



26 November 2010

RDC Inquiry
Productivity Commission
Locked Bag 2 Collins Street East
MELBOURNE VIC 8003

Re: Response to Productivity Commission Draft Report – Rural Research and Development Corporations

The Cattle Council of Australia is the peak producer organisation representing Australia's beef cattle producers. The objective of the Council is to represent and promote the interests of Australian beef cattle producers through wide and regular consultation with, and policy advice to, key industry organisations, relevant Federal Government Departments and other bodies regarding issues of national and international importance to beef cattle producers.

Cattle Council appreciates the opportunity to comment on the Productivity Commission's draft report on Rural Research and Development Corporations, released September 2010.

Cattle Council has some comments on the scope of the draft report, the distribution of public and private benefits from rural research and development and comments on the proposed Rural Research Australia. We also have comments on some specific recommendations to reduce funding to the RDCs and the recommendations and information requests on levy and review arrangements in Chapter 9.

Please accept our submission.

Yours sincerely

Greg Brown
President



Abbreviations

CCA – Cattle Council of

CRC – Cooperative Research Centre

DAFF – Department of Agriculture, Fisheries and Forestry

GVP – Gross Value of Production

MLA – Meat and Livestock Australia

NRM – Natural Resource Management

R&D – Research and Development

RDE – Research, Development and Extension

RRA – Rural Research Australia

Rural Research and Development Corporations

Response of Cattle Council of Australia to the Productivity Commission Draft Report, September 2010.

1 Executive Summary

Cattle Council welcomes the Commission's findings that the RDC model is fundamentally sound and that an entirely different approach would be unlikely to deliver as good an outcome for the community. The finding that RDCs are working effectively as investors in RDE on behalf of industry is consistent with Cattle Council's experience with the industry services body MLA.

Cattle Council endorses the set of guiding principles for RDCs in Draft Recommendation 5.1 and we believe that MLA is already aligned with these.

The proposed measures to improve evaluation and reporting mechanisms are welcomed, so long as they can be implemented in a simple, low cost mechanism that allows for accumulation of program wide evaluations.

The proposals to abolish maximum levy rates and streamline the levy setting and amendment process are sensible, given that strong industry support is still required before changes can be made.

Cattle Council strongly disagrees with the recommendation to reduce the Government contribution to RDCs on the basis that it will not deliver improvements in the efficiency of the rural RDE framework and will have several unintended consequences.

Recommending cuts to the RDCs will have a negative impact on the functioning of the broader rural RDE system. Rural research require increased resourcing, not less, to equip Australia's farmers with the tools and technologies to manage future challenges of improving productivity in an environment of increasingly limited resources.

Given the positive findings on RDC performance and the recognition of the important role that RDCs play in the rural RDE framework, the Commission's recommendations should focus on improving the efficiency of the broader rural RDE framework. This could be achieved by setting clear national priorities for rural RDE and aligning the deployment of public and private resources to maximize the delivery of benefits for industry and the broader community.

2 Scope of the Draft

Cattle Council supports the National Farmers Federation view that the immediate priority of Government, in partnership with industry, should be to establish a set of outcomes for Australia's rural RDE system to deliver. It should then consider if its investments are adequately aligned, sufficiently resourced and sensibly distributed to deliver those outcomes.

Australia's beef cattle producers, and the rural sector more broadly has the potential to contribute to several major public policy challenges facing Australia, such as managing future population pressures, Australia's response to climate change and the management of biodiversity, carbon and water. Australia's capacity to respond to these challenges will be driven by:

- investment in research and development to identify new technologies and practices to address these future public policy challenges;
- productive, profitable and resilient rural industries and communities to implement new technologies and practices and to support regional development.

While RDCs form only part of the rural RDE framework, they are a critically important component, particularly in applied and adaptive research. It is Cattle Council's view that any reduction in the Government contribution to RDCs will have a negative impact on the efficient functioning of the rural RDE framework which will have flow on impacts on the productivity and profitability of the rural sector and in turn, Australia's capacity to respond to these major public policy challenges.

In all likelihood, a greater investment in RDE will be required to respond to these challenges. However, without looking at the broader rural RDE framework, the Government cannot identify where it is likely to achieve greatest return on its investment.

