Australian Government
Productivity Commission

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Australian Government
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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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Shifting the dial: improving Australia’s **productivity** performance

The Australian Government asked the Productivity Commission to undertake an inquiry into Australia’s productivity performance and to recommend reform priorities. The review is the first in a series, to be undertaken every five years, of Australia’s productivity performance, with the aim of developing and prioritising reform options to improve the wellbeing of Australians.

The Productivity Commission’s first Review proposes a Joint Reform Agenda across all Australian jurisdictions to shift the orientation of reform and to ramp up the ambition for policy change in Australia. It is not a shopping list of things to do tomorrow in the ‘microeconomic supermarket’, but a coherent grouping of options that take some planning to implement over the medium term and require cooperation.

Governments and commentators should be wary of the seductive claim that something is well under way already in the areas under contention. While the policy issues we raise may seem familiar, Commission analysis shows that the headline recognition is often not supported by reality, or has not yet achieved the cooperation of all of the necessary participants.

The imperative for a new way of thinking about productivity and prosperity stems from two major factors.

First, income growth, particularly for wage earners, has stalled. This has partly been driven by the end of the resources boom, which gave Australians the benefits of high commodity prices. But of more concern is the diminishing role played by multifactor productivity, which measures the benefits derived from doing things better through learning, innovation and diffusion. Notwithstanding that all around us, new digital services and information technologies have abounded, this form of productivity has been weak in Australia, a malaise whose reach is global (figure 1).

Second, the type and focus of a productivity agenda has to reflect the contemporary structure and emerging directions of the Australian economy. Productivity enhancing reforms undertaken in the 1970s and 1980s (floating the exchange rate, liberalising capital markets, reducing industry assistance, privatising government business enterprises, workplace reforms, and changes to competition policy) underpinned significant productivity growth in the 1990s. While previous reform focused on the market sector, achieving better outcomes now requires a focus on the non-market sector (mainly education and healthcare) and on the quality of the cities, which is where 80 per cent of Australians live. The non-market sector now accounts for around 30 per cent of employment, and will further grow in significance. *These areas of the economy matter to all people*. Everyone wants an effective healthcare system, good schools and universities, and cities that function well.

The Commission's key reform priorities are:

- more integrated healthcare that places the patient at the centre, and that manages, and prevents the onset of, chronic ill health
- an education system that supports better teaching in both schools and universities
- cities that ease the costs of moving around and locates infrastructure and services where people most value them.

Better health care to reduce chronic illness and lift participation

Australia faces a rising wave of complex chronic health conditions that will lead to many years of life spent in ill-health and lower involvement in work for many people, and rising costs for the health care system (figure 2). Much ill health is preventable or, if present, could be better managed. For example, 96 per cent of the burden of disease posed by diabetes is preventable, including by stemming obesity levels. More than one in four adults – close to 5 million Australians – are currently obese, with a preventable disease burden only outweighed by smoking.

Prevention and management of complex health conditions, by integrating care by GPs and other clinicians with care in hospitals, is a key initiative. Change can be orchestrated locally if the Australian, State and Territory Governments move away from centralised control, leaving much greater scope for local experimentation and flexibility in solutions at the health district level.

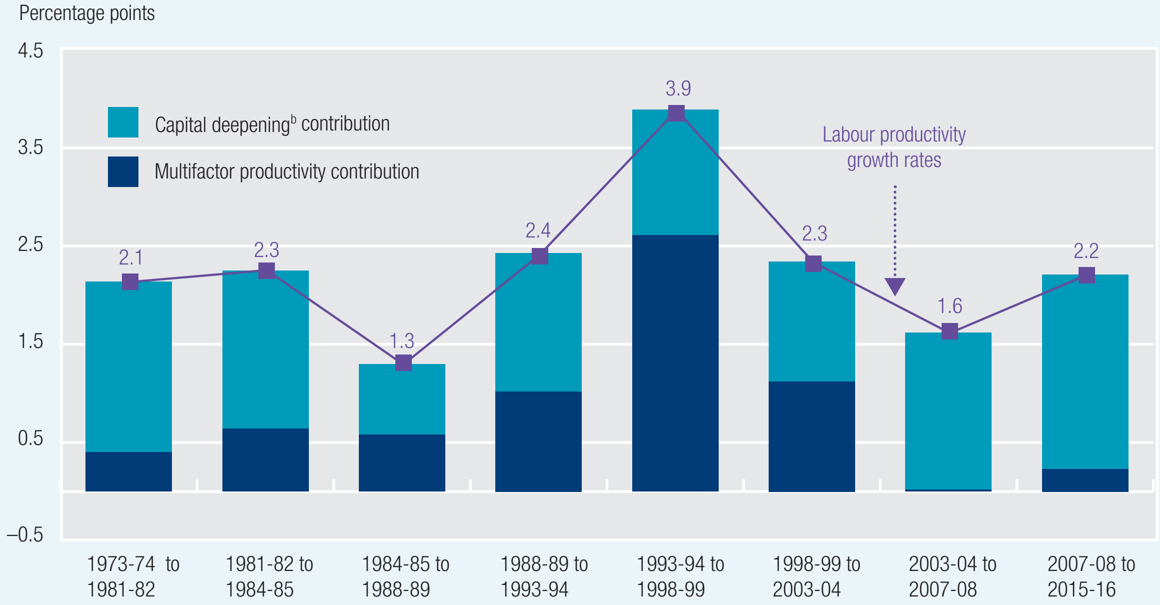
> There should also be a move to the full adoption of patient-centred care, where the outcomes and experiences of people are the key focus.

Suppliers, rather than patients, are currently the centre of the current system – a cultural anachronism that many people, including some key professional bodies, are challenging – with only partial success. (As just one symptom of this, the costs in unnecessary waiting borne by Australians in doctor's waiting rooms is around one billion dollars annually.) There are practical steps to change this, such as the systematic collection of, and action on, patient experiences. Getting clinicians to endorse this approach will be critical.

Ensuring diffusion of best practice is also an area inviting immediate action. For example, 75 per cent of acute bronchitis is treated with antibiotics, whereas the clinical evidence suggests a rate close to zero.

Reform of Australia's health care system will not only improve patient outcomes, but offers the prospects of benefits of up to $140 billion over the next 20 years.

Figure 1: Multifactor productivity has fallen away since 2003
Australia's long-run productivity trends, 1973-74 to 2015-16[a]

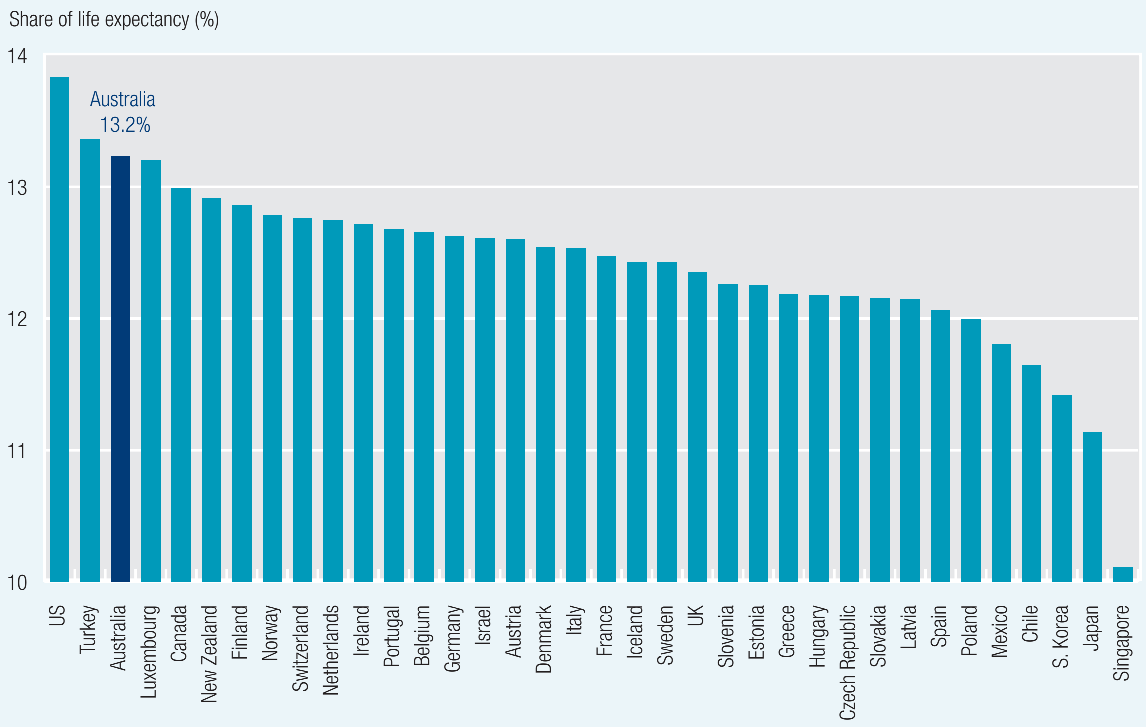


a Relates to 12 industry market sector.

