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December 20, 2010

RDC Inquiry
Productivity Commission
**LB2 Collins Street East PO**
**Melbourne Vic 8003**

Dear Sir,

This joint submission responding to the Commission's Draft Report into Rural Research and Development Corporations is made on behalf of the following organisations that represent growers in the Murray Valley region: The Australian Dried Fruits Association Inc, Almond Board of Australia, Summerfruit Australia Ltd, Australian Table Grape Association and Murray Valley Citrus Board.

This response focuses on the following issues raised in the Draft Report:

- Capacity to vary split of levy between R&D and Marketing
- The phased reduction of matching funding from $1 for $1 to $0.50 for $1.00.
- Voluntary contribution matching funds.
- New Rural R&D body to conduct joint research.

**Capacity to vary split of levy between R&D and Marketing.**

The industries are strongly supportive of Horticulture Australia's ongoing efforts to achieve greater flexibility under the recommended arrangement.

**The phased reduction of matching funding from $1 for $1 to $0.50 for $1.00**

The industries believe that there is a strong public good aspect to much of the research funded for the inland irrigated horticultural crops that are not only mainstays of the local economies but are also major exporters. Further, we note that governments, through their R&D agencies have already withdrawn significant funding of the public good aspect of rural research as co-funding of projects with these research providers has seen costs increase significantly as proposal budgets have been loaded with infrastructure and management on-costs and the level of funding contributed for researcher and technical officer salaries and operating costs reduced significantly. The CSIRO has also withdrawn altogether from R&D for the horticultural industry with the exception of the wine industry.

This experience of rising project costs being imposed on industry R&D programs provides compelling evidence that industries will not increase levies to meet the funding shortfall that would accompany the implementation of the recommendation to reduce matching funding.

Over the past decade very few industries have increased levies despite the program of work they can fund diminishing due to rising costs. It is reasonable to conclude that it is highly unlikely industries will increase levies despite the program of work they can fund diminishing due to a reduced level of available funds. The industries making this submission that have not increased levies since HAL's inception in 2001 are Almonds; Citrus; Dried Grapes; Dried Tree Fruit, Prunes, Summerfruit and Table Grapes. The Pistachio industry runs its R&D program based on voluntary contributions raised from producers.

**Voluntary contribution matching funds**

Horticulture Australia's voluntary contribution program is important to both large and small horticultural industries. Small well organised industries such as Pistachios can collect R&D contributions from growers and without loss of funds in levy collection costs apply these funds to their R&D program in exactly the same way larger industries conduct their levy research programs. Larger industries within HAL such as Citrus, Almonds and Dried Grapes have also applied funds from Trust Funds, budwood sales and other operating revenues to fund R&D projects with no distinction between these and levy funded projects from the point of view of private and public benefit. A significant percentage of our VC projects relate to the extension of information gained from the R&D program, an area vacated by State Departments but one crucial if the technologies developed are to be utilised and a return on the industry and Commonwealth R&D investment realised.

**New Rural R&D body to conduct joint research**

Increased collaboration and co-operation is a highly desirable outcome however we do not support the proposed mechanism to achieve this. We believe it is not an efficient nor effective way of achieving this result.
Industry R&D investment is guided by Strategic Plans. Objectives and strategies vary greatly from industry to industry. The outputs required to implement the strategies, being the information, goods or services invested in with the HAL funds, are often not clearly identified in the Strategic Plans.

This is a poor position from which to identify projects that could and should be undertaken co-operatively. Having recognised this as a key factor impacting on the capacity to fund co-operative research and implement highly effective R&D programs many of the Murray Valley industries have adopted the same objectives and are preparing plans with clearly identified outputs that are required. The overlap of the need for the same or similar information, goods or services will highlight where co-operative R&D can be undertaken and still underpin the implementation of the industry strategic plans which provides the return on the investment.

The establishment of a new body removed from this planning process and further complicated by the diversity in Agriculture will not ensure already scarce investment dollars will deliver high priority outputs required to implement the strategies. It is the clarity of planning that will best facilitate co-operative research not a new body with its associated overheads.

**Other Matters**

In conclusion, we wish to offer support for some of the other submissions made in response to the draft report, particularly in relation to the continuation of Government funding at current levels. Relevant extracts from several of these submissions are attached (refer appendix).