In its draft report, the Commission was limited by the Terms of Reference and did not extend the inquiry beyond the rural RDC's to the broader rural R&D framework. However, the recommendation to reduce the Government contribution to RDC's will have impacts on the broader rural R&D framework that have not been considered in the Draft Report. Without considering, or modeling the impact of reduced overall funding for RDCs on the broader rural RDE framework, the reduction becomes a test or experiment on how the system responds.

3 Proposal to reduce Government funding for the existing, industry specific RDCs to half the current rate.

Cattle Council's primary concern with the Draft Report is the recommendation to reduce the cap on Government matching contribution to existing RDCs from 0.5%GVP to 0.25%GVP. Cattle Council believes this move, if implemented, would have unintended consequences resulting in detrimental effects on industry productivity, rural research capacity and the amount of additional, socially valuable, research conducted in the rural RDE sector.

3.1 Impact on additional socially valuable research

The Commission's draft report places a lot of weight on the concept of 'additionality', the amount of additional, socially valuable research purchased by Government matching funding to RDCs. Cattle Council members have reported that State research agencies are increasingly making the funding of research projects contingent on external funding from RDCs. For many State run research programs, the majority of State contribution is 'in kind', with the bulk of project expenses coming from RDCs. If overall

funding to the RDCs is reduced, there will be less funding available to contribute to State research programs, fewer research programs will be run and with resources sitting idle, the pressure will increase on State agencies to further reduce their research capacity.

The Commission makes the point (p108) that RDCs are investing in too much short term, low risk, near to market research. Cattle Council does not believe this assertion applies to MLA, which invests in a balanced R&D portfolio consisting of strategic, development and applied work. Clearly with a smaller Government and larger private contribution, the focus of RDCs would shift more towards short term, low risk and near to market projects in order to demonstrate returns to the levy payer. This would skew research activity away from longer time frame, higher public benefit research activities.

3.2 Willingness of industry to replace Government funding

In its Draft Report, the Productivity Commission anticipates that the private sector will respond to any reduction in public funding by increasing its own contribution through levies and private investment. While producers value research and development, they are unlikely to make the perfect market response that the Commission might expect.

Cattle Council is concerned that if Government contribution to research and development is reduced as recommended, that producer support to increase the levy may not be forthcoming, and in fact support may actually decrease. There are two pieces of evidence that suggest this may occur

1. The high returns from investment in RDC projects (shown in project evaluations and acknowledged by the Commission in its draft report) indicate that there is already significant underinvestment in R&D and is evidence of continued market failure in R&D investment. The Commission's draft report claims that market failure issues in rural research and development are resolved by compulsory levies, this is not consistent with the evidence.

Cattle Council, as one of the peak bodies responsible for recommending changes to the cattle transaction levy to the Minister for Agriculture, is not receiving pressure from members to seek an increase in levies, despite the evidence of high returns.

2. In New Zealand, where no Government matching funding for research and development exists, producers last year opted to cease paying the wool levy, effectively choosing not to invest in research and development. Australian Producers on the other hand, in the most recent levy poll, voted to retain the wool levy despite the problems with the industry services body highlighted throughout the Commission's draft report.

The result of the New Zealand levy vote is not consistent with the Commission's prediction that producers will increase contributions to research and development to reach the optimal investment level.

The experience of Cattle Council is that the focus of producers when it comes to levy expenditure is on growing market demand for product. Rightly or wrongly, producers see gains in market access and

increasing domestic demand as more likely to deliver stronger returns sooner than the investment of levies in research and development, which will deliver productivity gains over a much longer period of time.

The lag times from commissioning research, through to development, extension and adoption to pay back acts as a disincentive to investment of levy funds in RDE, a point highlighted by many submissions to this enquiry. This disincentive is balanced by the incentive of Government matching funding to maintain producer commitment to paying the RDE component of the levy.

The Draft Report notes (p36) that the compulsory levy is well supported and well regarded. As Cattle Council put in its original submission, the matching funding is a large part of what underpins producer support for the R&D levy. The R&D component of the levy is well supported because of the matching funding arrangement.

