Submission by Robert Ingram to the Productivity Commission in relation to the review of the Rural Development Corporations (RDCs)

Firstly, I would like to thank a number of senior agricultural economists currently working in the industry in both the public and private sector who have provided substantive input, guidance and editorial support to this paper.

Key Points

From my perspective the current institutional set-up for rural R&D suffers from three problems that are insufficiently appreciated by the Australian community:

- Crowding out – a problem common to all public investments which also afflicts public R&D, and given the cost of raising government revenue (30 cents in the dollar on average), an undoubted cause of social waste.

- As innovative and progressive business people in all sectors know, R&D corporations regularly "pinch" ideas from local innovators and then recycle them as industry R&D investments – not good for the innovators, a veil for Corporation laziness, focuses not on genuine areas of market failure, but on areas which are already private goods.

- Subsidy culture causes a loss of focus and a misallocation of funds – this can be seen especially when levy payers meet and make excuses for poor investments – a problem which I think is discussed well in the PC's draft.

The Conundrum Going Forward - Sorting out the Mess and Maximising the return to Producers from the Research Dollar Spend

- There is now a huge entrenched bureaucratic system that seeks to justify itself, both the fund managers (government and so called industry companies) and the researchers. Their issue is to ensure their funding sources for the next three years. The industry's issue is how does it get a more efficient system to make the industry sustainable for this generation and the next.
- The current system is inefficient. In particular it recycles the same technology, indicating that the adoption rates are low and therefore the financial returns to producers are not sufficient to institutionalise the practice at the farm level. Examples can be provided.
- The current system is also inefficient in that the RD&E provided retains inefficient producers in the industry leading to all sorts of market, social and environmental distortions and impacts.
- Innovative, progressive farmers are not substantively rewarded for the comparative advantage that they gain by seeking new knowledge and early adoption and adaption of that technology.
- RD&E organisations plagiarise from leading farmers and then extend that knowledge and innovation across the industry further reducing leading farmers' comparative advantage.
- Not one of the RDC's, state departments or CRC's have said the system is severely inefficient and needs to be substantially restructured - they have all sought to substantively retain the status quo with modifications at the margins.
- One State Department has used the best economists in the world in this field (who support the current model) to justify retention of the existing system.
- The current R&D system through the RDC's and the support they provide to the state departments and CRC doesn't work in the best interests of farmers, the taxpayers, and the social, environmental and economic sustainability of our whole community.
- The current model substantively negates any motivation by the private sector to invest substantially in agricultural research in Australia or for that matter internationally with implications for the developing world. There is a much reduced incentive for the private sector to invest in those areas where subsidised rural research funding is provided. Conceptually, we would expect the RDCs to focus on areas of market failure – primarily where potential investors cannot obtain *enough* of the benefits to justify their investment. These are typically areas of farm management rather than product development. But we see the RDCs showing little regard to the notion of market failure and instead seeking to take the lead in research in whatever the area – genetics, pasture and grain varieties for example. The situation is not helped by producers and their

associations continually calling for RDC action in a whole range of areas. The Commission's approach of a greater relative reliance on levy funding for the RDCs might just see a bit more focus on market failure.