b Rate of increase in capital per worker

Source: Productivity Commission 2017, Shifting the Dial: 5 Year Productivity Review, Supporting Paper no. 1, figure 4

Figure 2: Australians live more of their lives in ill-health
Years spent in ill-health as a share of life expectancy



Source: Productivity Commission 2017, Shifting the Dial: 5 Year Productivity Review, Supporting Paper no. 4, figure 7

Improved educational outcomes to ensure workforce skills match future job requirements

Falling school results (figure 3) and concerns about teaching quality raise questions about the capacity of workers to adapt to the wave of economic changes predicted in coming decades. It is deeply troubling that a 15 year old in 2015 had the mathematical aptitude of a 14 year old in 2000.

Instruction in areas where the teacher is unfamiliar with the discipline is widespread in certain subject areas. For instance, 30 per cent of IT teachers in years 7 to 10 have inadequate academic preparation in the field. If there are problems in the schools, these are even worse in the vocational education and training system, which is in disarray.

Universities will soon become the key vehicle for skill formation, yet their teaching function plays a subordinate role to their research role, and the outcomes for many graduates are poor. Many (dissatisfied) students are acquiring major debt to cross-subsidise research that has little or no connection to the quality of their degrees.

The Commission's recommended reforms in this area include improving teaching quality, re-building the VET sector, providing genuine options for acquiring new skills as people switch jobs and careers, using new technological models for educating people, and improving employment outcomes for university graduates, including through the creation of teaching-only universities, and the potential application of consumer law to the higher education sector.

Better functioning towns and cities

Cities account for most of the nation's output and employment. Forty per cent of Australia's GDP is produced in Sydney and Melbourne alone, and with the rapid growth of these cities, this will inevitably grow. (To illustrate this trend, in 2015, Melbourne grew by more people every five days than Hobart added in the entire year.)

Australian cities face increasing pressures as they grow: congestion, poor infrastructure decisions, ad hoc and anticompetitive planning and zoning, and an unsustainable funding basis for roads (figure 4). Stamp duty taxes, while a bonanza in times of rising housing prices, are unfair and inefficient.

The Commission's recommended reforms focus on:

- planning and land use policies, including the application of competition principles to land use regulation, and better provision for growth through streamlining development assessment systems. These sound like 'dry' matters, but having affordable services and housing options where people want them is central to peoples' daily lives
- improvements in public infrastructure provision and use. As the Commission noted in its 2014 public infrastructure report – which is still gaining traction – 'white elephants' should become an endangered species
- establishing road funds, based ultimately on user pricing. This recognises that technological change will make fuel excise an ever-diminishing source of revenue for funding roads. Road pricing and consumer input into decisions will finally provide coherence to road construction and maintenance, escaping the present allure of projects with political appeal, but that may not be in the public interest
- switching from stamp duties to taxes based on land value, which would avoid penalties imposed on those who choose to move (for either work or lifestyle reasons) and provide a more stable revenue source.

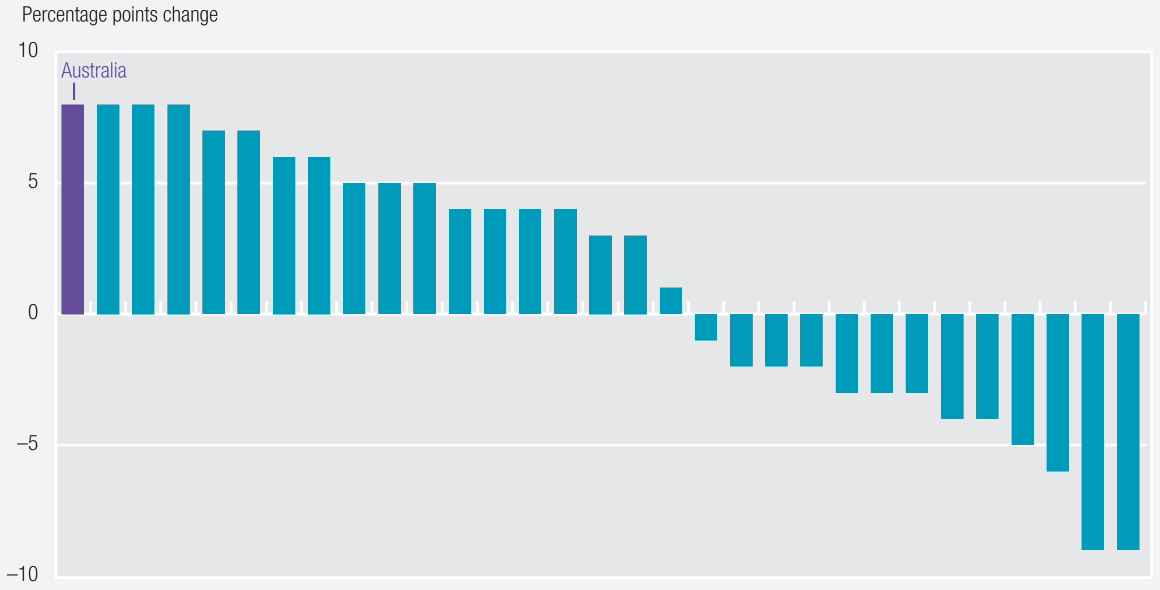
Market-based productivity reforms should not be overlooked

While the Commission's recommendations focus on the non-market (services) sector, many opportunities to address market-based reforms still remain, including the persistent failure of Australia's energy market, redundant regulations, and flaws in workplace relations. Putting a price on carbon, for example, is an essential requirement for creating a more certain environment for investment in generation.

How can change occur?

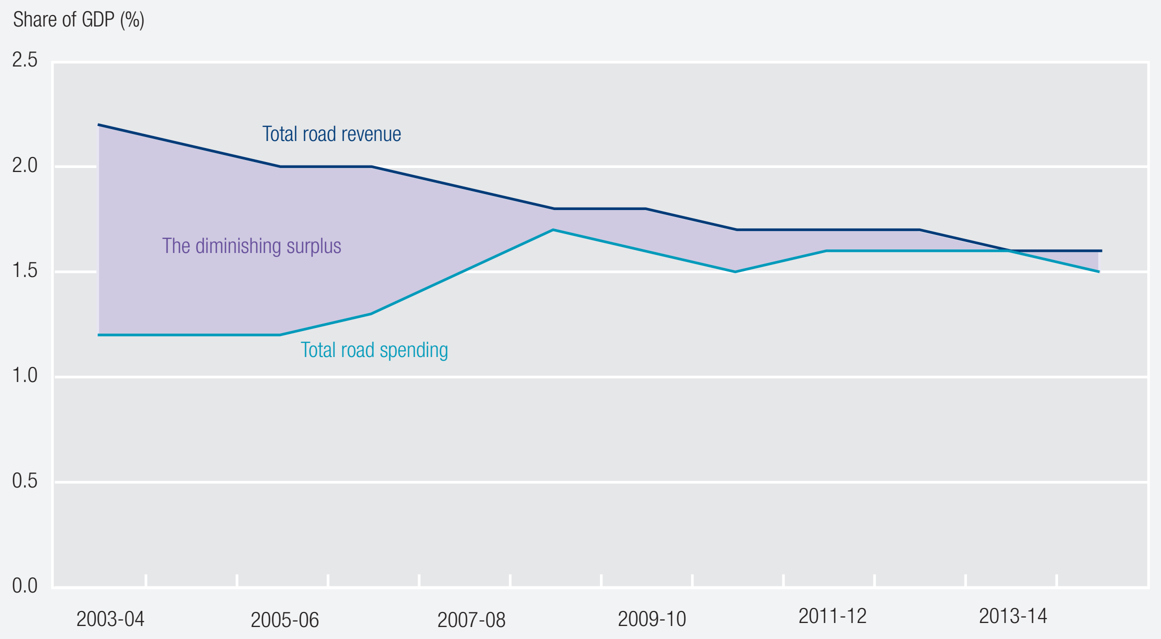
Achieving change will require a package of initiatives with buy-in and collaboration from all levels of government – local, state and national – with the States and Territories having significant responsibility. The Commission proposes a Joint Reform Agenda, to be negotiated between jurisdictions in 2018 and submitted to COAG for endorsement. Many of the reforms should be palatable because they have a 'human face' and produce no or few losers. No one wants clogged cities or clogged arteries.

