Performance Benchmarking of  
Australian and New Zealand Business  
Regulation: Food Safety**

*Draft Research Report*

**National Agreement Performance  
Information 2008: National Agreement  
for Skills and Workforce Development**

*Steering Committee for the Review of  
Government Services Provision Report*

**National Agreement Performance  
Information 2008: Appendix –  
Education and Training**

**National Agreement Performance  
Information 2008: National Education  
Agreement**

*Steering Committee for the Review of  
Government Services Provision Report*

**Productivity Commission Annual  
Report 2008-09**

**Gambling**

*Discussion Draft*

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**Wheat Export Marketing  
Arrangements**

*Issues Paper*

**Executive Pay: Economic Issues from  
the Commission's Report**

*Chairman's Speech*

**Public and Private Hospitals**

*Discussion Draft*

**Contribution of the Not-for-Profit  
Sector**

*Draft Research Report*

# Current commissioned projects

8 February 2010

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

## **Bilateral and Regional Trade Agreements** – *Commissioned Study*

Issues Paper released 21 December 2009. Draft report due June 2010.

Final report to Government 27 November 2010.

Contact: Andrew Irwin Ph: 02 6240 3350

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

[www.pc.gov.au/projects/study/trade-agreements](http://www.pc.gov.au/projects/study/trade-agreements)

## **Wheat Export Marketing Arrangements** – *Public Inquiry*

Issues Paper released October 2009. Draft report due March 2010.

Final report to Government by 1 July 2010.

Contact: John Salerian Ph: 03 9653 2190

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

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

## **Market Mechanisms for Recovering Water in the Murray-Darling Basin** – *Commissioned Study*

Issues Paper released August 2009. Draft report released December 2009.

Final report to Government by 24 March 2010.

Contact: Rick Baker Ph: 03 9653 2146

Email: [water\\_recovery@pc.gov.au](mailto:water_recovery@pc.gov.au)

[www.pc.gov.au/projects/study/water-recovery](http://www.pc.gov.au/projects/study/water-recovery)

## **Contribution of the Not-for-Profit Sector** – *Commissioned Study*

Issues paper released April 2009. Draft report released October 2009.

Final report to Government 31 January 2010.

Contact: Jenny Gordon Ph: 02 6240 3296

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

[www.pc.gov.au/projects/study/not-for-profit](http://www.pc.gov.au/projects/study/not-for-profit)

## **Gambling** – *Public Inquiry*

Issues paper released December 2008. Draft report released October 2009.

Final report to Government 26 February 2010.

Contact: Troy Podbury Ph: 02 6240 3257

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

[www.pc.gov.au/projects/inquiry/gambling-2009](http://www.pc.gov.au/projects/inquiry/gambling-2009)

## **Performance Benchmarking of Australian Business Regulation: Occupational Health and Safety** – *Commissioned Study*

Issues paper released April 2009. Draft report to be released January 2010.

Final report to Government by 23 March 2010.

Contact: Sue Holmes Ph: 02 6240 3351

Email for OHS: [ohs@pc.gov.au](mailto:ohs@pc.gov.au)

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

## **Annual Review of Regulatory Burdens on Business** – *Commissioned Study*

The Commission is undertaking a series of annual reviews of the burdens on business from the stock of Commonwealth regulation. In 2010 the Commission is reviewing regulations affecting business and consumer services.

Issues paper released 3 December 2009. Draft report due June 2010.

Final report to Government August 2010.

Contact: Les Andrews Ph: 02 6240 3251

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

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