Australian Dairy Industry Council Inc.

Submission in Response to the

Draft Report of the Productivity Commission

Inquiry into Rural Research and Development Corporations

by the

Australian Dairy Industry Council

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Inquiry into Rural Research and Development Corporations
Productivity Commission
Locked Bag 2, Collins St. East
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To the Productivity Commission,

Dairy Industry Response to the Draft Report on Rural Research and Development Corporations

The Australian Dairy Industry Council (ADIC) welcomes the opportunity to respond to the Productivity Commission's (PC) draft report on Rural Research and Development Corporations (RDCs).

This submission should be read in conjunction with the ADIC's previous submission to the inquiry (dated 7 July 2010). It addresses key issues from the draft report and also supports the submissions of Dairy Australia (DA) and the points made in them.

It should be noted that, as a member of the National Farmers' Federation (NFF), Australian Dairy Farmers Ltd (ADF) has contributed to, and supports, the main contentions of the NFF submissions to this review. In particular, ADF and the ADIC support the view that the Productivity Commission has taken too narrow a view by restricting its analysis to focus on the efficiency of government funding solely through RDCs. The NFF's recommendation that a whole-of-government strategy for rural innovation be developed is supported by both ADF and the ADIC.

The ADIC is the national policy and advocacy body of the Australian dairy industry and represents the interests of Australian dairy farm families and businesses, dairy manufacturers and traders across all states and territories. The ADIC has since the mid '80s striven to ensure that dairy Research, Development and Extension (RD&E) has remained focused, affordable, supported and relevant. The ADIC is comprised of Australian Dairy Farmers Ltd (ADF) and Australian Dairy Products Federation Inc (ADPF)

The ADIC appreciates the fact that the PC's draft report is largely positive about RDCs and the work they do. As Group B members of Dairy Australia, ADF and ADPF have an obligation to achieve the Australian dairy industry's vision of growing an internationally competitive, innovative and sustainable industry. In this role we continually work closely with DA to evaluate RD&E performance, investment decisions and outcomes.

Key Representative Bodies in Dairy Industry Value Chain

A list of the key representative bodies of the Australian dairy industry is attached (attachment 1) to clearly differentiate their composition, relative responsibilities, and activities. This explains the authority by which the ADIC makes this submission in response to the draft report and comments on DA and its activities. The ADIC clearly delineates its policy and advocacy role from the RD&E investment and management role of DA.

This submission, as with our previous submission to the inquiry, is written in support of DA, as an RDC, and thus a subject of the PC Review. DA is an industry owned service body investing in RD&E and data acquisition and analysis on behalf of the whole of Australia's dairy industry value chain. DA is primarily funded through levy funds from farmer stakeholders and Federal Government 1:1 matching funding.

Background

Dairy farms are predominantly small, family businesses that are vital to the sustainability of regions. The integration between farm and manufacturing is unique to the dairy industry and consequently farmers are comfortable investing throughout the supply chain where they can see this will ultimately result in benefits to farmers.

The dairy industry is Australia's third largest rural industry, with a farmgate value of production of $4 billion in 2008/09 and directly employing 40,000 people. The through-chain value of dairy is significantly higher, as the industry directly and indirectly employs approximately 100,000 people and produces dairy products valued at $9 billion a year. The industry exports approximately 50% of total milk production and will continue to be a significant contributor to the national economy.

Given the uneven international playing field on which the Australian dairy industry competes – against the subsidised production of milk and milk products, trade quotas and other non-tariff barriers to trade; RD&E that keeps our production systems world-class is vital for competitiveness in world markets.

The ADIC perceives 'world-class' to mean high levels of production that are cost-effective, profitable, environmentally-sound and meet domestic and international community expectations and quality standards.

It is worth noting that dairy is one of Australia's leading rural industries in terms of adding value through further downstream processing. Much of this processing occurs close to farming areas, thereby generating significant economic activity and employment in country regions. ABARE estimates this regional economic multiplier effect to be in the order of 2.5 from the dairy industry.