Figure 3: The rising group of left behind
Change in share of students with the poorest maths skills, OECD 2003-2015



Source: Organization for Economic Cooperation and Development (OECD); Program for International Student Assessment (PISA)

Figure 4: Road-related revenues are in structural decline



Source: Productivity Commission 2017, Shifting the Dial: 5 Year Productivity Review, Supporting Paper no. 9, figure 1

The Productivity Review, including detailed recommendations, is available on the Commission's website at:
pc.gov.au/inquiries/completed/productivity-review/report/productivity-review.pdf

Shifting the Dial: 5 Year Productivity Review
> Released October 2017

National **Disability Insurance** Scheme costs

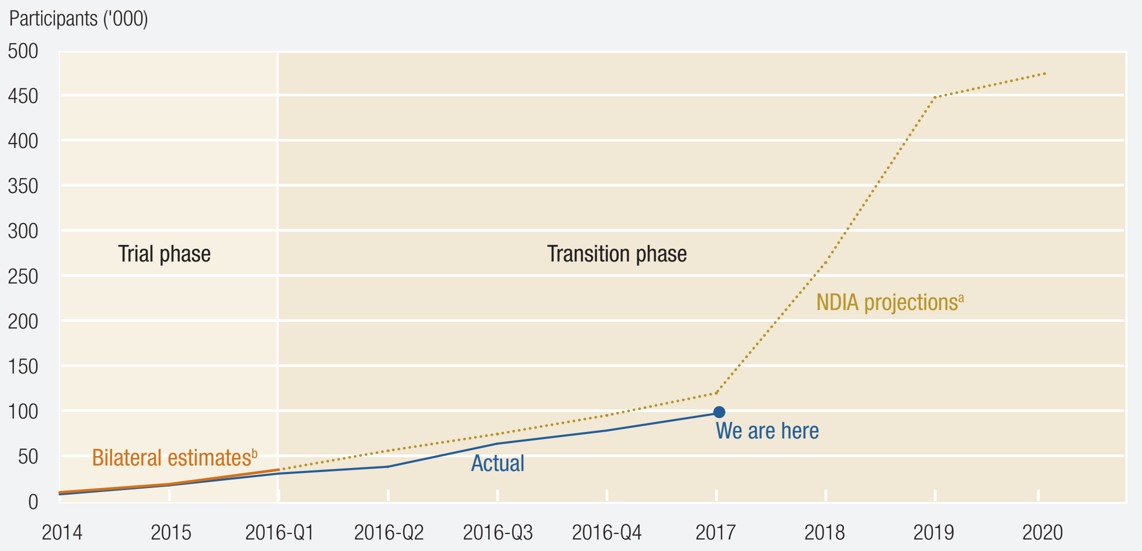
The final report of the Commission's study into the cost of the National Disability Insurance Scheme (NDIS) was released in October 2017.

The report found that there is an extraordinary level of commitment to the success and sustainability of the NDIS by governments, people with disability and their families and carers, providers of disability services, and disability advocates. If the scheme is implemented well, it will substantially improve the wellbeing of people with disability and Australians more generally.

Unprecedented national reform

The NDIS is a major, complex national reform. The scale, pace and nature of the changes that the NDIS is driving are unprecedented in Australia – to reach the estimated 475 000 participants in the scheme by 2019-20, the National Disability Insurance Agency (NDIA) needs to approve hundreds of plans a day and review hundreds more. The intake of participants

Participant numbers will increase substantially over the next three years[a]



a Scheme participant projections are based on projections prepared by the Scheme Actuary for the NDIA's 2015-16 Annual Financial Sustainability Report using data at 30 June 2016. The Commission adjusted the projected number of participants for the four quarters of 2016-17 to be consistent with the bilateral estimates reported in the latest NDIA quarterly report.

b Bilateral estimates based on the NDIA's quarterly reports.

with approved plans is already falling behind the expected pace and if the current trend continues, it will take an additional year before all eligible participants are in the scheme (figure).

The Commission recommends that governments and the NDIA start planning now for a slower intake of participants, including working through the financial implications.

Based on trial and transition data, the Commission found that NDIS costs are broadly on track with the NDIA's long-term modelling, however, this is mainly because scheme participants are not using all the supports in their plans.

The Commission found that in the transition phase, the NDIA has focused too much on quantity (participant intake) and not enough on quality (planning processes), supporting infrastructure and market development. The report calls for greater emphasis on pre-planning, in-depth planning conversations, reporting on the quality of plans, and more specialised training for planners.

Other key challenges identified in the report include developing the supply of disability services and growing the disability care workforce (1 in 5 new jobs over the next few years will need to be in disability care, but workforce growth remains too slow). The Commission recommends:

- independent price monitoring and regulation
- more effective coordination among governments to develop markets (including intervening in thin markets)
- a targeted approach to skilled migration to increase the disability workforce
- better equipping participants to exercise choice.

The Commission also notes that the interface between the NDIS and other disability and mainstream services is critical for participant outcomes and the financial sustainability of the scheme. The Commission recommends Governments set clearer boundaries at the operational level around 'who supplies what' to people with disability.

National Disability Insurance Scheme (NDIS) Costs

> Study Report

> Released October 2017

Reforming Australia's **water resources** sector

The National Water Initiative (NWI) has made a significant contribution to managing Australia's water resources, but further work remains. A Commission draft report identifies future reform priorities and recommends they be progressed through a renewed national water reform agenda.

Australia is viewed as a world leader in water management. This reputation is the direct result of cooperation between Australian, State and Territory Governments in water reform over the past 20 years. A cornerstone of these reforms is the 2004 National Water Initiative (NWI) (see box). In recent years much of the policy focus has been on the Murray-Darling Basin, including through the implementation of the Basin Plan, but the NWI remains nationally relevant.

In early 2017, the Australian Government asked the Productivity Commission to undertake an inquiry into national water reform. The Commission is to assess progress in achieving the objectives and outcomes of the NWI and make recommendations on future reform priorities. A draft report was released in September 2017, and the Commission's final report will be submitted to Government by the end of 2017.

The inquiry provides the first of the Productivity Commission's three-yearly assessments of the progress of the NWI, required under the *Water Act 2007*. The Commission will also undertake inquiries into the effectiveness of the implementation of the Basin Plan every five years, with the first to be completed by the end of 2018.

What is the National Water Initiative?

While some State and Territory Governments began reforming aspects of water policy in the 1980s, a comprehensive national approach commenced in 1994 with COAG's Water Reform Framework. The NWI was developed in 2004 as an extension of the 1994 reforms to maintain the momentum of reform, respond to overallocation, and address water scarcity issues arising in the early years of the Millennium Drought (1997 to 2009).

The NWI included eight key elements for which there were agreed outcomes and actions:

- water access entitlements and planning frameworks
- water markets and trading
- best practice water pricing and institutional arrangements
- integrated management of water for environmental and other public benefit outcomes
- water resource accounting
- urban water reform
- knowledge and capacity building
- community partnerships and adjustment.

What have the reforms achieved?

The Commission found that overall, most jurisdictions have made good progress in meeting the objectives and outcomes of the NWI. The reforms have significantly improved the way water resources are managed and water services delivered, resulting in significant benefits for the community.

Water resource management

The introduction of water entitlement and planning frameworks has created secure property rights and established transparent processes for deciding how water is shared between environmental and consumptive uses. This has provided the fundamental basis for the establishment of water markets, and has underpinned the move towards improved environmental sustainability.

