Australian Government

Grape and Wine Research and Development Corporation

Response to Productivity Commission
Review of Rural Research and Development Corporations

November 2010

GWRDC

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Introduction

The Grape and Wine Research and Development Corporation (GWRDC) is pleased to provide this response to the draft report of the Productivity Commission's review of Rural Research and Development Corporations (rural RDCs).

In our response, we provide general observations on the intent of the review as well as specific feedback and comments on the draft recommendations, findings and information requests. GWRDC is putting forward its views in addition to an extensive submission that is being prepared by the joint RDCs.

We understand the intention behind the review and the desire of government to be more engaged in shaping how its contributions to the rural RDCs are spent.

With a particularly difficult economic operating environment within the grape and wine industry at present, the R&D levy is seen by some as another tax, hence GWRDC has to work very hard to justify our existence to our levy payers. We view this review as an important step in maintaining the best return on the total R&D investment and welcome this level of scrutiny.

Similarly, the Federal Government contributes roughly half of the funding to our budget and can legitimately ask what is generated that is of public good using taxpayer funds? We believe that we do deliver real and measurable public good benefits through the research, development and extension work we purchase. But we also support the principle that there should be scrutiny and accountability for taxpayer funds and we would welcome reporting against clear guidelines on the public good that we deliver.

The Productivity Commission's draft recommendation to reduce the amount of funding provided to the rural RDCs seems to be motivated by cost saving rather than being an evidence-based decision. It seems somewhat short-sighted in the context of industries that operate in timeframes of decades or generations rather than four- year budget cycles.

In our response, we provide feedback and input into the recommendations documented in the draft Productivity Commission, but we start with a series of rationales about why investment in grape and wine research and development (R&D) (and more generally rural R&D) is a worthwhile activity that should be maintained or expanded, but certainly not contracted.

Hon. Rory McEwen
Chair
GWRDC Board

November 2010

The Australian wine industry is unique

The grape and wine industry has a highly sophisticated value chain and is firmly on the international stage. The industry requires significant knowledge development, brokering and analysis functions that GWRDC facilitates and provides.

Our industry is one of the few rural industries that value adds its raw product (wine grapes), turning them into the finished product before it is purchased by an Australian consumer or leaves our shores. Our R&D levy is collected along the value chain (i.e. $2/tonne from the grape grower and $5/tonne from the wineries) and our R&D effort spans much of the value chain. With most other commodities the R&D levy is collected only from primary producers and generally the R&D effort is focussed just on production. Yet there is a common set of rules for all industries with respect to government matching funds, and in our view, this is a shortcoming of the current rural RDC system.

Furthermore, GWRDC is much more than just an R&D funding organisation. In addition to funding research and disseminating information, we have a research brokerage role to ensure that duplication is minimised. We also have the capacity to enhance and extend benefits by looking at additional scope for a given topic and we act as a clearing house of information both in an international and domestic context.

It could be argued, however, that the grape and wine R&D and marketing efforts lack integrity because they do not operate seamlessly along the entire value chain. This is because there are two separate organisations servicing the grape and wine industry's needs for R&D and marketing, namely GWRDC and the Australian Wine and Brandy Corporation (AWBC). We can understand industry's argument for a fit-for-purpose organisation that services the whole of the value chain for the grape and wine industry.

Unlike other commodities, in some cases value adding in grapes and wine is not something you do *to* the commodity, it's actually creating value *around* the commodity. There are many examples where what we are selling is an experience, a connection with a place, with people and with stories. With wine it is possible to add value by doing nothing to the product itself but by simply selling the story differently. Moving from a volume- and production-focussed industry to a value- and profit-based industry is where the grape and wine industry needs to head, which is perhaps in contrast to some of the other rural industries.

Case Study: Commodity-based industry — no such thing?
Within the grape and wine industry, there is a broad spectrum of business sizes ranging from large multinational corporations, to medium-sized enterprises, down to small, family-owned businesses, and the public good outcomes from research are very different across these different enterprises. It is not clear how the proposed PC plan to establish RRA would accommodate these differences, as it appears that a 'one size fits all' approach is being proposed. There is arguably as much diversity within the grape and wine industry as there is across different industries, meaning that the range of issues that need to be considered is cross sectoral on the commodity axis (e.g. large vs small wine businesses) as well as on the industry axis (e.g. wine vs grain).