DA spends around $30-35 million a year in RD&E projects for the benefit of Australian dairy farmers and manufacturers. DA has been able to leverage available funds by as much as 300%, significantly enhancing the benefits received by the dairy industry and the wider community.

For more detail on the industry and the operation of DA please refer to DA's submissions to the inquiry.

Key points

It is important to reiterate that the ADIC strongly considers that the current RDC funding model:

- Delivers significant public benefits in both the short and longer term, while appropriately being largely directed at delivering benefits for the respective sponsoring industries; and
- Cannot be compared directly with other industries, RD&E incentive schemes or taxation models given the circumstances of agriculture, family unit farming businesses, and its susceptibility to extrinsic factors such as drought and climate change. Agricultural RD&E cannot be made subject to controlled environment experimentation that can be conducted in a laboratory.

As outlined in our previous submission the ADIC contends that government funding levels for agricultural RD&E are comparable to other industries and does not support the PC's contention that RDCs are funded at a level that is significantly higher when compared to other industries.

The ADIC queries the formula used in coming to this conclusion and therefore does not support reducing the cap on the Australian Government's matching contributions for all statutory levies from 0.50 per cent to 0.25 per cent of an industry's gross value of production.

The ADIC maintains that if the matching contribution is reduced there is not the capacity or incentive for dairy farmers to fill the gap in funding as the PC simplistically contends.

This will put at risk rural RD&E that brings benefits to the wider community, contributes significantly to the national economy and constitutes an equal partnership between government and industry.

Funding

The ADIC is encouraged that the PC has recognised the importance of the current RDC model and the good work that RDCs carry out. There can be no doubt that the current model works well for both government and rural industries, and has enabled the dairy industry to achieve significant leverage and support of its RD&E investment.

The industry has achieved this without depending on a levy on processors. The ADIC supports the PC draft finding that RD&E levies should not be extended beyond their current application and applied to processors for the reasons presented in Section 9.4, but particularly because as price takers in a global market any additional impost on processors would be manifest in the price paid to dairy farmers for their milk.

However, ADIC challenges recommendation 7.1 of the draft report, which proposes two major changes to the current RDC model:

1. Reducing the cap on the Australian Government's matching contributions for all statutory levies from 0.50 per cent to 0.25 per cent of an industry's gross value of production, with the reduction being phased in over ten years; and
2. Funding the proposed the new RDC, Rural Research Australia (RRA) with a direct appropriation that would be progressively increased over five years to approximately $50 million a year.

The PC's basic rationale for reducing matching funds is that 'a significant part of the Government's funding contribution appears to have supported RD&E that primary producers would have had sound financial reasons to fund themselves' and the belief that the government funding contribution to RDCs for RD&E is well above that provided to other industries.

The ADIC's submission to the inquiry in July argued strongly that the current funding model - which sees dairy farmer levies matched by federal government funding on a dollar for dollar basis:

- Is the most effective vehicle for Government and dairy farmers to invest prudently and profitably on behalf of their industry and, indirectly, for the wider community;
- Delivers significant public benefits, directly and indirectly, to the wider community;
- Should not be compared directly with other industries given the extraordinary circumstances of family farming unit businesses and their susceptibility to extrinsic factors such as drought; and
- Encourages collaboration and leveraging of funds to increase the overall pool of funds and resources.

The ADIC firmly believes this to be the case and rejects the PC's rationale for reducing matching funds. The ADIC holds grave concerns that reducing government funding will disenfranchise levy payers, compound market failures, and also reduce external agency support and alienate industry stakeholders.

