Submission to Productivity Commission

Review of Rural Research and Development Corporations

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Executive Summary

The NSW Farmers' Association (the Association) appreciates the opportunity to provide feedback on the Productivity Commission's Draft Report on Rural Research and Development Corporations (the Draft Report) and looks forward to the release of the Commission's final paper.

Having reviewed the Draft Report the Association makes the following comments;

1. **The Association fundamentally opposes the recommendation that the Commonwealth halve its contribution to industry specific Research and Development Corporations (RDCs) over 10 years.** The Association disputes the finding that agricultural industries are able to retain the benefits of productivity improvements in the long term, as historically these only serve to maintain the viability of farm businesses and provide cheaper and more plentiful food and fibre to consumers.

2. **The Association disputes the assumption that private sector funding for rural research and development (R&D) will increase following a withdrawal by government.** The reasons for corporate spending on rural R&D being focussed in overseas markets will not be affected by a withdrawal of government funding. Further, it cannot be assumed that producers will agree to raise levies. The long term nature of R&D investments often don't compare favourably to competing expenses such as the adoption of existing technology.

3. **The recommendation to withdraw funding is extremely untimely given the foreseeable challenges and opportunities faced by the agricultural sector.** Without sustained investment to develop solutions to water reductions, climate variability and rising prices for fuel and fertiliser, the Australian economy will miss the opportunity to capitalise on large populations in our region entering global food markets. These are issues which are outside the lifetime of many of the farmers who will be deciding on industry's R&D investment, making it unrealistic to expect their support.

4. **The Association support any measures, which deliver better services and more efficient use of our Members' levy contributions**. As part of the industry structure which oversees many rural RDCs on behalf of levy payers the Association is disappointed to see that the Draft Report made no recommendations on how industry and government R&D investment can be spent more wisely. We seek a commitment from the Productivity Commission that it will document detailed and costed options for efficiency improvements in its final report.

5. **The Association supports the proposal to establish Rural Research Australia (RRA), subject to further details on funding and RRA's charter.** While we support the establishment of a portfolio in this area, we strongly oppose the recommendation to use funding reallocated from industry specific RDCs. There is also a great deal of uncertainty in the Draft Report around the scope of RRA and what mechanisms it will use to liaise with industry to ensure its outcomes are practical.

Defence of current government contributions

In its Draft Report the Commission recognised features of the agricultural industry, which lead to a market failure in private R&D. It acknowledged that these failures cannot be overcome through a levy system alone but fails to appreciate some important issues. In its initial submission, the Association outlined the fundamental reasons justifying continued government support for rural R&D. Despite these reasons remaining unchanged they have not been adequately addressed in the Commission's Report

Industry funding of public benefits

The Association disputes the Commission's assertion that where a private benefit is attainable, the private sector should fund 100% of that project, even where a larger proportion of the outcome will benefit the wider public[1] The Association argues that due to the wider public benefits generated, the agricultural sector should not be expected to cover the full cost of these projects. Further, the Commission overlooks the fact that government may be sacrificing substantial public benefits due to the private sector favouring competing projects with a higher level of private return. Accordingly, a black and white application of this principle would not always deliver the best overall outcome.

Diffusion and propriety of private benefits

The Association submits that widespread technological adoption diffuses private benefit. Widespread uptake of technologies which increase output will increase supply and therefore lower commodity prices. The beneficiaries of this process are consumers, with a temporary benefit flowing to producers who adopt technology early, at the expense of those who adopt later.[2]

Further, the Association believes that funding productivity improvements in an industry which competes globally against heavily subsidised producers overseas is an appropriate role for government. There is a case to argue that public investment in rural R&D is a cheaper and more socially responsible way of safeguarding our agricultural industries than the direct subsidies used overseas.

Levels of private sector investment

The Draft Report compares the ratio of public and private investment in rural R&D internationally and, using the lower ratio of Australian private R&D investment, argues that domestic public funding is displacing private investment. The Association posits that lower private investment in Australia is driven by large multinational agribusinesses undertaking research offshore. Australian agriculture is reliant on privately developed, technology-intensive imports of chemicals, farm machinery and plant varieties. Despite the location of their development, these technologies are paid for by Australian producers, the benefit of which contribute to productivity gains in Australian agriculture.