Yours sincerely,

**Brendan Sidhu**
**Chairman**
**Almond Board of Australia**

**Mark King**
**Chairman**
**Australian Dried Fruits Assoc Inc**

**Jeff Scott per**
**Nick Muraca**
**Chairman**
**Australian Table Grape Association**

**Jan Denham**
**Chairman**
**Murray Valley Citrus Board**

**John Moore, per**
**Ian McAlister, Chairman**
**Summerfruit Australia Ltd**

## APPENDIX

# Extracts From Various Submissions to the Productivity Commission Inquiry into Rural Research and Development Corporations

### AUSTRALIAN INSTITUTE OF AGRICULTURAL SCIENCE AND TECHNOLOGY (AIAST)

**Rationale for government funding support**

It is acknowledged that if industry alone was the benefactor of the RD&E investment the case for public contributions to funding would be weak. As we have indicated above, however, the impact of improved productivity and environmental performance in the rural sector stretches well beyond the farm gate. The impact is significant within rural communities, on the natural resources and, indeed to the nation as a whole. Immediate productivity gains may be readily measured and the return to growers may be measurable. However, it is far more challenging to measure the impact downstream, within communities, and through the better management of natural resources. What is not in contention, however, is that healthy rural communities and sustained natural resources are fundamental to the strength and resilience of the nation as a whole.

Whilst there is still some disagreement amongst the experts as to what constitutes public and private good, the general consensus is that the direct benefit/cost ratios in agricultural R&D are high, although the indirect public benefits are not always fully appreciated or achieved.

Most of the private benefits in agriculture have associated public gains because farmers are land managers, agriculture is an export orientated industry and the industry underpins most rural communities. The dispersed nature of agricultural and grazing industries, which manage the majority of the Australian landscape, results in greater public benefits than applies to other sectors of the economy. In fact, Stephens in his paper to the recent AIAST conference made the point that he could not find an outcome from agricultural R&D that didn't have some public good (Stephens, 2010). He is probably right.

AIAST is concerned that these public/private good relationships are not always understood by those who adopt a more purist economic stance and looks forward to the Productivity Commission adopting a realistic view of this balance.

### AIAST RESPONSE TO DRAFT PC REPORT

As seems to often be the case with these sorts of reports, and government expenditure decisions generally, the main basis for argument is whether or not the expenditure is in the private or public good.

In the case of this report, it is conceded that there is a lack of data, which in our view makes the judgements about spill over effects subjective at best. The Report fails to adequately recognise that agriculture is different in that good technology and practices have impacts well beyond production and farmer benefit.

The additional benefits – public benefits - were covered in our initial application and include such things as benefits in natural resource management, the food challenge, managing greenhouse emissions/carbon, employment and regional benefits. Agriculture is somewhat unique in providing these benefits at the same time as improving productivity.

AIAST does not believe that there is adequate justification provided in the Report for reductions in government support. Having said this, we support the need for a broader strategy to provide for increased contributions by farmers in circumstances where they see it is to their benefit to do so.

### DAFF RESPONSE TO THE DRAFT PC REPORT

**Funding of the RDCs**

DAFF does not support the Commission's recommendation for a reduction in the cap on government matching contributions, and an overall reduction in public funding for RDCs. The enormous challenges that industry is now facing to maintain productivity growth, adapt to climate change, continue to be internationally competitive and maintain the natural resource base require greater investment in R&D from both the public and private sector. DAFF notes that the Commission recommends that the cap on the government's matching contributions should be reduced to 0.25 per cent of an industry's gross value of production, but it is unclear why this figure has been chosen as the appropriate level for the cap. ABARES's submission on the draft report will query the metric that the Commission has used to compare support for rural R&D with support for non-rural R&D, and thus justify a reduction in funding.

ABARES's submission will also cover the effectiveness of the RDC model in improving agricultural productivity. Rural R&D that contributes to increased productivity through more sustainable use of natural resources results in significant private and public benefits and the level of public investment should be considered with this in mind. The Australian agricultural sector plays an important role in environmental stewardship. Agricultural industries have the twin objectives of profitably and efficiently utilising the environment to produce food and fibre while at the same time maintaining and sustaining the natural resources they rely on, that also belong to Australia as a whole. This puts these industries in a unique position, making it difficult to compare them with other sectors in relation to the appropriate level of R&D support.

In 1989 when the RDC model was established, the rationale for the government's involvement was based on recognition of the spillover benefits to the community, the substantial risks in some investment, and the potential for free riding. Notwithstanding the need for increased investment, DAFF argues that government involvement in rural R&D investment is still underpinned by the same rationale.