The current government RD&E model ensures the taxpayer derives a minimum $2 RD&E value for every $1 invested by government. Furthermore, the community can be assured that this RD&E will be consistent with the Rural RD&E priorities set by Government in 1994, and reviewed in 2007. These priorities, by definition, "ensure RD&E objectives of the Australian Government are met" and "better target agricultural, fisheries, forestry and food industry RD&E efforts." [1]

The dairy industry, through the ADIC, was the first to take advantage of the Primary Industries and Energy Research and Development (PIERD) Act to set up a corporate RDC in 1990. This reflects the industry's ongoing view that public/private investment in RD&E is essential to maintain sustainability and productivity in an open market-oriented economy like Australia.

The ADIC notes that the agreement reached with government over implementation of the PIERD Act was in return for government agreeing to provide matching funds up to the 0.50% cap of gross value of production. The dairy industry agreed to effectively double the rate of the industry RD&E levy on farmers. This meant the government's seed money secured an immediate, ongoing and significant increase in industry funding of RD&E. The partnership continues to work well to the benefit of farmers, rural communities and Australia in general.

Recommending a fundamental shift in this funding balance is unwarranted. It will put rural innovators at a disadvantage to other sectors without any obvious gain for the community. The dairy industry, through the ADIC, ADF, ADPF and DA and other stakeholders, has worked hard to actively engage with government and be a partner with government in RD&E. The ADIC considers this partnership to have worked well to date with good outcomes for industry, government and the wider community.

The current model and ancillary government programs and policies recognise, and go some way to compensate the agricultural industry for the market failure that occurs with RD&E in regional Australia as it applies to issues such as natural resource management (in particular water), climate risk and family unit farming businesses.

The PC has failed to adequately recognise the impact of these market failures on agriculture, and the dairy industry in particular, and the necessity of government intervention to address under-investment in RD&E by the private sector. There are several factors that lead to this under-investment but the key causes are the:

- Small scale of the vast majority of dairy farm businesses;
- Potentially long time lags before investments are realised;
- Rapid pass-through of benefits when adoption occurs; and

[1] www.daff.gov.au/agriculture-food/innovation/priorities

- Incentives that exist for some farms to ‘free ride’.

The ADIC strongly asserts that RDC’s Government funding levels for RD&E are comparable to other industries and does not support the PC’s contention that they are funded at a level that is significantly higher when compared to other industries.

The PC’s assumptions on the relative levels of funding for RD&E through RDCs when compared to other industries are based on invalid assumptions and are misleading. The key issue is that the government contribution to RD&E for other industries under the tax incentive and tax offset schemes is understated. It is essential to measure the total government contributions in each measure when comparing different mechanisms through which government contributes to the cost of RD&E – this must include all appropriations and foregone tax revenues. The Council of Rural Research and Development Corporations’ Chairs (CRRDCC) and DA’s submissions to the inquiry provide further detail on these calculations.

The PC appears to hold the view that matching government contributions are not generating sufficient additional research that delivers public benefits. As the PC acknowledges the dividing line between public and industry benefits is extremely difficult to define or quantify. They are often inextricably linked and in the long term, it is usually the case that if RD&E brings a return to industry then eventually it brings a return to the public as well.

DA has an excellent track record of marrying research with public benefits to research with industry benefits, to encourage adoption and take up in industry. There is currently a growing degree of collaboration between the respective RDCs and also between DA, government agencies, research institutions and industry that leverages existing funding and provides benefits to both the public and private sector.

The ADIC does not accept that cutting Government funding by half will lead to increased private sector investment and the PC has not provided compelling evidence to show that private sector involvement will increase to replace the lost funds. Halving Government funding will certainly not lead to investment at the same level in areas such as natural resource management, climate risk and the small family farm unit businesses that are integral to regional and rural communities.

The ADIC maintains that if the matching contribution is reduced there is not the capacity or incentive for dairy farmers to fill the gap in funding as the PC contends. It seems a remarkable leap of faith to expect that the proposed reduction in government funding of 50% will result in greater investment from farmers, particularly when there is no evidence to back this proposal.

This will put at risk rural research and development that brings benefits to the wider community, contributes significantly to the national economy and constitutes an equal partnership between government and industry. This action is being proposed at a time of significant risk for the dairy industry.