Matching funding for research and development is fundamental to maintaining producer commitment to fund the sorts of long term research needed to deliver a competitive and sustainable industry in the future. Without the incentive of matched funding, producers will tend to focus on marketing and market access activities, which are of critical importance, but will not in themselves deliver the long term productivity gains that will be needed by industry to manage future production challenges in an environment of increasing resource scarcity.

3.3 Influence on rural research capability, capacity and future skills

Cattle Council is concerned that the recommendation to reduce the public contribution to RDCs will have adverse impacts on the broader rural RDE framework, particularly on the research community that is drawn on to do both industry and public benefit research in agricultural and natural resource science.

Several submissions to this inquiry mentioned the challenges Australia faces in the areas of natural resource management, agricultural production and global and domestic food security. Many of the current leading scientists in these high public benefit and public interest fields 'cut their teeth' on applied, near to market rural RDE. The training ground for Australia's future rural RDE capacity is the research commissioned by RDCs and any withdrawal of funding in this area will have an adverse effect on opportunities and development of young researchers that will form Australia's future RDE capacity.

A compounding influence of the reduced Government contribution to rural RDE is the message it sends to young people interested in rural sciences. Intentionally or not, prospective researchers and students will interpret the reduced Government contribution as reflecting a low priority of importance placed by Government on agricultural science.

In the Australian beef industry, any reduction in MLA's research capability will be compounded by the winding up of the Beef CRC, scheduled for 2012. The beef industry has been advised that after three successive, successful iterations of the Beef CRC, there is unlikely to be funding for another beef industry specific CRC.

3.4 Impact on the Broader National RDE Framework

Cattle Council is supportive of the intent of the National Research Development and Extension Framework to promote greater efficiency between rural research agencies and improve alignment between industry and Government research priorities. Cattle Council has some concerns that despite commitments not to do so, some State agencies will see the National RDE Strategies as an opportunity to withdraw resources from RDE activity.

Given the changes already underway to the rural RDE system through the National Research, Development and Extension Framework, it is Cattle Council's view that it would be unwise to conduct a secondary experiment to reduce funding to RDCs over the same period.

4 Distribution of public and private benefits

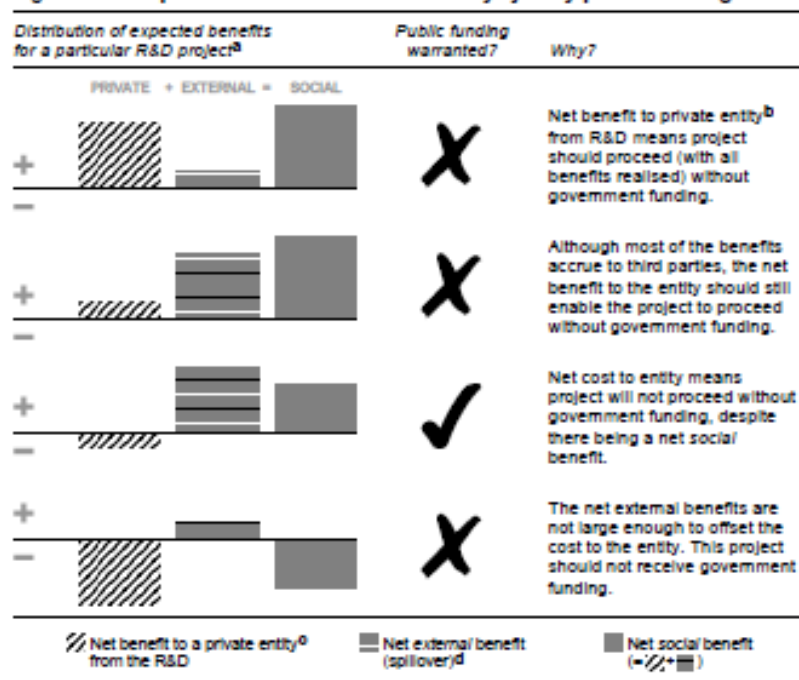
Cattle Council does not accept the findings of the Draft Report (Chapter 7) that the agriculture sector receives comparatively generous support from Government through the RDC model. Arguments against this finding have been made by many of the initial submissions detailing both on the level of support to industry relative to other industries and agriculture (Dairy Australia, Across Agriculture) and on the range of market failures in the rural RDE system that require Government intervention (Cattle Council, Across Agriculture, Dr John Mullen). While compulsory levies address some market failures, they do not address all, such as the large number of independent, geographically dispersed business that make up the agriculture sector and the contribution agriculture makes to managing Australia's natural resource base.