Rural R&D will continue to help agriculture maintain pace despite declining Terms of Trade

A well-known phenomenon across agriculture is the declining terms of trade for agricultural produce experienced over time. In order to keep pace with this operating condition, producers have had to continually improve productivity or generate additional value per unit of product or both. Producers who have been unable to achieve such improvements have either been forced to exit the industry or have gradually eroded the equity of their business.

Application of outcomes from rural R&D has enabled rural industries to keep pace with the declining terms of trade, but it certainly has not enabled those industries to 'get ahead' of this phenomenon. Another way of saying this is that the outcomes from R&D allow the rural industries to maintain parity in a competitive world and those industries will go backwards in the absence of R&D and the subsequent innovation that takes place in industry using the outcomes of R&D.

R&D is unable to solve every challenge faced by rural industries however. Exchange rates, the cost of finance, the cost of labour and trade barriers are all examples of operating conditions that are out of the control of producers. However, the rural research effort is one activity that rural industries can have some influence over, and rural industries have been active in contributing to the research effort for many decades via the RDC model with great success, enabling them to maintain pace in a highly competitive world.

Another way for the grape and wine industry to maintain pace in the face of declining terms of trade is to grow the size of the wine category within the consumer base globally and then to expand Australia's market share within that larger base. Clearly, to achieve this, an integrated whole-of-value-chain approach, where marketing operates 'hand in glove' with R&D is essential if we are to move from a production-focussed industry to a profit-based industry. Marketing for wine is addressed more directly in other sections.

Case study: Competitive Advantage through R&D

GWRDC makes investments to help the Australian grape and wine industry maintain a competitive edge in the marketplace. An example is the extensive and rigorous research effort into removing winemaking faults and delivering a consistent, fault-free product to consumers. Australian wine is now recognised around the world as being high quality and fault free but, while such innovation creates a point of difference, it does not always equate to a competitive edge over our competitors. The rapid uptake of R&D by our competitors is a constant threat as in some cases they have been in a better position to translate discoveries into competitive advantage. This may require a change in our investment strategy with a view to protecting those discoveries that enable the Australian wine industry to maintain a unique position in the marketplace, however, this is difficult with the larger levy payers being multi-national corporations.

The flip side is that Australia's rural industries also gain a lot of information from international R&D efforts. However, this would not be the case if we (Australia) did not have something to bring to the table. We would not gain access to the large pool of R&D information overseas if there was not some form of knowledge exchange and much of this information generated is funded via the GWRDC. It gives us a seat at the global R&D table and gives the Australian industry the opportunity to exploit international discoveries faster than our overseas competitors. Hence competitive advantage through application of R&D works both ways with those who can innovate the fastest being the beneficiaries.

It is acknowledged that the rural RDC model works well and is revered across the world

The PC review acknowledges there are no serious faults with the rural RDC system and highlights the importance of the government funding contribution to the RDCs and to the sustainability and profitability of Australian agriculture and we agree. It is clear that without this funding there would be less innovation and growth in the industry – particularly because of the fragmented nature of industries and the difficulties in the whole of industry gaining the benefits of private R&D investment. Rural industry needs the aggregation of the R&D effort through the mandatory levy to succeed and the RDC model provides this. The R&D that is commissioned by RDCs would not be done by private companies. It is also commonly reflected that Australia's rural RDC system is revered as the world's best model to fund rural R&D. In the USA, the wine industry is twice the size of Australia's but only raises $1.5 million voluntarily for R&D and very little research is done by individual companies.

The RDC model is critical to the future growth of the agriculture sector. Over a 30 year period (1974–75 to 2003–04), Australian farms have consistently achieved average multifactor productivity growth of 2.8% per annum. No other industry, with the sole exception of telecommunications and information technology, comes close to this achievement (Australian Government Productivity Commission, 2005). The work of the rural RDCs is responsible for 'seeding' much of this growth.

Significant public good does emerge from rural RDC investment

The draft report suggests there is not enough public good coming out of the rural RDCs and this is a rationale for redirecting and reducing public funding. We believe that there are three issues here: the definition of public good, the need for a clear direction from government on the desired outcomes, and a better demonstration and reporting of the public good benefits being achieved. The rural RDCs would be assisted by a clear definition of what is meant by the Government when they use the term 'public good'. There is also an absence of clear direction from Government as to what specific outcomes we are seeking to generate collectively in the area of public good.

We believe that nearly all investment in RDCs has public good benefits including:

- environmental stewardship—looking after our natural resources for the future
- regional development—ensuring profitable industries for regional areas, and
- social cohesion—contributing to the viability of regional communities.