DAFF's original submission in response to the Commission's issues paper provided further detail on this rationale, so it is not repeated here. However, DAFF makes the following key points:

The Commission suggests that Australia's public support for rural R&D is relatively generous compared to other developed economies, based on OECD data, and implies that this would support an argument for reduced funding. However, this does not take into account the support provided to international rural producers in the form of high tariffs and direct farm subsidies. It is too simplistic to compare the levels of public R&D funding between countries without considering other public support measures. OECD data shows that Australia's producer support estimates averaged 4 per cent of gross farm receipts from 2007 to 2009, compared with 9 per cent for the United States, 23 per cent for the European Union and 47 per cent for Japan. Support for R&D as a percentage of total producer support estimates was over 50 per cent for Australia, but only 2 per cent for the European Union and Japan and 7 per cent for the United States (OECD 2009).

Options for increasing private investment in rural R&D require further consideration in the Commission's final report. There is little evidence to suggest that public investment in rural R&D is crowding out private investment. Indeed, noting that a number of industries have set their levy rates to collect an amount equal to the maximum government contribution, it is possible that if government reduces its investment in the RDC model, levy payers may see less incentive to invest themselves and may vote to reduce their levy. In the case of the industry-owned companies (IOCs), levy payers might choose to alter the levy proportion so that a lesser amount (equivalent to the reduced government matching amount) is directed towards R&D, and a higher amount towards marketing. The Commission has provided no evidence to suggest that industry is likely to respond with increased levy contributions.

Individual primary producers have a limited ability to access other mechanisms, such as tax concessions or intellectual property rights, that might encourage increased private investment in R&D. The small size and low cash income of the majority of agriculture, fishing and forestry businesses effectively excludes them from access to the current R&D tax concession, with its expenditure threshold of $20,000. If these businesses do undertake any individual R&D investment, they are generally unable to quarantine an economic return through the creation of property rights, again due to their small business size and the nature of rural research.

The Rural R&D Council has identified that improved international linkages can provide significant opportunities for increasing private investment in rural R&D in Australia. Stable legal and government institutions, a relatively well educated workforce and large regional landscapes with good infrastructure make for an attractive investment environment. The council will identify strategies for improving international linkages during the process of finalising and implementing its National Strategic Rural R&D Investment Plan.

It can be difficult to delineate where the private benefit of investment in rural R&D stops and the public benefit starts. There are significant spillover benefits from investment in rural R&D. Spillovers may occur from farms in a given industry to farms in the same industry, farms in other industries, non-farm businesses, overseas industries and the community in general. Without sufficient matching public investment to attract private investment, there is likely to be under-investment in R&D in the face of a need for an increased national rural R&D effort.

It should not be assumed that research capability is elastic and able to expand quickly if any decision to reduce funding is reversed in future. A reduction in government funding sends a signal to research providers of a change in priorities, and they may adjust their operations accordingly. There may also be more direct effects, in that RDCs are a significant source of funding within Australia's rural R&D system. Any reduction in funding to RDCs should be considered in the context of the potential flow-on effects to bodies such as CSIRO and universities that currently conduct RDC-funded research. The nature of the relationships between R&D investors, R&D providers and the industry recipients of R&D are clearly demonstrated in each of the sector strategies developed to date under the National Primary Industries RD&E Framework.

Recognising the demands on both public and private funding, DAFF notes that the Commission has not considered in detail the potential for improving the efficiency and effectiveness of the current model (beyond dismissing the option of amalgamating RDCs and recommending that performance reviews assess administrative efficiency). The benefit of having 15 RDCs is the significant level of industry engagement that is achieved, but there are associated administrative costs and challenges. The significant total expenditure on operating and overhead costs and the variations between RDCs' operating costs suggest there is scope for efficiency gains – to increase the proportion of funding available to direct towards R&D – through shared administration systems, contracted support services and harmonisation of common processes to achieve best practice standards. The RDCs are making progress in streamlining their processes to reduce costs but more work can be done in this area.

**HAL – ORIGINAL SUBMISSION**

**Market Failure**

As outlined in many discussions on R&D the conventional rationale for mandatory levies and matching government funding of Rural R&D is the existence of failures in the market for R&D goods and services. The presence of these failures, if not attended to, will cause national investment in rural R&D to be substantially less than the economic optimum. Producers are typically reluctant to engage in mandatory levying arrangements, but are encouraged by matching government funding arrangements.

