



**DAIRY AUSTRALIA**

**COMMENTS**

in relation to

**PRODUCTIVITY COMMISSION**

**DRAFT REPORT**

on

**RURAL RESEARCH AND DEVELOPMENT CORPORATIONS**

**November 2010**

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## INTRODUCTION

This note is a response to the Productivity Commission's Draft Report on Rural Research and Development Corporations that was released on 23 September 2010.

Dairy Australia (DA) is the industry-owned national service body for the Australian dairy industry. DA was formed in 2003 to flexibly drive a range of innovation and service activities that would support a profitable, competitive and sustainable Australian dairy industry. DA operates as a company limited by guarantee with a skills-based board. While DA's charter and funding agreement require it to undertake a broad range of service activities on behalf of stakeholders, for the purposes of this inquiry DA is classed as one of nine industry-owned rural RDCs whose activities and role are under review. The review's findings, therefore, have significant potential to impact on DA's future operations and effectiveness.

As noted in our initial submission in June DA's approach to both the current inquiry and the Commission's draft report is guided by our strong view that:

- Rural RD&E has generated significant benefits both to industry and to the Australian community through productivity growth, higher living standards and a wide range of social and environmental spillovers.
- The social and industry gains from rural RD&E are inextricably linked and warrant ongoing public contribution
- The current rural levy framework has not removed all market failure risks in relation to rural RD&E. Government co-contributions play an important role in addressing these risks. Therefore, changing the basis of current co-contribution arrangements could exacerbate rather than reduce the risk of market failure.
- There is significant value for both industry and the broader community in continuing the current RDC joint investment model.
- Developing and delivering RD&E as part of a closely inter-connected matrix of industry services is critical to maximising the value and return on industry / government investment.
- There is a clear industry-specific dimension to meeting agriculture's innovation challenge. The effective conversion of government and industry based R&D investment into profitable, sustainable farm and manufacturer practices requires both close alignment between researchers and industry stakeholders and a strong understanding of industry business models and the drivers of profit/ resilience.
- The unique technical capabilities and positioning of RDCs are pivotal to this partnership process and remains a cornerstone of successful innovation.
- Challenges such as climate change will require increased cross-sectoral collaboration between RDCs and other groups within the broader innovation system. But strong industry-based RDCS have a key role to play in delivering desired outcomes because of their unique positioning and capacity to translate broad high level knowledge into effective industry-based innovation and solutions.
- Rural RDCs must continue to evolve and adjust to changes in the circumstances of the industries they serve and across the broader community.

With regard to the Draft Report, DA welcomes the Commission's conclusion that the RDC model is fundamentally sound and has important strengths as a vehicle for planning, funding and delivering rural R&D, including:

- Strong linkages with primary producers that bring both a strong end user focus to research funding decisions and facilitate better uptake of R&D outputs (to the benefit of both industry and the broader community)

- An accumulated expertise in funding and managing research and a capacity to act as a research integrator in order to minimise unnecessary duplication / effort.

DA also welcomes the Commission's recognition in the report that:

- Australia has benefited significantly from past public and private investment in rural R&D and there have been significant positive spillovers accruing to the Australian community from the R&D undertaken by RDCs
- RDCs have and continue to pursue administrative efficiencies within the RDC network, and are working to develop a culture of more rigorous project evaluation

DA supports the Commission's findings that:

- RDCs should be cognizant of the intent of the Primary Industries RD&E Framework in determining their overall and regional spending.
- RDCs should continue to recognise and cater for differing regional research needs within their industry, but not be required to precisely calibrate the regional distribution of benefits of their project portfolio.
- The imposition of industry levies does not, of itself, remove the risk of market failure and under-investment in rural R&D from a community perspective
- Setting fixed targets for the share of total rural R&D funded by government is difficult and problematic. An appropriate assessment requires a comprehensive review of all R&D funding arrangements, not just that applying to RDCs.
- There is a need to develop and assemble more comprehensive and consistent data on rural R&D spending and performance.
- There is merit in more coordination between federal and state departments and industry about government spending programs relating to rural R&D.
- Rapid change in the current RDC model is likely to be disruptive.
- Transferring funds from industry RDCs to bodies like CSIRO or DAFF is unlikely to generate significant improvements in R&D outcomes (because of their lack of direct alignment with industry).
- The explicit redistribution of support between RDCs would not be appropriate.