A large proportion of investment has public benefit to all Australians through the sustainable management of natural resources with the reality that many rural towns would cease to exist in the absence of strong rural industries around them. The rural industries are custodians of a vast proportion of Australia's land mass, and the RDCs have been providing them with the tools and information to help manage that resource into the future. With this in mind we would argue that more, not less, funding be put towards rural R&D.

Over time, the RDCs have been working on broader, cross-sectoral issues that have aligned with the national rural R&D priorities and the national research priorities. Clearly, this review highlights that this effort is not working as Government would like and we do believe there is the potential to continue to improve the efficiencies through greater collaboration and cooperation. We understand

and respect that a partner providing close to 50% of the funds would want their priorities embedded within the activities funded by rural RDCs. However, this expands the scope of what is expected from the rural RDCs without providing clear guidelines on what is expected from those funds.

The PC recommendation for increased investment for cross-commodity issues is supported, however, our view is that the establishment of RRA is not the most effective mechanism to achieve this. We would contest that 'structure needs to follow strategy' and that the strategy needs to be more clearly thought through before jumping to the solution of what the structure should be (e.g. RRA). Another mechanism to be considered is contribution to programs or projects by individual RDCs on an as-needs basis.

Government investment into RDCs warrants closer scrutiny

We recognise the concerns raised around the responsiveness of the RDCs to government priorities and, given that the government contributes around 50% of the R&D investment, increased accountability and improved governance should be expected and is supported.

In terms of how to accommodate more Government input, the process we propose is for input into RDC's strategic and operating plans in terms of activities and priorities. This would provide a more strategic approach to research by Government feeding into the planning processes. If this were done properly, the need for a Government representative on the RDC Boards would be redundant.

The proposed focus on evaluation is welcomed as this will enable RDCs to assess the value for money and adopt continuous improvement principles. There would also be an increased focus on the impact of both public and private investments and the promotion of success.

Notwithstanding this, we would seek increased clarity about what is requested by government from their investment as well as a process to develop and report regularly against the government priorities. Embedding the cross-sectoral framework within the RDCs is difficult as the scope of the framework is wider than the RDC mandate and it may result in cost shifting.

Reducing the amount of funding to the RDCs is not an evidence-based decision

GWRDC is surprised that the PC has come to the conclusion that the rural RDC system works well and then recommends that government funding should be halved as the PC predicts that additional industry contributions will replace the reduced government funding. There appear to be other motives at play as this does not appear to be an evidence-based decision.

The overview of the draft report states, 'The current arrangements involve large subsidies for research that primary producers would often have sound financial reasons to fund themselves'. However, the PC review provides no evidence or examples to substantiate this claim. This statement could be interpreted as implying that the RDCs are investing where there is no market failure, where industry would invest in their own right. This is not the case. It would be of no surprise to the PC that GWRDC, like all the RDCs, has a policy whereby it refrains from investing where there is no market failure.

The federal funding for RDCs (as estimated in the PC review of $218m) is less than 15% of the total pool that goes to rural R&D nationally. When combined with levy payments, this totals $466m, which means that collectively *the rural industries* have direct influence over 31% of the *total funding pool for rural R&D* in this country, which does not seem unreasonable.

The suggestion that industry should spend more on rural R&D is easy to make but much harder to achieve. Industry would argue that they contribute a great deal to government funding via income tax, company tax and alcohol excise as well as to state government revenue. Overall federal tax revenue has increased linearly for a decade but, on the flip side, primary producers (e.g. many grape growers) are currently operating at a loss and it would be very difficult to convince them to spend more on R&D through higher levies in the current climate.

Another factor to consider is that the cost of R&D is subject to inflation, which is constantly rising, but it is being funded from a relatively flat (and in some industries declining) income stream. This means that there is less research effort overall each year in real terms. A combination of the rising cost of research and a halving of government funding would leave a massive hole in the rural R&D sector.

Finally, the reduction in matching funds from government on the basis that not enough of the government funding is used for public good outcomes is questionable given that nearly all investment in RDCs has public good benefits, including environmental stewardship, regional development and social cohesion within rural communities. We would welcome clearer government guidance about the public good outcomes they desire us to report against.

Case Study: Innovation Pipeline

It needs to be acknowledged that the Government and RDC funding only contributes to a proportion of the innovation pipeline. Innovation is driven by industry and research (and the funding of that research) is a small part of the cost of securing a process improvement or a new product. The table below outlines the continuum of research, adoption and innovation that takes place and who funds which area, using yeast research as an example.