The factors that lead to the current offshore R&D situation, such as the size of the European and American markets and the regulatory environment in Australia, will remain unchanged irrespective of whether Australian government funding is withdrawn. In fact, a survey by the Australian Farm Institute recently found that many companies would be less likely to undertake R&D in Australia without the support of the RDC system.[3]

The Draft Report appears to partially base its recommendation to withdraw RDC funding on the assumption that producers will vote to raise their levies to fill any funding gap. The Association

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[1] Illustrated in Figure 1, page XIX
[2] This effect was noted by Pardey et al. in their paper *Agricultural R&D Policy: A Tragedy of the International Commons* 2008
[3] *Private Sector Investment in Agricultural Research and Development in Australia,* Australian Farm Institute, September 2010: 41.3% of respondents claimed they would reduce their R&D spend following a 50% reduction in funding of the RDCs

considers this assumption to be ill conceived. Although historically there has been a strong return on investment paid through the current RDC system, investment in agricultural R&D is inevitably high risk and takes years and sometimes decades to pay off, if at all. The Commission appears to have misjudged the farm sector's appetite for these risks. It is important to note that the median age for Australian farmers is well over 50 and many are focused on retirement. Choosing to make a 20 year investment which will pay off after they leave the industry is not a rational decision and government support is warranted to ensure the next generation of farmers can keep pace internationally. Industry levies are highly controversial in some industries – often where the bulk of producers obtain benefits without direct involvement with their RDC.

An important issue is the potential for producers to trade off levy payments in preference for the adoption of new technologies. With many farm businesses under drought induced financial pressure producers may prefer to use their income to invest in new technology, which will deliver immediate benefits rather than longer term, high risk investments in R&D. For example, the average wheat producer (who is already paying $1,715.88 pa in levies) may decide that the $353.16 pa it would cost to offset a 50% cut in Commonwealth funding[4] is better spent paying off GPS technology which would improve their productivity from year 1. The Association is concerned by the prospect that increased levies may impact on producers' willingness and ability to take up R&D outcomes.

Outcome of funding withdrawal

The recommendation to withdraw $110 million from industry specific RDCs has been made without any clear modelling on the full effect of this proposal. As the Draft Report acknowledges, the RDC system is able to use its spending power to influence the research agenda of a number of research providers, many of whom co-contribute to RDC projects. Before any withdrawal of funding is progressed the Association believes it is crucial to understand the flow on effects of any withdrawal of RDC funding on the total rural R&D spend.

As we outlined in our initial submission, the agricultural sector faces a number of foreseeable challenges including water reductions, climate variability and the rising costs of inputs such as fossil fuels and phosphate. These factors place uncertainty over the sector's future and significant public support is warranted to create solutions to these problems. The recommendation to withdraw funding from rural R&D could weaken the sector as an investment choice and threaten the community's future access to food and fibre. Moreover, with a rising number of countries entering the global market for food products, scaling back agricultural productivity growth will be a lost opportunity for the Australian economy to profit from the forecast increase in food demand within our region.

Cost savings and rationalisation

The Association is concerned that the focus of the Draft Report appears to be in cost saving for the Government. There was very little commentary on how additional investment into the rural R&D sector could be used to provide new benefits to industry and the wider public, through increased productivity, employment and economic activity. As the Association noted in its original submission, without the productivity gains associated with rural R&D the efficiencies of today's agriculture production would not have materialised. Consequently, either consumers would be paying much higher prices for their food and fibre or agricultural production and the economic benefits it generates would have been significantly eroded. Within this context, the Association requests that the Commission model the cost benefits that additional funding to rural R&D will provide to the community.

The Association notes that there were no recommendations within the Draft Report on how the RDC structure could be improved to deliver better services using the current budget. At the

[4] Based on an average of the average wheat receipts for 2007-08, 2008-09 and 2009-10, ABARE Grains Report, May 2010 and GRDC revenues for 2008-09

Sydney hearing the Commission suggested that the benefits of taking on different structures is a matter for levy payers, who should be seeking to maximise their investment.

The Association believes this is another instance where the Commission has misjudged the power of pluralistic decision-making by industries. RDCs operate across a range of rural industries and to expect stakeholders to develop a consensus on any system-wide restructure is unrealistic. The Commission is in a unique position to assess how savings and efficiencies could be made within the RDC structure.

An initiative suggested in the Association's initial submission was the framework used by the Agriculture and Horticulture Development Board in the United Kingdom where each 'RDC' operates as a separate arm of one corporate entity. Other options could include co-location of RDCs in close proximity to one another and reassignment of RIRDC's 'emerging industries' to similar established industry RDCs.

While the Association does not hold a view on what changes to the RDC system might look like, we would encourage the Commission to put forward proposals for consideration in its final report which will lead to better returns on government and industry investment.

Rural Research Australia

In the past, the Association was supportive of the role played by Land and Water Australia. Consequently, the Association would, in principle, welcome a body within the RDC system to work on sustainability issues and act as a vehicle for cross-sectoral research such as animal welfare. However there remain a number of questions with the Rural Research Australia (RRA) proposal, which are set out below.

