AWRI

The Australian Wine Research Institute Ltd

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Response to the Draft Report of the Productivity Commission regarding

Rural Research and Development Corporations

November 2010

Scope

The Australian Wine Research Institute (AWRI) previously made a submission to the Productivity Commission review of Rural Research and Development Corporations (RDCs). That submission was deliberately narrow in scope, focusing on the efficacy of the Grape and Wine Research and Development Corporation (GWRDC) from the perspective of an industry-owned RD&E entity that existed prior to the formation of, and has since received regular funding from, the GWRDC.

While AWRI supports many of the themes in the Productivity Commission's Draft Report, the commentary and recommendations in certain areas envisage substantial changes to the RDC framework and funding arrangements.

Of greatest impact in our view are draft recommendations 6.1 and 7.1, which have the potential to reduce the productivity and viability of Australian agriculture, in particular, the Australian wine industry, in times where innovation is necessary to meet growing (global) market demands. . This submission focuses on our assessment of the likely impact of draft recommendations 6.1 and 7.1, and also provides feedback on draft recommendation 9.1.

Other wine industry bodies, public and private, will make submissions concerning these and other draft recommendations.

Draft Recommendations 6.1 and 7.1

Among the most significant of all recommendations in the Draft Report are those concerning the proposed formation of Rural Research Australia (RRA), the proposed level of funding for RRA and, importantly, the mechanism by which funding would be made available to RRA. The 'public good', 'spillover benefit', and public policy versus private RD&E investment rationale that underpins much of the thinking in the Draft Report seems to culminate in these recommendations.

In our view the formation of a cross-sectoral RDC, RRA, has a strong basis in logic. Land and Water Australia (LWA), which was until 2009 a functional RDC, performed a similar role – as outlined in the core purpose of both entities:

"Land & Water Australia's unique charter was to invest in generating and managing new knowledge, focussed on the sustainability of Australia's productive agricultural landscapes. Its portfolio of work over 19 years ranged across the key challenges to both the productivity and sustainability of Australia's land and water resources."

LWA purpose as shown at http://lwa.gov.au/, accessed 2 November 2010

"It should establish and fund a new RDC, 'Rural Research Australia' to sponsor non-industry specific R&D intended to promote productive and sustainable resource use by Australia's agricultural sector. RRA's remit should broadly encompass land, water and energy use, with the precise coverage of its activities determined having regard to the further input to this enquiry."

RRA's purpose as outlined in draft recommendation 6.1, Draft Report, September 2010

Recommendation 6.1 would seem to suggest that the rationale for discontinuance of LWA in 2009 is no longer applicable, and that a cross-sectoral RDC sponsoring activities of relevance to all agriculture has a critical role to play in the broader RDC framework. AWRI supports the ideal of cross-sectoral research on major topics such as sustainability and climate change and believes that most stakeholders of Australian agriculture would be similarly supportive of such a recommendation.

In addition, AWRI supports the notion of direct Australian Government investment in cross-sectoral agricultural RD&E. We understand that the funding levels proposed ($50 million in the first instance) are greater than the budget made available to the former LWA and as such the recommendation signifies an increase in the priority of such activities. We caution that RRA should be established in such a way as to not create a research agency solely beholden to the Australian Government – both to ensure that its activities are useful and adoptable and to ensure that the rationale for discontinuance of LWA is not brought to bear on RRA at some point in the future.

However, AWRI does not support the proposed mechanism for funding RRA (draft recommendation 7.1). The public-private partnership, a defining strength of the RDC model, involves a 1:1

industry:government investment. This model is widely viewed, at least in the grape and wine industry the world over, as a world's best practice mechanism to fund precompetitive, industry-relevant research and the associated spillover or community benefits. Draft recommendation 7.1 would seek to reduce the 'value cap' from 0.5% to 0.25% over time, effectively halving the maximum available funding to most agricultural industries by way of government matching of statutory levies. In practice, AWRI projects a reduction of 25% in the funds available to the GWRDC (and presumably to most other RDC's that are at or approaching the relevant sectoral value cap).