	Basic research	**Strategic research**	**Applied research**	**Application**	**Adoption**
Research	gene discovery	genes for flavour compounds	selecting yeasts with favourable characteristics	winemaking trials	commercial adoption
Funder	Government funding	Government & industry funding	Government & industry funding	Industry funding	Industry funding

Draft Recommendations, Findings and Information Requests

In this section of the response, GWRDC will provide specific feedback on those Draft Recommendations, Findings and Information requests that it deems appropriate to contribute to.

Overall spending on, and funding for, rural R&D

Draft Finding 5.1

GWRDC endorses this finding as we believe being prescriptive about the amount of funding could be unnecessarily limiting to what is achievable from the rural sector in terms of both 'public' and 'private' outcomes.

Draft Finding 5.2

GWRDC supports this finding, however, we would ask the government to clearly articulate the sort of 'socially valuable' research from public funding that it expects and refers to in this finding. This would help the rural RDCs more closely align with these priorities.

Public funding principles

Draft Recommendation 5.1

GWRDC supports the recommendation that public funding should be governed using principles stated in the recommendation. This recommendation constitutes sound governance and given the quantum of public funds going into rural R&D this seems reasonable. In addition to this, GWRDC would suggest that actual decisions around how funding is allocated should be evidence based and transparent.

Draft Recommendation 5.2

GWRDC supports this recommendation.

Draft Recommendation 5.3

GWRDC supports the recommendation to establish a mechanism to better inform and coordinate the totality of its funding for rural R&D.

Changes to the configuration of, and funding for, the RDC model

Draft Recommendation 7.1

In Draft Recommendation 5.1, it states that it would be inappropriate to establish a target level for overall spending on rural R&D. However, implicit in Draft Recommendation 7.1, an amount is prescribed for how much rural R&D funding should be apportioned to the proposed public benefits RDC Rural Research Australia (RRA), in the absence of any detail around what this would be used for or a business case outlining proposed benefits from this investment.

Furthermore, we believe that the recommendation that the cap on matching contributions for all statutory levies be reduced from 0.5% to 0.25% of an industry gross value of production over 10 years is far too severe to ensure a sustainable level of rural R&D in the long term. One size does not fit all industries. Considering that inflation increases the cost of R&D every year even within the current framework, the amount of research that can be purchased declines each year. Hence, GWRDC doesn't support Draft Recommendation 7.1 to appropriate $50m for RRA or halving of the matching GVP cap over a 10 year period.

As discussed in the introductory section of the document, a generic set of rules for matching the statutory levies applied across commodities assumes all are equal, which of course they are not. The export levy, the wine grapes levy and the grape levy administered by AWBC and GWRDC, spans the value chain, hence our collective investments benefit participants all along the value chain, which is distinct from many other primary industries, where in many cases the levy just focuses on the production end of the spectrum. For this reason, an alternative mechanism for government matching funds could be a differential GVP cap according to how much of the value chain they have coverage of.

The recommendation to decrease the amount of funding to the RDCs over time doesn't appear to be evidence based and will leave a large gap in the national R&D effort. In particular, the longer term, 'blue sky' research will be the most likely to suffer. This sort of R&D is high risk, hence industry is unlikely to support on its own. Strategic R&D is often the source of step change breakthroughs, which will allow agricultural productivity to continue to grow to meet food security needs of the future. The question is, in the absence of significant government support, who will fund this type of research into the future?

In response to the information request on page XXXIX, it is the view of GWRDC that the programs in place within LWA were the sort of non-industry specific rural R&D that is relevant to promoting productive and sustainable resource use by the sector. This would certainly be a good starting point. In relation to consolidating funding and management of research that is currently the responsibility of other entities, MCVP and NPSI were absorbed by GRDC and CRDC respectively. It is our view that prescribing $50m towards an organisation like RRA in the absence of a clearly articulated business case of what topics such an entity might cover and what the outcomes might be is misguided. The level of funding required for such activity would be the final step in that process in our view.

The final information request is a moot point as we don't believe setting a predefined target is the way to go, as previously discussed.