Additionally, governments seek to promote the achievement of national policy objectives that are additionally identified. Currently these include productivity improvements throughout the economy, growth in regional economies and employment, improved global food security, better environmental stewardship including adjusting to climate change, and enhanced food safety and nutrition. Most, but not all, of these are identified to RDCs via the National Rural R&D Priorities in funding agreements.

The achievement of these objectives with respect to horticulture industries is best accomplished through the co-funding partnership arrangement provided by RDCs. This arrangement has demonstrated that the commercial interests of producers and the broader community/public interests can be achieved synergistically. Evidence of this is presented in following sectionsThe market failures potentially affecting the level of Horticultural R&D include non-excludability/non-exhaustion and the non-divisibility of research costs and 'small firms'. These are explained in further detail below.

**Non-excludability / Non-exhaustion.** This failure is particularly relevant in concentrated and region specific industries that are common in the horticulture sector. Over the past decade a vast majority of HAL's R&D expenditure has been on improving techniques for managing production processes. R&D outcomes have been deliberately focussed on outputs that enable the transfer to many individual growers, and this is promoted through investment in consultation and industry development.

The levy system enables the horticulture sector to make R&D outcomes accessible to all members of an industry without the risks of free riding. Even a small number of free riders will quickly encourage others to withdraw from any voluntary arrangements with the scale needed to undertake most R&D projects. The current system entails low costs for levy collection and compliance and hence maximises expenditure on R&D.

Further, production-based levies fund activities where the benefits to individuals are generally in the same proportion as the contribution they have made in levies, or, should the R&D not produce thedesired result, the risk and lack of return have also been shared proportionately.

**Non-divisibility of research costs and 'small firms'**. Research and development projects tend to require specialist skills and equipment, are costly to undertake, and thus cannot be undertaken by small to medium businesses. Further, such businesses are unable to benefit from the tax incentives and investment allowances available to larger firms able to undertake R&D in-house.

**HAL RESPONSE TO THE DRAFT PC REPORT**

**Rationale for public investment in Rural R&D**

Conventional rationale for mandatory levies and matching government funding of rural R&D is the existence of failures in the market for R&D goods and services. The presence of these failures will, if not attended to, result in national investment in rural R&D being substantially less than the economic optimum.

As outlined in our response to the Issues Paper for this review, the market failures affecting the level of Horticultural R&D include non-excludability/non-exhaustion and the non-divisibility of research costs. These factors are further exacerbated by increasing product diversity, a long and fragile supply chain, and the small size and low net capital value of the average horticulture enterprise.

In addition to investing in industry specific R&D, governments have also sought to use rural R&D to promote the achievement of national policy objectives such as growth in regional economies and employment, improved global food security, better environmental stewardship including adjusting to climate change, and enhanced food safety and nutrition (spillovers).

The current RDC model provides a mechanism to both address market failures and to achieve spillovers. The matching funding from the Commonwealth provides encouragement for industry participants to act collectively to address failures.

As outlined in our first response, horticulture industries are continuing and increasing their support for statutory levies (as well as voluntary levies). This trend indicates that current arrangements anc/the matching incentive are addressing market failure, however the PC has not assessed the risk of these market failures being sufficiently addressed going forward under a reduced level of matching funding. There has been no explicit consideration of the potential unintended consequence of reducing the levy to a level that may not be sufficient to encourage collective action.

**Voluntary contributions**

The Productivity Commission calls into question the continuation of voluntary contributions on the basis that these contributions (and when matched) are more to subsidise R&D that is heavily oriented to the particular needs of an individual commercial entity.

In formulating this view, HAL believes that the PC has overlooked the role of the voluntary contributions mechanism in horticulture industries.

HAL manages investment through voluntary contributions in the order of $20 million per year. HAL currently has 12 B-Class members, representing small or emerging industries that are yet to form a statutory levy. The Voluntary Contribution mechanism provides a "stepping stone" for these industries. Since HAL's inception, eight industries have transitioned from contributing voluntary levies to statutory levies and four industries have introduced statutory levies for both R&D and marketing purposes.

In the case of smaller or emerging industries that would otherwise not have the ability to raise a levy, the access to the matching dollar for voluntary contributions has resulted in opportunity for significant investment in R&D.

Voluntary contributions are also able to be made to HAL by value chain participants. This provides a key mechanism to attract the participation of the value chain in industry wide activities, and increases the connection between the farm gate and the consumer. Benefits arising from voluntary contributions funded R&D flow throughout the value chain from input suppliers through to consumers and are not restricted to the benefits of the voluntary contributions contributor.