There are currently many challenges facing the Australian diary industry. The Murray Darling Basin Guide affects almost 30% of Australia’s milk production, there is also the ongoing challenge of responding to climate variability and climate change, the costs associated with operating in a global market, meeting consumer demands for better quality and lower priced food and keeping pace with competitors in other countries.

All these challenges require an industry that is responsive, flexible and innovative, something the current system provides. Cutting Government funding in half will severely hamper the dairy industry’s ability to meet these challenges and damage the industry greatly at a time where there are already significant challenges to be faced.

In light of all the above factors the ADIC believes the PC's proposal to reduce Government funding is short-sighted and undervalues the contribution that dairy makes to regional communities, the economy, natural resource management, food security and the health and well-being of Australians.

Finally, it is also worthwhile noting that the PC has commented on changes to funding by the States and Territories, which appears to be falling, and its impact on RDCs, but has still recommended lowering Federal Government funding.

Proposed Rural Research Australia (RRA)

The proposal to establish Rural Research Australia (RRA) penalises existing RDCs, and compromises the unique and valuable RD&E that is conducted in each industry at the request of their stakeholders, by linking the proposed reduction in government funding to existing RDCs to the direct appropriation of $50 million a year to RRA.

This is significant funding that is a proportion of the proposed savings in reducing the cap on the Australian Government's matching contributions for all statutory levies from 0.50 per cent to 0.25 per cent of an industry's gross value of production over ten years.

The ADIC believes the proposal for RRA to sponsor non-industry specific RD&E intended to promote productive and sustainable resource use by Australia's rural sector needs further investigation and should not proceed if it means a cut in funding to existing RDCs. The PC's recommendation that RRA's remit should broadly encompass land, water and energy use is likely to result, if RRA is established in the future, in research that is useful to agricultural industries generally but may not be applicable to any individual agricultural enterprise. Existing RDC's will need to conduct further RD&E to apply RRA work on-farm to make the research useful and relevant to their industry, potentially negating to a large extent any benefits from the original research.

The ADIC is of the firm view that, even were RRA established with the above remit, it would not have the capacity to provide industry-specific research of the nature needed by the dairy industry of the magnitude currently supplied by DA. There are also concerns regarding the benefits of having a single large agency conducting all such research. DA has close and clear links to its dairy stakeholders and can react very quickly to adapt or undertake research as is needed. This valuable link to stakeholders would be lost through RRA conducting such research and there would be a consequent loss of 'ownership' by stakeholders.

Each agricultural industry is unique and thus each RDC is unique with its own farmer base, land management, water and other issues. DA is already conducting research in areas such as those mentioned above which is dairy-specific and will have clear public benefits, for example in water savings, in addition to those for the dairy industry. The close link DA has with its stakeholder's results in close alignment to their needs and increased industry take-up of RD&E. It is important that these links and close alignment are not lost through the establishment of RRA.

Administration

With regard to the principles to guide the future operation of the RDC program, the ADIC needs more detail in order to be able to comment fully on this but can broadly say we are aware that DA has strong governance processes in place and is continually striving for operational efficiencies.

It is important that any changes to administrative practices, such as regular independent reviews, do not place a greater burden of administration on RDCs and that clear advice is provided to RDCs on what is required regarding the implementation of any new processes. It is also important that any performance measures be developed in consultation with the RDCs and that they are relevant, efficient and effective. They should also be periodically reviewed to confirm actual value is delivered to all parties.

The ADIC would like to reiterate that the current practices provide a level of transparency, accountability and direct involvement by levy payers that must be maintained. These processes facilitate the fine-tuning and responsiveness which is so critical for the continuing success of dairy RD&E, which ensures the ongoing viability of the industry and provides significant benefits to the broader community.

Draft recommendation 8.4 proposes that provision should be made for the Australian Government to appoint a director to the board of an industry-owned RDC where that RDC requests such an appointment. The ADIC stresses that any such appointments must be made with due regard to the RDC's constitution and its legal provisions. The ADIC also maintains that any government appointments should remain a decision for the RDC board and should continue, and complement, the existing skills-based appointments to RDC boards.