There is widespread agreement that these reforms have produced significant financial benefits. Water entitlements are now valuable business assets, with financial institutions accepting them as collateral for loans. The capacity to trade water has allowed water to move to higher value uses and has provided a vital business management tool for irrigators.

The provision of water for the environment is also a key achievement of the reforms. The environment is now recognised as a legitimate user of the resource and environmental water has been allocated in all systems with significant water use. While the recovery of large volumes of water for the environment has only occurred recently, there is already evidence of improved water quality and ecological outcomes.

Water service delivery

Reforms to institutional arrangements for urban and irrigation infrastructure services has improved efficiency in water service delivery.

In the urban water sector, institutional and pricing reforms have brought significant benefits. Where adopted, the combination of the corporatisation of water utilities and the introduction of independent economic regulation has improved efficiency by separating service delivery from policy making, increasing the transparency of investment decisions and promoting more efficient pricing.

In the irrigation infrastructure sector, the corporatisation of bulk water providers has delivered more efficient water services and a stronger commercial focus that has benefited both irrigators and governments. Local ownership and management of distribution networks, which has been introduced in New South Wales, Western Australia, South Australia and parts of Queensland, is generally considered to have improved productivity, accountability, long-term planning and responsiveness to irrigators.

Overall, water reform under the NWI has delivered significant benefits to irrigators, other water users, and the broader community.

Why further reform is needed

While much has been achieved, further reform is needed because:

- there is important unfinished business from the NWI, including modernising water entitlement regimes in Western Australia and the Northern Territory, better engaging Indigenous people in water planning, extending economic regulation across all major urban water sector providers and improving urban water services in regional areas
- experience has revealed some gaps and limitations in the NWI, including the need for improved planning processes to ensure that major investments

in new urban water supplies to maintain water security are efficient
- of the need to respond to challenges, such as population growth in our major cities, the impacts of climate change and changing community expectations on the role water can play in improving the amenity and liveability of cities and towns.

Effectively, water managers in the future will have to manage a potentially reducing water resource and meet the demands of an increasing population for a wider range of water services.

There is still considerable scope to improve the efficiency, productivity and environmental sustainability of Australia's water use.

Priorities for future reform

The Commission has identified the following key priorities for a future national water reform agenda.

Maintaining the key foundations of water management

The achievements of the NWI in water entitlements and planning, water markets, water accounting and compliance, water pricing, and governance should be maintained. They are the key foundations of sustainable water resource management and efficient infrastructure service delivery. Strong commitment to community and stakeholder engagement in all areas of water management should also be maintained.

Revising existing policy settings

The Commission found a number of areas that require revisions to current policy settings to respond to contemporary issues and concerns. These include:

- more fully incorporating mining and other extractive industries into water entitlement and planning frameworks
- enabling the inclusion of alternative water sources, such as recycled water and stormwater, in water entitlement frameworks
- developing contemporary water entitlement and planning frameworks to underpin the second and third generation of water plans that are now being developed
- more fully recognising the water requirements of Indigenous people
- removing remaining barriers to water trade
- better targeting adjustment assistance.

Enhancing national policy settings

The Commission identified the following three key priorities for a future national water reform agenda:

- Making urban water management more robust and responsive. This involves more robust supply augmentation planning with all options on the table and clear accountabilities, enhancing competition through improving regulatory frameworks and exploring decentralised approaches to providing water and wastewater services.
- Improving environmental management. This requires: integrated management of environmental water and waterways, improved governance arrangements for managing entitlement-based environmental water, and facilitating adaptive management by implementing processes for monitoring, evaluation and reporting.
- Delivering new water infrastructure that is viable and sustainable – poor past decisions should not be repeated. The environmental sustainability and financial viability of new infrastructure should be ensured before government resources are committed.

Progressing reform

The Commission considers that retaining and renewing the NWI is the best approach to progressing national water reform.

The Commission recommends that the Australian, State and Territory Governments recommit to a revised and enhanced NWI that maintains gains to date; progresses the unfinished business; and provides guidance on new reform priorities.

National Water Reform

> Draft Report

> Released September 2017

> The Commission's final report will be handed to the Australian Government in December 2017.

Horizontal Fiscal Equalisation – **distributing** the GST revenue

A Commission draft report finds that the basic premise of horizontal fiscal equalisation (HFE) – fiscal equity in the Australian federation – has broad support. But the practice of HFE – the basis for distributing GST revenue to the States – has evolved over time and now embodies an undeliverable ideal, to give States the same fiscal capacity.

The system struggles with extreme circumstances and this is corroding confidence. There is also scope for the system to discourage desirable mineral and energy resources policies and State policy for major tax reform.

HFE has frequently been a point of contention among States, as each State has vied for a larger share of GST. But this friction has increased markedly in recent times as Western Australia's share of the GST has fallen to an unprecedented low (figure 1).

The practice of HFE in Australia

The Commonwealth Grants Commission (CGC) recommends a distribution of GST using a complex approach that covers all State government revenue and expenditure categories as well as payments they

receive from the Commonwealth. Conceptually, the CGC's formula does the following (figure 2):

1. States with low fiscal capacities are raised to the average fiscal capacity of all States
2. all States are raised to the capacity of the fiscally strongest (currently Western Australia)
3. remaining GST revenue is distributed to all States on an equal per capita basis.

How is the current system performing?

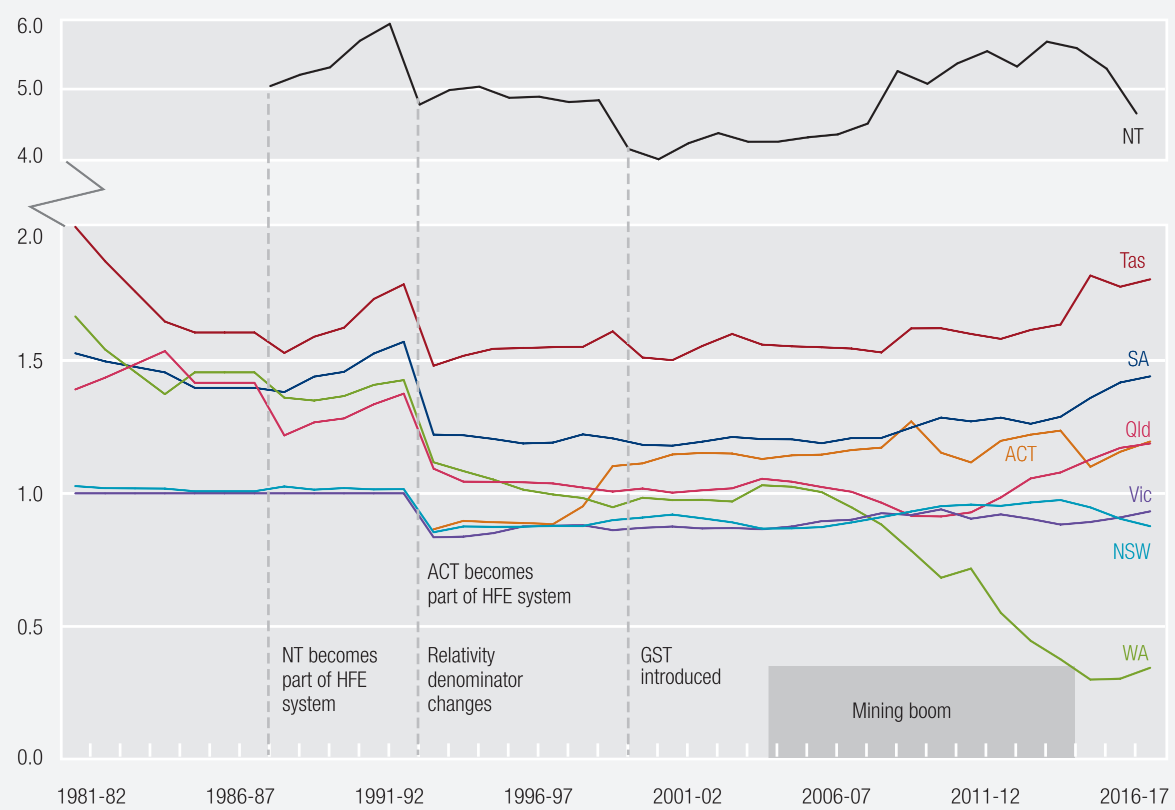
The current HFE system is functioning reasonably well in regard to:

- *equity:* Australia's HFE system achieves an almost complete degree of fiscal capacity equalisation – unique among OECD countries
- *an independent and transparent process:* the CGC, as an expert agency independent from governments, is well placed to conduct the HFE distribution process
- *stability:* HFE results in reasonably stable GST payments and a level of predictability for (most) States regarding budget outcomes.