However, several of the Draft Report's findings and recommendations significantly concern DA. We do not support them as currently drafted. Key among these are:

- The suggested phased reduction in government matching fund contributions to industry based RDCs (Draft recommendation 7.1)
- The incorporation of additional specific public funding principles and conditions into future rural funding agreements (Draft Recommendation 5.1, 8.1 and 8.2), and
- The creation of a new statutory RDC (Rural Research Australia) to sponsor non-industry specific R&D (Draft Recommendation 6.1) funded by an appropriation based on savings achieved through Draft Recommendation 7.1.

The following comments outline our concerns with these recommendations in more detail. The final section of this note includes comments on several other recommendations and findings of the Draft Report.

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## Phased reduction in government matching fund contributions to Industry based RDCs

The recommendation of most concern to DA is the call for a phased reduction in the ceiling on government matching funds from 0.5% of industry GVP to 0.25% over 10 years.

This appears to run counter to the logic of the report's basic finding that the current RDC model generally works well, has strong industry alignment and support and has helped deliver considerable benefits to both rural and broader Australian communities.

If implemented, this cut would have significant consequences for DA and our industry. At current production levels it would ultimately see the funding available for dairy R&D fall by up to \$9 Million per annum (a cut of over 25% of DA's current funding of eligible RD&E). Such a reduction would have significant consequences for DA's capacity to fund both longer-term and higher risk R&D activities and/or programs that have significant social spillovers in areas such as health and nutrition research, education, capacity development and natural resource management. These areas presently account for about a third of DA's current R&D program.

In framing its recommendation (and the associated recommendation to divert some of the identified "savings" to a new broad-based RDC) the Commission seems to have followed several lines of thinking. These include that:

1. Current funding arrangements deliver only limited additional R&D, beyond that which would occur in the absence of public funding;
2. Rural RDCs receive considerably more public support for R&D than other sectors
3. It is relatively easy to separate R&D programs (and their appropriate funding base) into those that deliver industry benefits and those that deliver broader public benefits.
4. Farmers are likely to take up a large portion of any reduction in public funding of rural R&D through higher levies based on the estimated returns from R&D investment, and
5. The impact of R&D on maintaining farm productivity may be overstated.

### Additionality

DA believes that the concept of additionality is already strongly embodied in the current objectives of the PIERD Act and the current RDC funding model. The second reading speech for the PIERD Act indicated that the joint government/industry funding model, and specifically the provision of government matching funding, was intended to provide an incentive that would encourage additional rural R&D for the benefit of both farm producers and the broader community.

Assessing the level of additionality achieved under different R&D support schemes is very difficult in the absence of a clear counterfactual (i.e. what research would have occurred in the absence of any scheme). The Commission has, itself, recognised the difficulty in determining such a figure in both this and previous reports.

While the Commission has noted that additionality is an objective of the new broader R&D tax offset legislation, it is not clear that the new legislation would apply additionality tests on a case by case basis to new R&D projects. Rather it would appear that additionality will be treated as a systemic objective of the new arrangements rather than a practical tool for determining the eligibility of specific projects for public funding support.

In the context of this review, it is not clear that the Commission has established whether the level of additionality achieved through public funding of rural RDCs is high or low compared to that generated by other R&D support schemes. The current levy/ matching fund arrangements were not designed to address a quantum level of underinvestment in R&D but rather, to create incentives to stimulate industry R&D and to some extent address the under investment that would otherwise occur. There may be some risk that the current arrangements support activities that may have been undertaken in the absence of public funding. However, there is no systematic evidence that the current matching fund contributions are crowding out private and industry-funded research.

In the case of dairy we would see that there is an equal risk that socially valuable research could be excessively curtailed to the detriment of the overall community if the Commission's recommendation is adopted. Current research programs with relatively high levels of social benefits versus industry benefits (e.g. health and nutrition research, capability development and training) would come under significant pressure if the funding base for dairy R&D is significantly reduced and the government contribution to R&D is significantly diluted.

This lack of precise information highlights the difficulty of using additionality as a basis for determining whether (and by how much) government should reduce its future contribution to rural R&D. Without more detailed evidence it seems inappropriate to recommend a major funding change based on this concept, especially given the Commission's general conclusion that the current system operates well.

