



26 June 2009

Not for Profit Sector  
Productivity Commission  
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Dear Commissioners

Primary Industries and Resources South Australia (PIRSA) is pleased to participate in the Productivity Commission's *Inquiry into the Contribution of the Not for Profit (NFP) Sector to the Australian Economy*.

PIRSA understands from the issues paper released by the Commission that the inquiry will focus on NFP organisations that operate in the community and social services sector.

PIRSA is an economic development agency of the South Australian Government. Its key stakeholders are the primary and related industries. Its involvement with the NFP sector is with organisations whose function is to enable the economic development of an industry sector or a region. PIRSA is aware that such organisations are on the fringes of the Commission's central focus. However, PIRSA is keen to alert the Commission to the need for Government involvement in this area. Accordingly, PIRSA considers that recent initiatives of the South Australian Government in the agricultural sector may be of interest to the Commission in its inquiries.

**Rationale for PIRSA's Involvement with the NFP Sector**

PIRSA's connection with the NFP sector has been long-standing, but its approach to that relationship has changed.

After the Second World War, there was an increase in Government intervention in primary production, particularly agriculture, as governments sought to guarantee food security and to ensure that economic growth would absorb returning soldiers into the workforce. Such intervention was in accordance with the belief that governments should play a greater role in society. Assistance was given in a number of ways including:

- tax deductions for capital works;
- increased investment in agricultural research, development and extension;
- and

- “orderly” produce marketing arrangements (that usually involved a cross-subsidy from domestic consumers).

The last two of these assistance measures involved extensive subsidy of (and other forms of interaction with) NFP organisations.

However, economic theory now suggests that assistance of this nature can: reward rent-seeking behaviour and crowd out a range of private-sector solutions. These include agricultural support services and collaborative marketing and other problem-solving organisations (rather than nurturing best-practice organisations of these sorts, as was often intended). In turn, this leads to sub-optimal economic and social development outcomes.

As a result of these developments in economic theory and of the introduction of the National Competition Policy (NCP) in Australia, there has been a re-assessment of Government’s role in Australian society and a general recognition that more efficient outcomes will occur if the level of government intervention is reduced. In particular, there has been an increasing understanding of the crowding out effects of government intervention and the detrimental effects this can have on the economic, social and environmental fabric of nations.

However, it is also recognised that the withdrawal of government activities should be accomplished in a measured way. Rapid withdrawal by government that leaves a vacuum in service provision can only lead to suboptimal outcomes. Withdrawal must be done in a manner that builds (or rebuilds) adequate capability in the community, particularly in relatively isolated regional communities, to provide those services that are required. This assessment underpins PIRSA’s current approach to the NFP sector.

### **What is the Best Way to Exit Services Traditionally Provided by Government?**

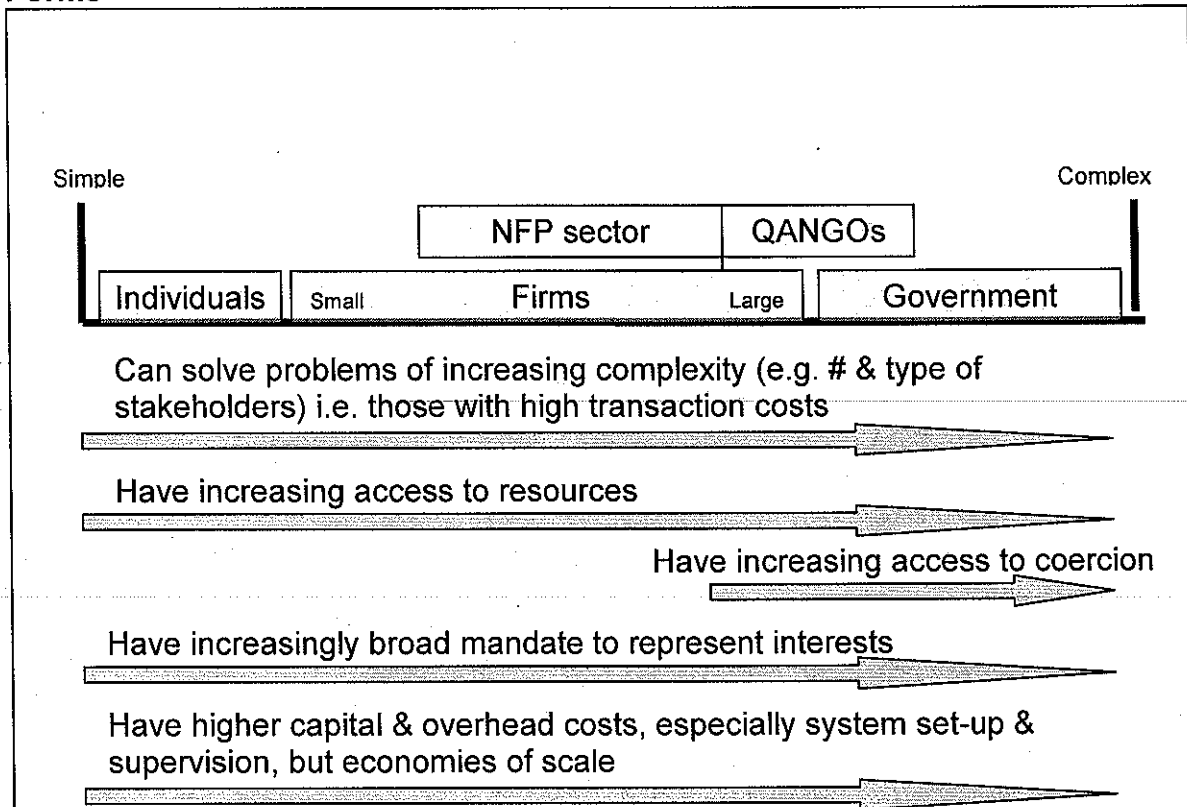
In some cases, the strategy can be relatively straightforward. Where successful private-sector and government-owned business models already exist, as in the provision of water or electricity, this can be the case. In South Australia, electricity generation has been wholly privatised while water supplies are provided by a Government-owned Corporation that is required to act in accordance with NCP principles and is expected to provide dividends to the government as its 100% owner.