However, there are deficiencies in a number of areas. These include:

- *equalisation is taken too far:* equalising comprehensively and to the fiscally strongest State means that when there is an outlier, the redistribution task is considerable
- *policy neutrality:* the potential for HFE to distort State policy is pronounced for major tax reforms and mineral resource policies. For example, Western Australia would lose about 88 per cent of the additional revenues to other States if it raised its iron ore royalties. Another example is if a State

Figure 1: Volatility and divergence in GST relativities[a]
State per capita relativities



a Ratio between a state's actual GST share and the share it would receive under an equal per capita distribution (ie, a state's share of GST divided by its share of the national population).

unilaterally cuts its rate of stamp duty on property in half, and replaces the lost revenue with a new broad based land tax. The potential GST effects of this reform are large – New South Wales and Victoria's GST payments could be reduced by up to $1 billion per year.

- *simplicity and comprehensibility:* full and precise equalisation has increased system complexity over time. This has led to the system being poorly understood by the public, and even by many within government.

In terms of overall national efficiency and growth, Australia's HFE system has typically been found to have little direct effect. However, the current redistribution is historically high, which may be elevating any efficiency effects.

The Commission's proposed reforms

A need for a revised objective

Equalising to the fiscally strongest State is not desirable or fair when that State is such an outlier, and when the pursuit of full equalisation may be resulting in broader (albeit in most instances small) costs to the economy. The Commission considers that HFE should aim for a different objective – a 'reasonable' level of fiscal capacity.

Like the current approach to HFE, the Commission's proposed objective puts equity at the heart of HFE but it acknowledges that there is a trade-off between full and comprehensive equalisation on the one hand, and efficiency and simplicity on the other hand.

Are there preferable alternatives?

The Commission considered a number of methodology changes to address deficiencies in the current system. One option is to apply broad indicators to replace the assessment of the various revenue and expenditure categories. This offers greater prospects for balancing accuracy and simplicity and is being considered further for the final report. Other options raised by participants, such as relativity floors or discounts for particular revenue streams do not resolve HFE's underlying deficiencies and likely have unintended consequences.

More fundamental changes were also considered that offer a departure from the CGC's full equalisation

Figure 2: Schema of the conceptual stages of the HFE process

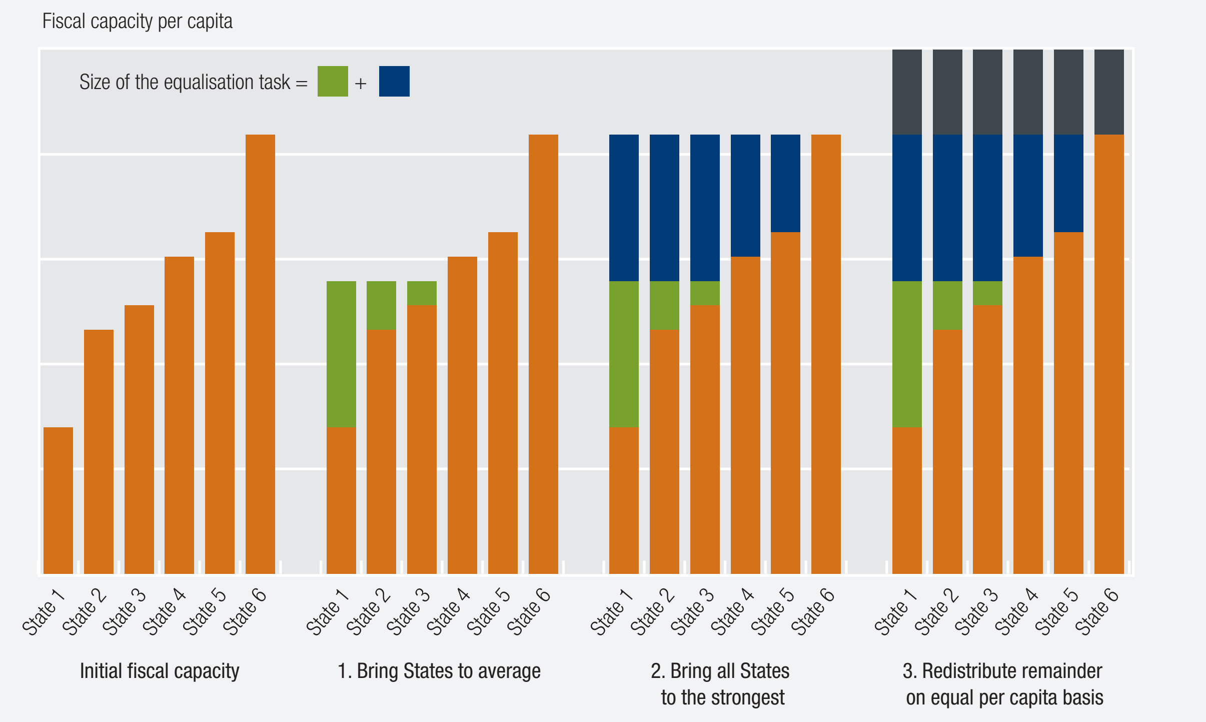
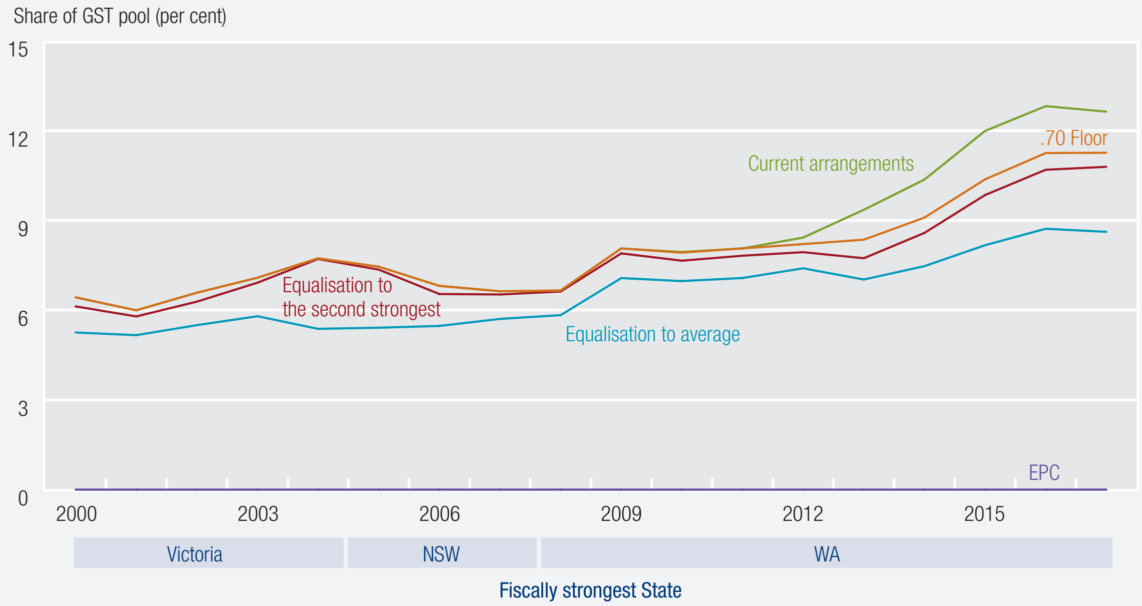


Figure 3: The equalisation task under alternative approaches[a]



a The pool used for these calculations includes Health Care Grants in earlier periods.

principles (figure 3). This includes an equal per capita approach. While this approach would be extremely simple and would have no adverse effect on States' incentives, it would fail to meet the core equity objective of HFE. Top up funding could also be provided to fiscally weaker States, but this would rely on Commonwealth Government funding, which has its own opportunity costs and is unlikely to be forthcoming in the current environment.