- There is a trend and an ever increasing trend to reduce government funding for agricultural research worldwide. The Commission has argued that it's hard to find a reason to provide preferential treatment for rural research or the rural sector above other sectors *in the Australian economy*. Thankfully the Commission has not fallen for the misguided notion that we need to compare our situation with some overseas situation. The taxpayer will be best served by focusing on the national interest. The Commission should recommend that the Statutory Funding Agreements require the RDCs to focus on demonstrated areas of market failure for both levy and taxpayer funding. I mean demonstrated through transparent ex ante and ex post analysis.
- The issue to be addressed is how do we effectively in a relatively short period of time move from the ineffective, inefficient amorphous mass of RDCs vicariously consuming taxpayer and levypayer funds to one that responds to the market and innovative progressive producers supported primarily by the private sector.
- As mentioned before the issue of pure research needs to be addressed, however, there are existing systems that effectively do this. It's then up to the private sector to adopt/adapt the pure research to industry. This has been done many times by the private sector already. Some pure research becomes institutionalised in farm practices; other research never sees the light of day (perhaps indicating poor initial cost benefit analysis).
- Another issue that needs to be addressed is the cost of externalities of production, (soil minerals & nutritional value of food). There is some evidence that by allowing market driven scale of production to develop this issue is addressed. Hence the point again of not propping up inefficient producers – recognising that lack of scale and inefficiency are closely related in farming. If you cannot effectively address the cost of externalities the only way that you can protect the environment is to provide subsidies in some form to the farming community and or taxes to deter undesirable behaviour. Subsidised research, development and extension may be an option but it needs to be explicitly considered against the alternatives.
- If we make substantive moves to institutionalise private research as the norm for on-farm research and extension there will be market driven adjustments in the scale of production. Structural change will continue to see producers, industries and regions continue to adjust. Sure this might mean net negative local social benefits but potentially it means net positive environmental benefits, and net positive economic benefits and food security.
- In substantively expanding private sector RD&E there needs to be recognition that the current regulatory and policy settings may discourage small innovative start-up companies develop and commercialise their innovations. This is risky investment and there are general economy wide programs to support such interests (and small business at large). The more concerning issue is the extent to which barriers are created by the current structure. Thus there would be a need to review the applicable policy and regulatory settings so as to not discourage small organisations and individuals, from where many innovations come, to make the investment to commercialise their IP.
- If you remove government funding to the RDCs the issue of levy payer funds then needs to be addressed. The RDCs can continue to operate on the basis of levies paid by producers who then set their own research and marketing agendas largely outside influence and control of government — largely because government still has to be involved given that its taxing powers are being used to collect the levies. The issue then arises in regards to growers opting-in and opting-out of paying levies. The issue can be challenged in the High Court to be resolved.
- For an organisation that is perceived as representing the sensible economic argument I am disappointed in the recommendations of the draft report in that it does not go far enough and leaves a "half pregnant" system. If we want to ensure the economic, social and environmental sustainability of our agricultural systems and its productive base (the land) this review provides us with the opportunity of taking the first substantive step to rationalising a system that causes inefficiencies and degradation of the environment. I look forward to the commission's final report that grasps this multiheaded RDC serpent and sets us upon a more sustainable course.

Summary and Recommendations

In view of the above faults:

I ask where does the PC's proposed 25% subsidy recommendation come from? It is 'half of the current 50%', but that is not genuine analysis. For 20 years or more it has been too high a rate for pig and chicken research since it is hard to believe that in industries as concentrated as these and with the scale of production involved, that there is significant underinvestment in R&D due to intra industry unpriced spillovers or inter industry unpriced spillover that would justify government support above the rate applying generally to Australian industry.

I am led to believe that across the whole of industry in Australia the average government support for research and development is about 25%. So if the productivity commission wants to adopt the status quo a recommendation of 25% is politically safe. More importantly it would create a level playing field between industries. Even then 25% might be too high for the farm industries as the matching up to that point includes matching or market research – an area of research explicitly excluded under other R&D support mechanisms.

However, I would urge the commission to take a closer look at the rationalisation of the equivalent to the RDCs and Federal agricultural research institutions in New Zealand in early 90s and in the past two years. Effectively government support was reduced to zero with the government's research responsibility being confined to pure research and areas of demonstrable market failure. This move, combined with a general approach to allowing market signals to determine production and investment decisions, has resulted in an agricultural sector in New Zealand that is now more productive, competitive and innovative then it's Australian cousin. If one looks at a number of agricultural sectors in New Zealand (sheepmeat, dairy, and apples and pears), I would argue that the evidence is that the flow of applied on-farm technology and innovation is from east to west across the Tasman (NZ to Australia) and a substantive part of this is due to the R&D funding and other restructuring that has taken place.

So I **recommend** that in its final report the Productivity Commission, **recommends the full withdrawal of government funding to the RDCs and government funding be provided for pure research and areas of market failure on competitive basis across all industries.**

The rural sector can compete for applied research grants through the standard Department of Industry (and other agencies) processes, like any other Australian business.

I would also **recommend** (noting that the French term for extension is "vulgarisation" which I think given the current situation in Australia allows for a nice play on words) **that the extension and application of the pure research at a farm level be undertaken by the private sector as this will force the pure research institutes to collaborate with the private sector at the earliest stages of research program development thus driving the relevance and potential for practical application at a farm level**.

As presented to the Commission in Melbourne, I **recommend that the issue of compulsory producer levies be left to be addressed by the industry itself, and if appropriate through challenges in the High Court. The commission can review this in 2020.** In the first instance let us address the issue of subsidised research funding and then flowing from that the issue of compulsory producer levies rises to become the contentious issue.

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