Where the withdrawal of Government may leave a vacuum, then a phased withdrawal of Government activity may be appropriate. At a national level, the phased withdrawal of tariffs in the automotive, steel and textile, clothing and footwear sectors, in conjunction with the introduction of industry restructuring plans, have allowed gradual adjustment of business models and strategies.

In recent years, the South Australian Government, through PIRSA, phased its withdrawal of a range of services to the food and agriculture sectors. In some situations, PIRSA sees a role for NFP organisations to fill the vacuum left by its withdrawal. Its approach to this matter is informed by the perspective of New Institutional (or transaction cost) Economics, from which a key question is “what suite of organisational forms is best suited to addressing the impediments to growth &/or

prosperity in the sector or region in question?" Figure 1 provides a somewhat crude summary of this approach.

**Figure 1: Spectrum of Problem Complexity & Appropriate Organisational Forms**



The key message from Figure 1 is that there are organisational "horses for courses" and these can be understood quite well in terms of a trade-off between the capital and operating costs of specific organisational forms, on the one hand, and the nature and size of the transaction costs that they are intended to reduce, on the other.

This is significant in agriculture where the minimum efficient scale for core functions is quite small (though typically around ten times the current average firm size), but the efficient scale for some functions essential to competitiveness are much larger. These functions are to do with solving problems experienced by the sector as a whole, but where property rights over the solutions are inadequate to draw forth a complete set of private-sector solutions. Such problems include:

- research & development into plant and animal breeding and environment degradation;
- regional and other types of generic branding;
- development and observance of product integrity protocols to protect generic brands;
- biosecurity; and
- access to foreign markets and other examples of government interface.

As suggested in Figure 1, such problems are amenable to NFP-sector solutions and in some cases these might be supported by (minimalist) legislation and/or subsidy

(thus the reference to QANGOs). Of course, some of them have traditionally been addressed by NFP organisations.

However, the key questions are:

- which *other* functions of this sort that have traditionally been dominated by governments could be efficiently addressed by NFP organisations (assuming property rights and other problems inhibit private sector solutions)? and
- what are the optimal strategies for handing back responsibilities to sectoral or regional communities as governments withdraw from the relevant services?

PIRSA has done a number of things whose aim has been, in part, to answer these questions and transfer functions to beneficiary sectors and regional groups. These include:

- Work with industry participants to develop a shared vision for the future of particular industry sectors through the creation of Industry Development Plans. In addition to articulating agreed strategies for realising the visions, the plans provide a forum for negotiating a revised role for Government (based on “market failure” principles). Numerous NFP organisations are involved in creating the Plans, of which twelve have been completed. These include SA Farmers’ Federation and representative organisations for the agri-food sector in question. Many of the Plans include takeover, by particular NFP organisations, of selected functions from which the Government withdraws. The functions taken over typically include some combination of: research, development and extension; some aspects of biosecurity; market research including supply and demand forecasting; and development of collaborative marketing arrangements (in the absence of marketing legislation).
- In order to ensure that these organisations are able to fund the functions taken over, as well as other commitments under the Plans, the South Australian Parliament passed the Primary Industries Funding Schemes Act 1998 (PIFS Act). This Act provides a legislative basis for regional industry groups to levy themselves (if two thirds are in favour) to fund industry development activities. To date, fourteen South Australian organisations have availed themselves of this facility<sup>1</sup>. Six of these are regional wine industry organisations.
- Various leadership and other capability-building programs in regional SA, especially focusing on younger and female industry participants.

PIRSA notes the Commission’s reference to programs of a similar nature in Victoria and Queensland (*Issues Paper*, Box 2, p. 14). Our understanding of the Victorian program is that the notion of building *social (and human) capital* is at its heart and we

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<sup>1</sup> Olives SA is a good example of the type of NFP organisation that PIRSA works with. The olive industry in SA is relatively young and dynamic and has been quick to establish a levy collecting scheme under the PIFS Act to enable it to undertake a number of the functions in which, in an earlier era, PIRSA would have played a major role (listed in the dot point above). More information about Olives SA is available at <http://www.olivessouthaustralia.com.au/>.

endorse that approach. Indeed, we consider ourselves still to be learning about effective ways to build social capital. A significant part of our purpose in this submission is to register our interest in ongoing dialogue about how to do this better.

Thank you for the opportunity to contribute to this inquiry. Should you require further information, please contact the PIRSA officer whose details appear on the attached submission cover sheet.

Yours sincerely

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**CHIEF EXECUTIVE**