The Cattle Council understands the reasoning in the Commission's draft report (Chapter 5) that the private sector should fund RDE that delivers private benefit and the public sector should fund RDE that delivers public benefit. However, the draft report appears to assume (Chapter 3) that rural RDE projects can be evaluated prior to commencement (ex-ante) for the likely distribution of public and private benefits. In reality ex ante evaluation is very difficult to execute and all projects will contain a mixture of private and public benefits. It is difficult to know on commencement of research what the outcomes and products will be, where spillovers will occur and what direction the research might take an industry.

Cattle Council believes there is greater scope for meaningfully distributing funding between Government, Industry and individuals in the area of extension, by evaluating the distribution of public and private benefits after the research is conducted (ex-post), when it is possible to conduct a more accurate analysis. This point is discussed later in this submission.

Cattle Council has some concerns over the reasoning used by the Commission to support Figure 1 (below) in the Draft Report which appears to suggest that Government should only invest in RDE that is expected to deliver negative private benefits and positive net social benefits.

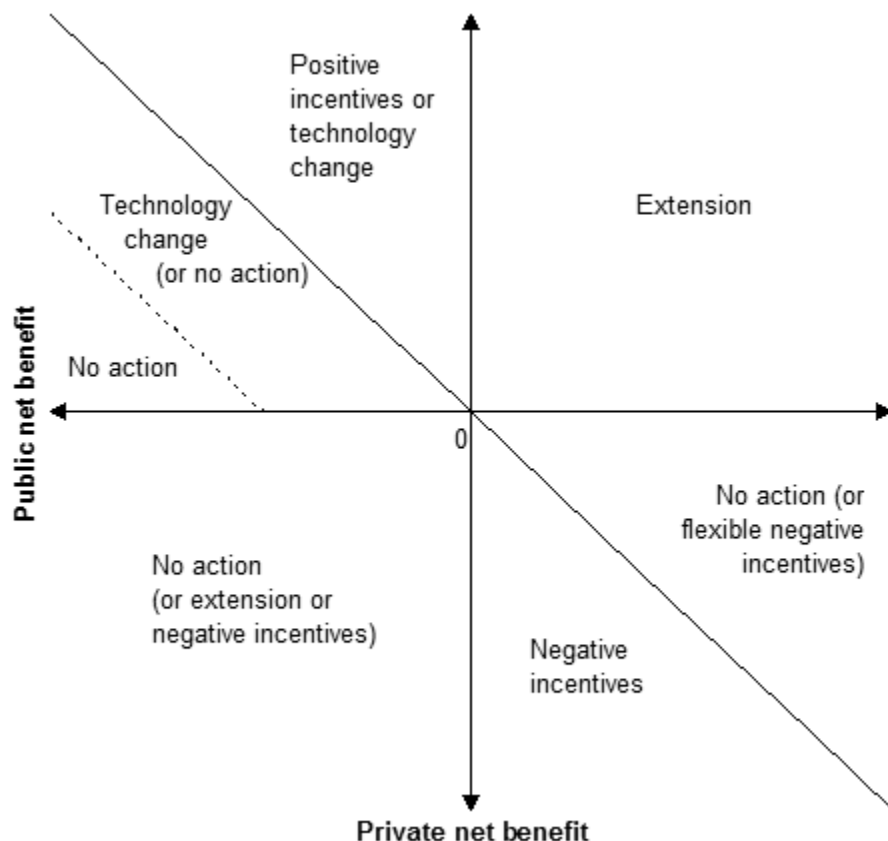
Figure 1 Spillovers from R&D do not always justify public funding



Cattle Council's concern is that investment in research and development that delivers negative private benefits will not be adopted and will therefore be largely wasted. The only exceptions to this being where a technology or practice gives industry a 'community license to operate' or equips industry to manage a future regulatory or environmental challenge.