Another option considered and proposed in the draft report is equalisation to less than the fiscally strongest State. This involves lifting States up to some agreed level of fiscal capacity and distributing the balance of the GST pool on an equal per capita basis. This approach could be used to bring States up to *any* level of fiscal capacity that is less than the strongest State, such as the average fiscal capacity or the fiscal capacity of the second strongest State. This approach addresses volatility introduced in the case of an extreme outlier State and would address some efficiency concerns.

The way forward

One thing that emerges from the assessment of different approaches is that none are perfect or universally supported by participants. All come at a cost, whether to equity, efficiency or simplicity, or some combination of these.

Equalisation to the average or the second strongest State still provides States with a high level of fiscal capacity, but not distorted by the extreme swings of one State.

Any material change to HFE in the current extreme environment will lead to significant redistributions of the GST. Timing and careful transition are paramount, especially to ensure the fiscally weaker States are not significantly disadvantaged.

Reforms to improve governance and accountability are also needed. Most importantly, there is a need for the Commonwealth Government to assume leadership and articulate a revised objective of HFE. The CGC should also take on a more prominent public communication and education role.

Ultimately though, reform to HFE will only go part of the way to improving outcomes within federal financial relations. There is a need to renew efforts to reform these relations more broadly. In the first instance, governments should work to a well-delineated division of responsibilities, particularly with respect to Indigenous policy. Genuinely reforming federal financial relations may then allow consideration of more fundamental reforms to HFE and afford a greater focus on the needs of the fiscally weaker states.

Horizontal Fiscal Equalisation

> Draft Report

> Released October 2017

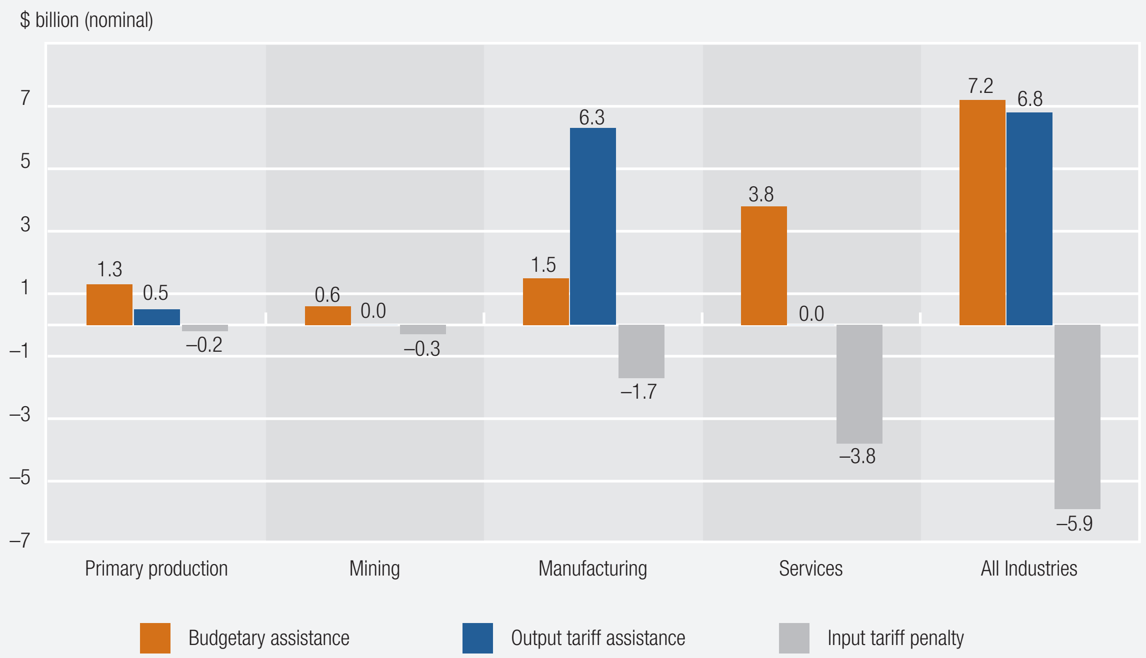
Government **assistance** to industry

The Commission's latest Trade and Assistance Review estimates that Australian industry received over $9 billion in net government assistance in 2015-2016. This year's review also examines some recently announced assistance measures that may stray from best practice.

The Australian Government assists industries through an array of measures, including tariffs on imported goods, budgetary outlays, taxation concessions, and regulatory restrictions on competition. The Productivity Commission is required to report annually on industry assistance and its effects on the economy. The Commission's latest quantitative estimates of Australian Government assistance to industry were released in July 2017.

For 2015-16, Australian Government assistance to industry was an estimated at $15.0 billion in gross terms. It comprised $6.8 billion in tariff assistance, $4.6 billion in budgetary outlays and $3.7 billion in tax concessions. As tariffs on imported inputs impose a cost on Australian industry of $5.9 billion, the net assistance to industry was $9.1 billion. This is a decline of 1.1 per cent on 2014-15, due mainly to a shift in imports towards lower or zero tariff items, rather than a reduction in tariff rates. The downward shift in both gross and net combined assistance continues the trend of declining assistance since 2011-12.

Figure 1: The incidence of assistance varies widely across industries. 2015-16



Data source: Commission estimates.

As in previous years, manufacturing received the most assistance – 56 per cent of gross and 77 per cent of net assistance – while tariffs imposed a penalty on the services sector. Service industries received no net assistance, with budgetary assistance outweighed by the tariff penalty (figure 1).

Over the past 40 years the industry assistance landscape has changed in fundamental ways. Tariff and import quota protection has declined to minimal levels. Complex and costly agricultural production, marketing, and pricing measures have been unwound. And highly selective and preferential grants, subsidies, and bounties provided to specific industries and firms are not as prevalent. Industry assistance today is focused on support for R&D (which makes up 47 per cent of budgetary assistance), facilitation of regional adjustment, assistance for small business, WTO compliant export assistance, and support for achieving environmental objectives.

This change has been driven by government recognition of the efficiency costs of the old protectionist framework. However, industry assistance in Australia continues to be influenced by reactions to specific events and disruptions, and assistance to individual industries and firms has not completely disappeared. The *Trade and Assistance Review* examined several recent developments in budgetary assistance where good practice has not been followed or is in some doubt.

Northern Australia Infrastructure Facility

While the $5 billion Northern Australia Infrastructure Facility (NAIF) had, at time of publication, yet to make any loans, to qualify a project would have to meet a number of criteria, including:

- that it would not otherwise be able attract finance, but would be commercially viable once constructed
- there would be a public benefit from the infrastructure (to justify the cost to the taxpayer of the short-term assistance provided).

Many of the projects suggested in the media as candidates for NAIF funding – such as the rail line to the Galilee Basin and various large irrigation dams – may fail at least one of these criteria. If the return on the investment does not cover the operational costs of the infrastructure and the costs of servicing the loan at market rates over the life of the asset, the small initial level of assistance provided by a concessional loan may simply become another case of inefficient resource allocation.

Arrium steelworks in the Upper Spencer Gulf

A $50 million grant to Arrium announced by the South Australian Government, with additional support proposed by the federal government, is the most recent measure in a long history of government support for the steel producer. Previous measures include wavering of mining royalties, protection through anti-dumping duties on imported steel, and local procurement practices, as well as financial support offered to new owners. This raises questions about whether assistance is an effective tool for building a sustainable business.

The need to support regions undergoing structural change is not in doubt, but the Commission has previously questioned the effectiveness of such assistance measures. There are few evaluations; assistance can be uncoordinated; and it is often targeted at maintaining existing business instead of helping workers and firms adjust to the changing environment. Rather than using industry assistance to resist inevitable changes driven by external forces, more effective approaches are required to assist workers in regions to adjust.

Electricity generation and storage assets

The Commission also examined responses to the problems afflicting the National Electricity Market, including prolonged black-outs in South Australia. Increased unilateral public investment in new energy generation and storage may not be the best solution if the fundamental problem is that investors do not have sufficient confidence in the market rules to make long-term investments.