The Association strongly opposes this body being funded using funds withdrawn from industry-specific RDCs. In addition to our reasoning above regarding overall funding, using reallocated funds to establish an RDC tasked with collaborative work would damage the culture between these bodies and the quality of their cooperative work. The Association believes that the proposal for RRA has merit and if adopted, should be funded from additional government sources, not at the expense of industry specific R&D.

The Draft Report does not offer sufficient detail regarding the role RRA will play and whether its scope will include cross-sectoral issues and if so, what mechanism (if any) will be in place to discourage free riding by relevant RDCs.

Whether cross-sectoral work will be incorporated into RRA should also be considered in any recommendations made by the Commission on intermediate sanctions for non-performing RDCs. It may be difficult to establish which body is responsible for delivery of targets in this area, making action by stakeholders seeking compliance equally problematic.

Under the current proposal, the Association holds concerns about the applicability of the work RRA will undertake. The Draft Report stipulates that RRA's work should be entirely for public benefit, however this again oversimplifies the distinction between public and private benefit, such as projects to minimise topsoil loss which provide environmental as well as productive benefits. Further, for outcomes to result in changed agricultural land use management there will need to be some publically funded incentive for private adoption, in recognition of the public benefit derived from private investment. To overcome this and ensure outcomes are practical and farm-ready it is important to have input from industry and industry-specific RDCs.

The Draft Report does not detail whether RRA's work would apply only to productive landscapes. It is likely that RRAs work would extend beyond farm resource management into broader sustainability work, in which case RRAs funding sources should be similarly broadened to include the Department of Sustainability, Environment, Water, Population and Communities and the Department of Climate Change.

With reference to our earlier point on efficiencies, the Association questions whether it is necessary to form RRA as an entirely new RDC, particularly when it is looking to then adopt work from the Rural Industries RDC (RIRDC). Without certainty around the scope of RRA it is difficult to put forward a position on this issue. We would, however, encourage the Commission to look at synergies between the RRA model and RIRDC's charter, and question the need for two separate RDCs.

In summary the Association supports the principle of the Federal Government allocating additional funding to create an RDC portfolio in this area and will look forward to working through the details of any recommendation following the release of the Commission's final report.

Specific recommendations and information requests

Marketing and industry representation

The Association strongly supports the Commission's recommendation to enable all RDCs to take on an industry funded marketing role. There are clear synergies in this relationship as outlined in our initial submission and this should be an option for all rural industries.

The Association is less supportive of the Commission's decision to delay a recommendation on industry representation until the ten-year review. Current industry representative structures are under financial strain and it is possible that many industries will be looking to identify alternative structures and funding sources within the coming 10 years. The Productivity Commission's support in confirming the ability of RDCs such as APL and AECL to effectively conduct R&D while advocating for their industry would ensure this option is available if chosen by other industries.

Reporting Requirements

The Association is concerned by the numerous reporting requirements recommended by in the Draft Report, namely;

- A regular Australian Government review of rural R&D programmes [Draft recommendation 5.1]
- Pressure through PIMC to have state and territory governments undertake reviews of rural R&D programmes.
- 3 yearly independent performance reviews for all RDCs (currently required for IOCs) [Draft recommendation 8.6]
- An annual monitoring report collated by DAFF on all RDC activities [Draft recommendation 8.7]
- A follow up review on implementation of the Commission's recommendations in 10 year's time [Draft recommendation 9.5]

The Association is concerned that complying with these recommendations would be unnecessarily time consuming for the senior management of the RDCs, reducing their capacity to deliver outcomes for stakeholders. While proper oversight of the investment made by industry and government is a positive aim, the Association would welcome any streamlining of these requirements to ensure they are pragmatic and do not overwhelm the RDCs.

Intermediate sanctions for non-performing RDCs

The Association does not fully agree with the Commission's finding that government lacks the tools to take action against underperforming RDCs without withdrawing funding. While we acknowledge the performance issues raised in relation to Australian Wool Innovation, the Association is satisfied that these issues have or are presently being rectified. This resolution has been brought about by government working with the RDC board, to implement changes without the need to cut funding. A resolution in this extraordinary circumstance acts as proof that the current system is functioning rather than evidence of an issue.

However, if the Commission was to make a recommendation on this issue, the Association believes that inclusion of an arbitration clause within future statutory funding agreements and the PIERD Act could be a means of settling disputes. The arbitration clause could require any difference under the agreement to be settled through arbitration, where an independent intermediary would determine an appropriate course of action to resolve performance issues.

In essence this process would formalise and expedite the sort of dialogue between AWI and the government which resolved the issues in that circumstance. The risk of this is that arbitration will be invoked capriciously by both parties and become a costly alternative to proper dialogue between parties.