The net impact would be a reduction in government support for the RD&E activities in the grape and wine industry. AWRI's RD&E activities that are supported through the RDC system provide tangible outcomes Australian wine industry. The impacts of these recommendations come at a time when the Australian wine industry is facing reduced water allocations, drought, unfavourable exchanges rates, retail consolidation, climate change and market demands for sustainable land use including improved carbon efficiencies. A reduction in government support through the RDC system limits the industry's ability to deliver on these market demands and may result in a contracted grape and wine sector.

The Draft Report contains an implicit assumption that the grape and wine industry would obtain benefit from the activities undertaken by RRA, and to an extent this is probable – we believe, however, that RRA by necessity would be unable to address the priorities of each agricultural industry and that it would ultimately fund research in areas that represent the greatest overlapping interest from all agricultural sectors. As such, the level of RD&E investment into issues of direct interest to the grape and wine industry would fall in real terms.

Perhaps most significantly, we project that the impact of a reduction in the applicable value cap would result in a net reduction in total investment by all RDCs, even after correcting for the proposed $50 million allocation to RRA. Our modeling suggests a net reduction of between $50 million and $100 million, with a likely figure being close to $75 million. We conclude, based on our close interaction with industry participants and stakeholders in the grape and wine industry, that industry would not fill this shortfall and, as such, the most likely outcome of a significant reduction in Australian Government investment in agricultural RD&E would be a commensurate net reduction in on-the-ground RD&E.

In addition, we project that draft recommendation 7.1 would lead to an even greater than anticipated reduction in 'value-adding' RD&E. The RDC governance arrangements and bodies that manage RDC affairs and investments across all sectors are unlikely to change significantly in scope or size, meaning that, with less funds available, proportionally less funds would be available for actual R&D than is currently the case – in addition to the (re)introduction of an administrative expense for RRA. If draft recommendation 7.1 is implemented, the efficacy of the purchase-provider model for RDCs that invest a large proportion of their funds in one or two entities (including the GWRDC in AWRI – AWRI successfully competes for 30-40% of GWRDC's available funding per annum) would need to be carefully considered with a view to consolidating the purchase and provider functions to ensure that more of the reduced available funding is utilised in productive activity.

Finally, the recommendations have an unintended but substantial impact on RDE providers such as AWRI. While many RD&E providers and institutions conduct activities across a range of agricultural sectors (e.g. CSIRO, DPI's, Universities), institutions such as the AWRI conduct activities that are aligned to a single sector – in AWRI's case the grape and wine industry. Any reduction in governmental support for sector-specific RD&E has the potential to significantly undermine the operational viability of such institutions. It is the AWRI's view that a steady decline in proportional investment made at the AWRI, if continued into the future, runs the real risk of jeopardising AWRI's critical mass and in so doing the risk of diluting the value of the prior investment in the AWRI by both Federal and State Governments and the regional and rural communities.

While draft recommendation 7.1 envisages a steady change over a period of 10 years, presumably in an attempt to minimise such disruptions to sectors, projects and RD&E providers, the long-term impacts are that sector-specific RD&E will suffer and that sector-specific RD&E entities will find it increasingly difficult to meet the needs of their constituents and levy payers, undermining a business model that AWRI has operated under, in various ways, for more than 55 years.

Given that:

- By OECD standards Australia does not invest nearly enough in RD&E to fulfill the productivity and innovation requirements of the future, agriculture being a notable exception as a field where investment is broadly in line with OECD norms;
- The RDC model is one area where the Australian innovation system is viewed as operating at world's best practice and a model under which substantial economic, environmental and social returns have been generated over the past couple of decades;
- All agricultural industries must continually improve in order to maintain market share and overcome significant business pressures including a strong Australian dollar, water restrictions and unpredictable weather;
- It is difficult to accurately partition the economic, social and environmental benefits of investment in R&D given the significant interplay between the issues;
- Available data on the flow of RD&E benefits to the Australian public interest is not sufficiently comprehensive to create a case for significant change;
- Draft recommendation 7.1 if implemented would undermine a key strength of the RDC framework and likely lead to a net reduction in agricultural research of relevance to the grape and wine industry;
- Contrary to the commentary from the Productivity Commission, many farmers groups and other agricultural industry stakeholders, including AWRI, believe that their sectors would not increase investments to fill a shortfall created by a reduction in Australian Government funding for RDCs; and
- Sector-specific RD&E providers would be placed at a disadvantage relative to multi-sector RD&E providers;

we urge the Productivity Commission to **pursue the ideal of RRA** proposed in recommendation 6.1 **but not at the expense of existing RDCs** as envisaged under recommendation 7.1. The Productivity