In the paper 'Public benefits, private benefits, and the choice of policy tool for land-use change', David Pannell explains a set of principles for selecting appropriate policy tools to encourage or discourage land use practices based on the mixture of private and public benefits they deliver. Figure 2 below supports the Commissions view that research and development should be targeted at practices that deliver positive public and negative private benefits, to drive technology change to make the land use profitable. Where Pannell's model differs from the Commission's thinking is in the role of Government in funding extension, particularly for high public benefit R&D. Cattle Council believes that public expenditure decisions based on this framework would be more effective than under the framework outlined in Figure 1 in the Draft report.

Figure 2: Efficient policy mechanisms to deliver public benefits from agricultural practices or technologies



The most effective use of public RDE funds to achieve environmental outcomes is to convert practices or technologies that deliver large public benefits from marginal or unprofitable to profitable. This, for a small investment of public money, has the potential to lead to very high public benefits as the practice is taken up more widely. Once a new technology or practice that delivers large public benefits is proved through appropriate R&D to be profitable, Government should be investing heavily in extension to boost adoption. The Commission's draft report should be amended to reflect this.

5 Extension

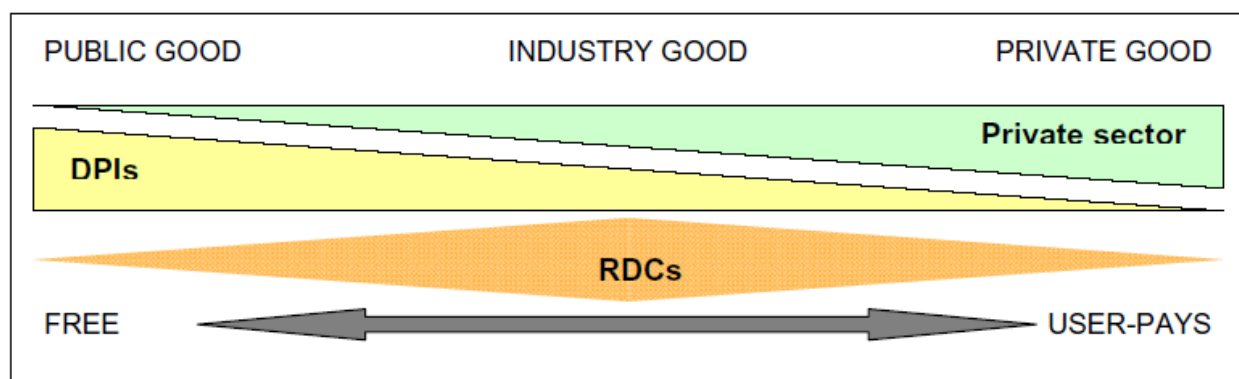
In its draft report, the Commission recognized the importance of extension, that extension activity was performed well by the RDC's and acknowledged that State Governments have been progressively withdrawing effort in extension activity. The draft report however glosses over issues of who should pay for increased effort in extension and adoption of rural RDE.

Cattle Council believes there is a greater role for private sector involvement in extension for high private benefit technologies and practices, we also believe there is a strong case for increased Government funding for extension activity for research and development outputs that deliver modest private

benefits and high public benefits. The need for additional funding in this area has been overlooked in the draft report.

Cattle Council has endorsed principles for investment in extension developed by Meat and Livestock Australia. The principles are based on investing levy funds in extension activities that achieve the broadest industry good in a way that does not crowd out private sector involvement.

Figure 3: Role of Private, Public and Industry investment in the Extension Framework



State Governments are rapidly withdrawing resources from extension and increasingly calling upon RDCs to fund extension activity, particularly in the 'middle ground' of programs that deliver a mixture of private and public benefits.

It is Cattle Council's view that the Draft Report could be improved by giving greater consideration to extension and adoption of rural R&D and recommends increased Government funding for extension of technologies and practices that deliver public benefits.

6 Rural Research Australia

The Commission's draft report seeks comments on the scope and purpose for the proposed Rural Research Australia (RRA). Cattle Council sees some positives for RRA to replace cross industry research in the areas of soil, water and vegetation management that has suffered from underinvestment since the winding up of Land and Water Australia. However, the new body would be similarly exposed to future funding cuts and CCA is concerned about the cost and disruption to the RDE framework if RRA is to meet the same fate as its predecessor.