The ADIC also notes that experience in Government and broader skill sets are already captured on many RDC boards.

Improving the Levy System

The ADIC supports changes to levy arrangements that continue the close, transparent and accountable relationship that currently exists between DA and dairy farmers. We support recommendations, 9.2, 9.3 and 9.4, that simplify processes for RDCs and improve the efficiency of levy collection and implementation by the Department of Agriculture, Fisheries and Forestry.

The ADIC is of the view that flexibility around levy arrangements is important. The dairy industry should not be constrained by additional government processes if it wishes to increase its investment in RD&E.

The ADIC refers the PC to the DA submission for further detail on recommendations relating to levy matters.

Conclusion

The ADIC is encouraged that the PC has recognised the importance of the current RDC model and the important and necessary work that RDCs carry out. There can be no doubt that the current model works well for both government and rural industries generating significant advances in productivity and adaptation, and enabling the dairy industry to achieve significant leverage and support of its RD&E investment. However, the ADIC holds grave concerns that reducing government funding will disenfranchise levy payers, compound market failures and also reduce external agency support and alienate industry stakeholders.

The PC has failed to recognise the business structures prevalent in agriculture, and the dairy industry in particular, and the necessity of government intervention to address market failures in the agricultural sector. There are clear public benefits that are realised from the current model that cannot be provided more efficiently through any other method than a levy and matching government funding. This provides the incentive for levy-payers to invest at the levels they do and does not prioritise their needs as secondary to broader community benefits.

There are currently many challenges facing the Australian dairy industry and these challenges require an industry that is responsive, flexible and innovative, something the current system provides. Cutting Government funding in half will severely hamper the dairy industry's ability to meet these challenges and damage the industry greatly at a time where there are already significant challenges to be faced.

In light of all the above factors the ADIC believes the PC's proposal to reduce Government funding is too narrowly focussed, short-sighted and undervalues the contribution that dairy makes to regional communities, the economy, food security and the health and well-being of Australians.

Finally, it should be noted that the ADIC supports the National Farmers Federation's call for a national strategy on rural RD&E, before any decisions are made based on the Productivity Commission report.

If you have any questions regarding this process please do not hesitate to contact us on (03) 8621 4200.

Yours sincerely

Wes Judd
Chairman (ADIC)

John Williams
Deputy Chairman (ADIC)

Attachment 1

Key Representative Bodies in the Dairy Industry Value Chain

The Australian Dairy Industry Council (ADIC)

ADIC is the peak industry organisation where dairy farmers and dairy companies come together to agree whole of industry policy. ADIC comprises Australian Dairy Farmers Limited and the Australian Dairy Products Federation Inc. which are the peak policy bodies for Australian dairy farmers and dairy companies, respectively. Policy agreed through the ADIC is used to represent and advocate the interests of all sectors of the dairy industry to state, national and international Governments and organisations.

Australian Dairy Farmers Limited (ADF)

ADF is the peak industry body of Australia's dairy farmers constituted from the six state dairy farmer organisations (NSW Farmers' Association Dairy Committee, Queensland Dairyfarmers Organisation, United Dairyfarmers of Victoria, Tasmanian Farmers & Graziers Association Dairy Council, South Australian Dairyfarmers' Association and Western Australian Farmers Federation Dairy Section). ADF's primary purpose is to represent the interests of dairy farming businesses and families, and it is the long established voice of Australian dairy farmers.

Australian Dairy Products Federation (ADPF)

The ADPF is the peak policy body for commercial/non-farm members of the dairy industry. Its role is to develop policy and represent members on issues of collective interest. Membership is open to entities operating in Australia that are engaged in the manufacture, marketing or trading of dairy products and/or dairy related products. Currently there are 26 Member organisations that account for over 90% of the milk collected and processed in Australia.