Commission would do well to maintain the existing levels of investment in RDCs and argue for the reintroduction of an RRA-like entity with additional Australian Government support. In addition, we urge to the Productivity Commission to formally acknowledge in subsequent documents the critical importance of the public:private matching partnership and recommend that this aspect of the RDC framework not be altered in any significant way.

Draft recommendation 9.1

The Draft Report requested feedback regarding the following issue:

The Commission seeks further input on whether R&D and marketing levies should be separate; or combined into a single industry levy, with some scope for a Rural Research and Development Corporation (see draft recommendation 8.3) to vary the allocation of funds between R&D and marketing without seeking the formal approval of levy payers.

Some agricultural industries, e.g. eggs and pork, have elected to combine research and industry representation activities (including marketing) within a single entity. The grape and wine industry is actively evaluating this option. Providing the appropriate controls and processes are established and a net benefit results, AWRI would have no objection to such a model.

However, AWRI would strongly encourage the retention of separate levies for each of RD&E and marketing. The former underpins long-term productivity and sustainability while the latter underpins sales in the short- and medium-term. Both are critical aspects of an industry's success. However, when any industry finds itself in difficult market conditions, marketing activities with the aim of boosting sales short-term can take precedence over medium-term or long-term RD&E, often on the basis that RD&E that underpins future sales is of little use if the industry cannot sell its products in the short-term.

It takes many years to build the entities, systems, projects, people and capital equipment to deliver rural RD&E. That investment is rapidly lost in the absence of consistent investment; were RDC's to make annual decisions on the relative mix of RD&E and marketing, and/or vary the relative mix at short notice, entities such as the AWRI would likely find it very difficult to maintain core competencies.

About the AWRI

The Australian Wine Research Institute (AWRI) is an organisation dedicated to the advancement of the Australian grape and wine industry. Established in 1955 and governed, operated and largely financed by Australia's grape and wine producers via the GWRDC (two thirds of AWRI's revenue is derived from GWRDC), the AWRI is the engine room of precompetitive research, development, extension and technical innovation for the industry. The AWRI's purpose is *to contribute substantially to the ongoing success of the Australian wine industry*, a purpose that has been constant since AWRI's inception.

The AWRI's activities can be broadly grouped into four key functions:

1. **Research**: Fundamental and applied research into wine composition, quality and sensory characteristics, and communication of the findings. Specific areas of expertise include chemistry, microbiology, engineering, packaging, sensory science, compound analysis, spectroscopy, oenology (winemaking) and viticulture (grape growing);

2. **Development**: Translating and applying research, wherever it is undertaken, into useable applications for adoption by grape and wine producers;

3. **Extension:** Communication of R&D and practical solutions through a range of knowledge-dissemination activities including articles in trade journals and peer-reviewed publications, the AWRI website, regular in-field seminars and workshops in grapegrowing/wine regions (our aim is to visit more than 30 of Australia's major wine regions at least once every year) and technical troubleshooting services.

4. **Commercial:** Fee-for-service analytical facilities, 'market-pull' proof-of-concept studies, product benchmarking and technical validation, export certificates.

AWRI's unique relationship with industry practitioners, academia and other business partners has contributed to the success of the Australian wine industry. The AWRI is currently involved in more than 60 collaborative research projects with private companies, universities and other research providers. The organisation is also part of major collaborative ventures; most recently, the Wine Innovation Cluster (WIC). WIC is the latest physical infrastructure and collaboration concept at the Waite Precinct, bringing together four leading agencies in the grape and wine sector – AWRI, CSIRO Plant Industry, the South Australian Research and Development Institute (SARDI) and the University of Adelaide – with the aim of delivering results for the wine industry that would otherwise not be possible as stand-alone agencies.