Cattle Council has some additional concerns about RRA if it is intended to have responsibility for all 'non industry specific research and development', leaving the existing RDCs to focus on industry specific, productivity focused research and development. If RRA were to be given this remit, it would act as a disincentive for the other RDCs to engage in cross industry, public good RDE where opportunities might arise. This would be at odds with the rationale for Government investment in rural R&D and against the intention of this review.

The Commission in its final report may consider suggesting alternatives to the proposed RRA to deliver the same public benefit outcomes. For example, the Government could commit the same quantum of resources to achieve a set of desired outcomes in research into land, water and energy use and allow the existing industry RDCs to tender for those resources to deliver the desired outcomes. If the research is delivered through the industry RDCs it is more likely to result in outputs that deliver both public and private benefits and therefore more likely to be more widely adopted by industry, increasing the overall public benefit.

Cattle Council would have concerns with the impact of research and development outputs from Rural Research Australia on the rural extension and adoption framework if, as proposed, it is to focus only on projects that deliver public benefits with no or negative private benefits. If the extension of RRA outputs will be delivered through the same network as the productivity focused R&D outputs from other RDCs it would lead to confusion amongst producers and impact negatively on the effectiveness of extension for both the proposed RRA and the existing RDCs.

7 Improvements to Governance Arrangements

Cattle Council agrees with Draft Recommendation 5.1 to establish an overarching set of public funding principles, and we believe that the operations of MLA are consistent with those principles. We are also supportive of Draft Recommendations 5.2 and 5.3 to establish a process to maintain robust data on funding and spending in the rural RDE framework, this will bring much needed clarity to the operation of the overall framework and allow for more informed decision making on future RDE investment.

Cattle Council supports the governance principles for RDCs outlined in draft recommendation 8.1, which we believe are already followed by MLA. Cattle Council supports the requirement for RDCs to undertake regular, comprehensive and transparent program wide project evaluation process proposed in Draft Recommendation 8.5. While this evaluation is time and resource hungry it is critical to ensure MLA continues to deliver value to levy payers and to the broader community.

Cattle Council is supportive of the project evaluation work done to date by MLA and the CRRDC but acknowledges that it can be further enhanced. Hence, Cattle Council supports draft recommendation 8.5 to improve project evaluation and believes the CRRDC has an important role to play in facilitating consistent methodology and reporting of this process across all the RDCs.

Cattle Council has some concerns over the cost of implementing additional reviews and reporting in Draft Recommendations 8.6 and 8.7. These concerns could be resolved if the reviews and reporting could be done through a process of accumulating program evaluation reports, complemented by a low cost audit and review of the governance and administrative arrangements of the RDCs.

8 Proposed Changes to Levy Arrangements

Cattle Council supports all Draft Recommendations in Chapter 9 to review levy arrangements and the levy principles and guidelines to improve regulatory efficiency and remove unnecessary regulation. The

cost of compliance with the way the principles and guidelines are currently administered acts as a barrier to amending an existing levy.

Given that strong industry support needs to be demonstrated to Government for a change in the levy, regulatory constraints such as the current maximum levy rates should be removed.

Cattle Council believes there should be greater flexibility for Government to amend the distribution of levies based on advice from industry if there is no resulting change in the total levy. For example if Cattle Council were to propose to Government that the levies paid to the National Residue Survey be reduced by 2c with a corresponding 2c increase in the levy paid to Animal Health Australia, that this suggestion should be accepted and processed by Government quickly and with minimal cost, provided there are valid reasons for doing so.

Regarding information request 9.3, Cattle Council would be wary of giving RDCs the flexibility to vary RDE and marketing components of the cattle transaction levy without the formal approval of levy payers. Cattle Council sees some value in allowing flexibility towards the end of financial years to shift funding between levy streams when it becomes apparent that significant milestones or contracts will not be completed and an opportunity arises to conduct a timely and targeted RDE or marketing project. It is Cattle Council's view that industry approval should still be required to shift funding between streams towards the end of financial year.

References

Pannell, D.J. (2008). Public benefits, private benefits, and policy intervention for land-use change for environmental benefits, *Land Economics* 84(2): 225-240.