Government investment in electricity market assets raises several concerns: a reduced pressure to resolve problems in the market rules; whether there will be pressure to keep prices down by reducing the return on the publicly-owned assets, which would undermine competitive neutrality; and the potential for 'special deals' to be offered to some customers, which can lead to a cycle of on-going assistance. The Alcoa smelter in Portland in Victoria is a case in point, receiving substantial government subsidies following the end of 'cheap' power from the now closed Hazelwood electricity plant.

Backward steps on sugar industry regulation

As the single desk export market arrangements were finally toppled in 2006, the marketer, Queensland Sugar Limited (QSL) was granted a ten year monopoly on marketing sugar exports from Queensland. Then, in 2015, the Queensland opposition introduced a bill, passed with cross-bench support, that effectively reregulated the industry, giving the growers control over where millers could market the sugar they mill. While a negotiated solution was reached in May 2017 between the miller, Wilmar, and QSL on sugar marketing, the legislation has yet to be repealed. To add to the advantages provided by this legislation to QSL, it has also been granted charity status, which gives it considerable payroll and fringe benefits tax exemptions.

Some progress in trade policy

The *Trade and Assistance Review* also reports on recent developments in trade policy. Recent multilateral trade negotiations have included: some success in the agreement to eliminate all agricultural export subsidies; entry into force of the Trade Facilitation Agreement; agreed tariff reductions for ICT products under the Expanded Information Technology Agreement; progress with building on the 2012 APEC Environmental Goods Agreement; entry into force in 2014 of the Government Procurement Agreement; and progress on the Trade in Services Agreement.

The Review also outlines the main conclusion of a Commission paper[1] on Rules of Origin: untangling the noodle bowl of overlapping trade agreements through unilateral tariff elimination. It also provides a brief summary of the modelling results from another recent Commission paper[2] on the effect that increased global protection could have on Australia, and appropriate policy responses.

Trade and Assistance Review 2015-16

> Released July 2017

1 *Rules of Origin: can the noodle bowl of trade agreements be untangled?* Productivity Commission Staff Research Note, May 2017.

2 *Rising protectionism: challenges, threats and opportunities for Australia*. Productivity Commission Research Paper, July 2017

Understanding **government expenditure** on services to Aboriginal and Torres Strait Islander Australians

The 2017 Indigenous Expenditure Report provides estimates of government expenditure on services provided to Aboriginal and Torres Strait Islander Australians.

The Productivity Commission published the 2017 Indigenous Expenditure Report (IER) – which includes the report, data, data manuals and other material – in October 2017, with all material available at www.pc.gov.au/research/ongoing/indigenous-expenditure-report/2017.

The IER provides estimates of Australian, State and Territory government expenditure for Aboriginal and Torres Strait Islander Australians across more than 150 expenditure categories, with data reported for 2008- 09, 2010-11, 2012-13 and 2015-16.

What can the estimates tell me?

When combined with other information, such as the Overcoming Indigenous Disadvantage: Key Indicators 2016 (https://www.pc.gov.au/research/ongoing/overcoming-indigenous-disadvantage/2016), the estimates contribute to a better understanding of the adequacy, effectiveness and efficiency of government expenditure on services to Aboriginal and Torres Strait Islander Australians. Expenditure may be compared across all States and Territories, and for Aboriginal and Torres Strait Islander, non-Indigenous and all Australians.

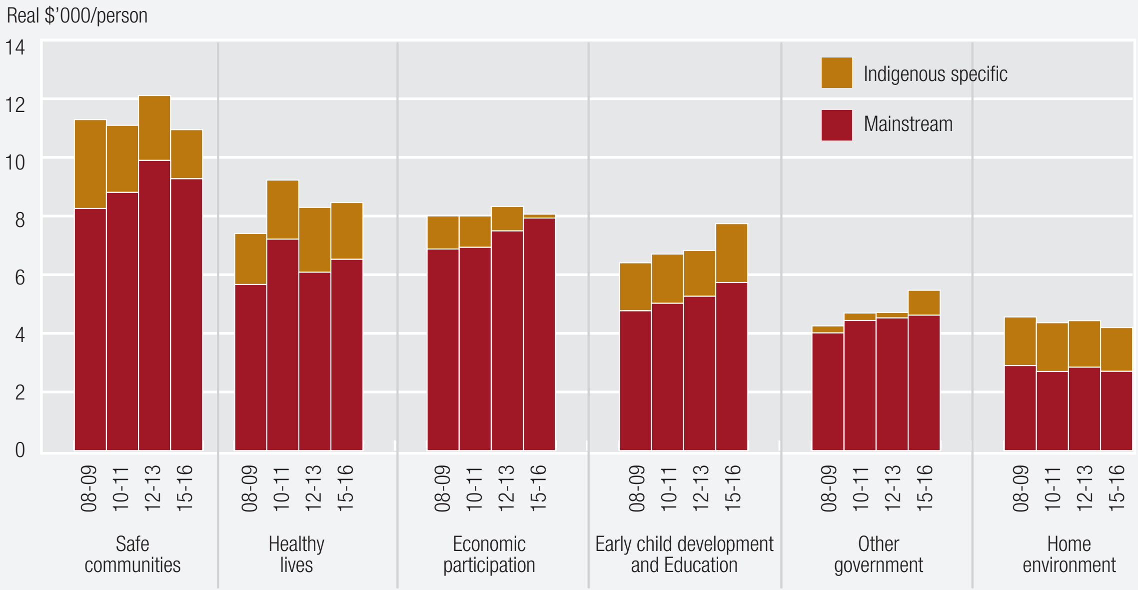
The IER is not able to provide information on whether spending has achieved its desired outcome; to do so would require tracking expenditure from governments to individuals, and then determining the impact of the various expenditures on individuals and associated outcomes. This type of study is best done through evaluation of specific policies and programs, which is outside the scope of the IER.

What were the estimates at an aggregate level?

In 2015-16, total direct government expenditure on Aboriginal and Torres Strait Islander Australians was estimated to be $33.4 billion, a real increase from $27.0 billion in 2008-09. The estimated direct expenditure per person was $44 886 for Aboriginal and Torres Strait Islander Australians, around twice the rate for non-Indigenous Australians ($22 356); a similar ratio to previous years. The higher per person expenditure (difference of $22 530) reflects the combined effects of:

- greater intensity of service use ($14 349 or 63.7 per cent) – because of greater need, and because of the younger age profile of the population

Figure 1: Expenditure on Aboriginal and Torres Strait Islander Australians, by building block and type of expenditure, by year[a, b]



a Includes Australian, State and Territory governments direct expenditure. b Expenditure data adjusted in real terms to 2015-16 dollars.
Source: 2017 Indigenous Expenditure Report, tables W2, W4, W6, W8.

- higher cost of providing services ($8181 or 36.3 per cent) – for example, because of more remote locations, or because targeted services are provided in addition to mainstream services (for example, Indigenous liaison officers in hospitals).

What were the estimates for Indigenous specific and mainstream services?

In 2015-16, Indigenous specific services (targeted expenditure assumed to relate exclusively to Aboriginal and Torres Strait Islander Australians) accounted for 18.0 per cent of direct expenditure on Aboriginal and Torres Strait Islander Australians, a decrease from 22.5 per cent in 2008-09. Mainstream services (expenditure available to all Australians through services and programs – for example, school education) accounted for 82.0 per cent, an increase from 77.5 per cent in 2008-09.

What were the estimates by building block?