Principles to guide the future operation of the RDC program and changes that give effect to those principles

Draft Recommendation 8.1

In response to Draft Recommendation 8.1, GWRDC supports this recommendation and is of the view that we achieve most of the points mentioned to a high degree already. The following points illustrate this:

- We believe we have a well balanced research program with an adequate balance of research spanning the spectrum from low to high risk
- We have a number of mechanisms in place to ensure timely adoption of research results, examples include the GWRDC Innovators Network, GWRDC Regional Grassroots program and AWRI Roadshows to name a few.
- Our funding is only ever used for R&D and related extension purposes and we do our best to promote effective communication with industry stakeholders, researchers and the Australian Government.
- We do publish information on the outcomes of all completed research projects in a timely manner, generally within 30 days of the final report being submitted.
- We already have a board selection processes that results in our board possessing an appropriate balance of relevant skills and experience
- We continually pursue ongoing improvements in administrative efficiency. Examples of this are our current discussions about co-locating with the AWBC and the two peak bodies, WFA and WGGA, and about merging with AWBC. These moves will create financial savings and ensure that the four organisations are more strategically aligned.
- In relation to ex-ante and ex-post project evaluation, we haven't conducted a great deal of ex-ante evaluation however we have done a considerable amount of ex-post project evaluation. We have also conducted a number of significant ex ante reviews in recent times to guide future investments in certain areas identified as generic knowledge gaps.
- We have not participated in an independent performance review, but would have no problem in doing so. We have participated in independent reviews of the value of the research we have funded.

Draft Recommendation 8.2

GWRDC has no objection to Draft Recommendation 8.2.

Draft Recommendation 8.3

Draft Recommendation 8.3 proposes the addition of marketing to the function of statutory RDCs. Currently the GWRDC only funds pre-competitive, sector wide marketing research. However, the grape and wine industry's peak organisations (WFA and WGGA) have indicated that they see benefit in the integration of the R&D and marketing organisations for the grape and wine industry (which are currently undertaken by the GWRDC and AWBC respectively). To create a truly integrated R&D and marketing organisation that services the entire value chain for the industry. However, not all of the functions of the AWBC would fit within an RDC framework (e.g. compliance) and they would need to operate outside a merged organisation.

In relation to the case for making industry representation an allowable function for any RDC, we would see this as a conflicted position. Our view is that keeping the peak bodies at arm's length is a better way to go and gain their input via strategy setting and planning.

Draft Recommendation 8.4

With a view to accommodating more Government input in to the RDCs, the process we propose is for input into our strategic and operating plans in terms of activities and priorities. If this is done properly, the need for a Government representative on the RDC Boards would be redundant. This would provide a more strategic approach to research by Government feeding into the planning and review processes.

Currently our Board selection process is competency based and we are of the view that it would be a backward step to move to a representative structure. If we support the concept of a competency based board, then perhaps we need to review the scope of competencies to address what is required from government.

Draft Recommendation 8.5

GWRDC has no issue with Draft Recommendation 8.5 as we already participate in the regular program-wide evaluation process that is currently facilitated by the Council of Rural Research and Development Corporations (CRRDC). Improving the robustness of the evaluation using the suggested strategies is a sound approach.

Draft Recommendation 8.6

GWRDC has no issue with Draft Recommendation 8.6.

Draft Recommendation 8.7

GWRDC has no comment on Draft Recommendation 8.7.

Levy Arrangements

Draft Recommendation 9.1

Removal of product specific maximum levy rates from the Primary Industries Levies Act 1999 seems like a futile act if the implication is that industry will then pay higher levies. Each industry has in place the amount that it can bear and seeks approval when it wishes to increase this.

In relation to the information request associated with Draft Recommendation 9.1, GWRDC takes the view that the research and marketing levies should be kept separate to allow for transparency from the moment the levy is collected right through to the point at which it is spent. The rural RDCs should be able indicate in their research plans what the forecast split is going to be, which will require sign off by their peak bodies anyway. This would abrogate the need to seek the formal approval of levy payers.

Draft Recommendation 9.2, 9.3 and 9.4

GWRDC has no comment on Draft Recommendation 9.2, 9.3 and 9.4.

Draft Finding 9.1

GWRDC has no comment on Draft Finding 9.1

Draft Finding 9.2

GWRDC concurs with Draft Finding 9.2. While we know we aren't required to precisely calibrate the expected regional distribution of the benefits of our portfolio within the regional distribution of levy payments, we do ensure that the majority of our research has a national focus and that the larger levy paying regions are accommodated adequately. Furthermore, we have a regional extension program where funding that is distributed within regions is apportioned based on levy payments.

Draft Finding 9.5

GWRDC has no comment on Draft Finding 9.5 other than to say it does not agree with the proposal to halve the amount of funding provided to RDCs over a 10 year period.