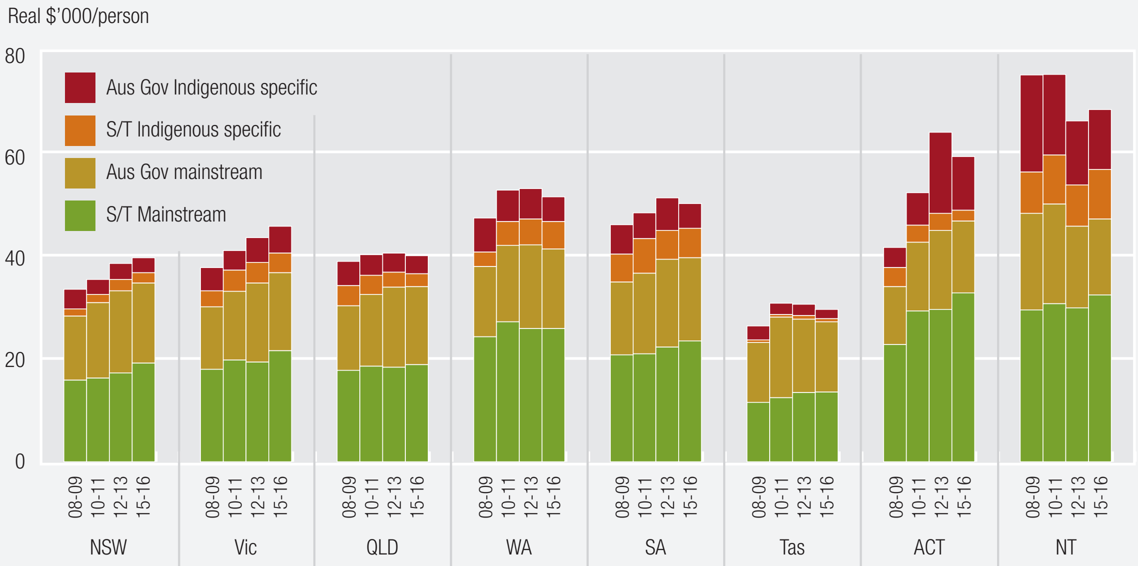
Expenditure is disaggregated across six broad areas that relate to the National Indigenous Reform Agreement and OID report building blocks: early child development and education and training; healthy lives; economic participation; home environment; safe and supportive communities; and other government services.

In 2015-16, expenditure per person for Aboriginal and Torres Strait Islander Australians was highest for safe and supportive communities ($10 948) and lowest for home environment ($4197). Expenditure on healthy lives, early childhood and education and other government services have shown upward trends since 2008-09, while there has been a decrease for safe communities and for home environment (reflecting a decrease in Indigenous specific expenditure). Expenditure for economic participation has remained relatively stable. (Figure 1).

What were the estimates by State and Territory?

Expenditure is also disaggregated across the eight States and Territories, including between Australian, State and Territory governments. It is important to note when referring to direct expenditure, that to avoid double-counting, transfers by the Australian Government to State/Territory Governments (indirect expenditure, as it goes to State and Territory Governments who then spend) is counted as part of the State/Territory Government direct expenditure (and not counted under the Australian Government). Total expenditure by the Australian Government (ie, direct and indirect expenditure) is available in the data tables on the 2017 IER web page.

Figure 2: Expenditure on Aboriginal and Torres Strait Islander Australians, by type of expenditure and level of government, by state and territory, by year[a, b]



a Includes Australian, State and Territory governments direct expenditure. b Expenditure data adjusted in real terms to 2015-16 dollars.
Source: 2017 Indigenous Expenditure Report database (All government direct real table; tables P.1 and P.2).

The Australian Government accounted for $14.7 billion (43.9 per cent) of direct Indigenous expenditure in 2015-16, a real increase of $2.2 billion (17.5 per cent) from 2008-09. The remaining $18.8 billion (56.1 per cent) was provided by State and Territory governments, a real increase of $4.3 billion (29.7 per cent) from 2008-09.

In 2015-16, expenditure per person for Aboriginal and Torres Strait Islander Australians was highest in the Northern Territory ($68 186) and lowest in Tasmania ($29 602) (figure 2).

Where can I find the estimates I want?

Data are presented on the 2017 IER web page in three formats.

Overview data

- 24 standard tables (pre-formatted) available in Microsoft Excel and PDF format. The tables provide high level estimates for 2008-09, 2010-11, 2012-13 and 2015-16 for expenditure and expenditure per person, adjusted for inflation.

Pivot tables (more detailed data)

- Six Excel workbooks are provided with a pivot table interface (each workbook has instructions for use)
- Using the pivot tables, it is possible to see the most detailed level of data for all reported expenditure codes. Users can also create their own custom pivot tables.

Advanced database

- An unformatted comma separated values (CSV) file for users who wish to analyse the data using their own preferred statistical software.

For more information...

The following are available from the 2017 IER web page:

- A short video on how to access the 2017 IER data from the different formats.
- The IER report and caveats to assist with interpretation of the data.
- The IER manuals for detailed information on the method for deriving IER estimates.

The IER is produced by the Productivity Commission for the Steering Committee for the Review of Government Service Provision.

For more information contact gsp@pc.gov.au

Indigenous Expenditure Report 2017

> Released October 2017

> pc.gov.au/research/ongoing/indigenous-expenditure-report

Collection Models for GST on **Low Value** Imported Goods

A short Commission inquiry confirmed that a model being implemented by the Government to collect GST on low value imported goods is the most feasible and practical approach currently available.

Online imports of low value goods ($1000 or less) shipped directly to Australian consumers are exempt from GST. Domestic retailers, whose sales *are* subject to GST, have long argued that the exemption unfairly advantages imports and harms local businesses. As online sales have grown, so have their concerns.

In June 2017, the Australian Parliament legislated that large foreign suppliers (including online marketplaces such as eBay) will be required to assess, collect and remit the GST on low value imported goods consigned to consumers in Australia. The Parliament also directed that the Commission check that this collection model is the best available, ahead of its implementation date of July 2018.

The Commission concluded that the legislated model, while imperfect, is the most suitable at this time. Although the model will impose significant burdens on foreign suppliers and will not be straightforward to enforce, it will help to improve tax neutrality, avoid disruption for consumers and should generate a modest revenue gain.

Among the alternatives, models that rely on collection by delivery agents could capture more revenue, but their feasibility is hampered by the paper-based declaration processes still used in international mail and the need for Australia Post to negotiate agreements with myriad other postal services. They would also impose much higher administrative and compliance costs, and could inconvenience consumers.

Other collection models, placing responsibility for GST on the consumer in Australia or on 'financial intermediaries' (such as banks and credit card schemes) are infeasible, due to the challenges of inducing consumers to remit GST and the lack of sufficient information collected by financial intermediaries. Advanced technological solutions may reduce or resolve these issues, but are untested and could not be deployed by mid-2018.

However, the suitability of some alternative models may improve over time. Although the Commission did not see sufficient reason to delay implementation, it did recommend reviewing the legislated model and the suitability of alternatives after five years (or sooner if triggered by adverse events). The Commission also discussed some possible improvements to the legislated model and its enforcement strategy, which could be considered if the model does not perform as expected.

Collection Models for GST on Low Value Imported Goods

> Inquiry Report

> Released October 2017

Current commissioned projects

6 December 2017

Competition in the Australian Financial System – *Public Inquiry*	
Consultation paper: 6 July 2017 Draft report: early 2018 Final report to Government: July 2018	Contact: Rosalyn Bell 02 6240 3308 Email: financial.system@pc.gov.au http://www.pc.gov.au/inquiries/current/financial-system#draft

Superannuation – *Commissioned Study and Public Inquiry*	
Stage 1: Study – Superannuation Competitiveness and Efficiency Issues paper: March 2016 Draft report: August 2016 Study report released: November 2016 ***Stage 2: Public Inquiry – Alternative Default Fund Models*** Issues paper: September 2016 Draft report: March 2017 A final inquiry report from stage 2 will not be issued separately. The inquiry will be incorporated into and finalised as part of stage 3. ***Stage 3: Public Inquiry – Assessing Competitiveness and Efficiency*** Issues paper: July 2017 Draft report: early 2018 Final report: June 2018	Contact: Jane Melanie 02 6240 3380 Email: super@pc.gov.au www.pc.gov.au/inquiries/current/superannuation

National Water Reform – *Public Inquiry*	
Issues paper: March 2017 Draft report: September 2017 Inquiry report to Government: December 2017	Contact: Jessica Hartmann 02 6240 3222 Email: water.reform@pc.gov.au www.pc.gov.au/inquiries/current/water-reform

Horizontal Fiscal Equalisation – *Public Inquiry*	
Guidance note: May 2017 Draft report: October 2017 Final report to Government: January 2018	Contact: Ana Markulev Email: hfe@pc.gov.au www.pc.gov.au/inquiries/current/horizontal-fiscal-equalisation

Transitioning Regional Economies – *Commissioned Study*	
Initial report: April 2017 Study report to Government: December 2017	Contact: John Salerian 03 9653 2190 Email: transitioning.regions@pc.gov.au www.pc.gov.au/inquiries/current/transitioning-regions

Log on to the Commission's website www.pc.gov.au for full details of all current projects.