### **Relative Levels of Funding for RDCs**

In framing its recommendation the Commission appears to rely heavily on a finding that the government provides disproportionately high levels of support to RDCs relative to other sectors of the economy. Section 7.1 uses two approaches to show that public support for RDCs is between 3 and 11 times that provided to other sectors (other than local motor vehicle production which the Commission sees as an inappropriate benchmark).

DA has significant concerns with the way in which the Commission has constructed these estimates of relative support. We believe that flaws in its approach result in the measured gap in favour of RDCs being grossly exaggerated. It does not, therefore, provide a credible base on which to recommend a significant reduction in public support for RDCs.

#### *Rates of Support*

Table 7.1 of the draft report presents estimates of the government contribution per \$100 of net industry contribution to R&D under different general tax concession schemes versus matching fund payments to RDCs. The Table suggests that the government contribution via the 125% R&D tax concession of \$8.11, while the contribution to RDCs is \$91.03.

As DA has noted in earlier correspondence, these numbers are not like for like comparisons. Even if they were correct (which DA disputes) the numbers presented cover the government contribution to different aggregate amounts of R&D spend, an issue which reduces their value for comparison purposes.

More importantly, the Table 7.1 estimates for the general R&D Tax Concession and Tax Offset schemes do **not** show the total government contribution (by way of revenue foregone) per \$100 of net industry investment. Instead they only show the "additional" revenue foregone by government for spending on R&D compared to the situation where a firm spends the same amount on non-R&D activities. To achieve the numbers on Table 7.1 the Commission counts revenue foregone by the government under the general tax deduction for normal (non R&D) business outlays as part of a company's net contribution to its R&D spend. This approach considerably understates the actual government contribution to R&D under the tax incentive and tax offset schemes.

The Commission's numbers contrast with the Treasury's explanation of the new R&D tax offset scheme. In May 2009 the Treasury press release on this scheme said that for small businesses (those with turnover <\$20 M) "this means that firms will receive a tax refund of 45 per cent of their R&D spending when they file their tax return".

The Commission numbers also contrast with estimates presented in the Treasury authorised Explanatory Memorandum to Tax Law Amendment Bill (R&D) 2010. The worked examples of this document (pages 10-12) show that a firm that invests \$1.0M on eligible R&D would receive tax offsets ranging from \$375,000 (old 125% tax concession) to \$450,000 (new tax offset). Therefore, the net company contribution per million dollars of R&D investment ranges from \$550,000 and \$625,000. This indicates that the true government contribution (in

terms of revenue foregone) per \$100 of post-tax industry investment ranges from \$60 to \$82. The government contribution is even higher for R&D expenditure that qualifies for the accelerated 175% tax concession.

The anomaly in the Commission's approach is highlighted by the Table 7.1 statement that under the 125% tax concession "*gross R&D expenditure of \$108.11 is required to achieve a net industry contribution of \$100*". The reality is that, under this scheme, for a gross R&D investment of \$108.11 a company's net contribution after lodging its tax claim would be \$67.57 (not \$100 as the Table suggests). Similarly a gross outlay of \$129 under the 175% tax concession would result in a net company outlay / contribution of only \$61.28 (not \$100).

The Treasury explanations suggest that the more appropriate way to compare the incentive and government contribution to non-agricultural R&D schemes covered by Table 7.1 is on a stand-alone basis (not relative to the general government deduction for business costs).

The Commission is correct that, for accuracy of comparison, the total government contribution to RDCs should also reflect the tax deductibility of levy payments made by farmers. Allowing for this factor will increase the measured support for RDCs from the number shown in the draft report. But the relative support rates between rural and non-rural R&D remain much closer than Table 7.1 implies.

Table 1 below provides a more consistent comparison of government contributions to R&D under different tax schemes. It shows the total government contribution per \$100 of R&D investment under different schemes (including appropriations and foregone tax).

This suggests that the total government contribution per \$100 of R&D expenditure in the non rural sector ranges from \$37.50- \$52.50 under existing and planned concessions.

The comparable contribution for R&D undertaken through rural RDCs ranges from \$47.64 to \$63.35 (with the figure depending on the rate of income tax payable by individual farmers).

On this basis, the relative government contribution to rural R&D is not dramatically different from that afforded comparable non-rural enterprises. Government support for RDCs ranges between 1.2 and 1.7 times the contribution provided to non-rural R&D. Under either the proposed 150% tax offset scheme or the existing 175% premium R&D tax concession<sup>1</sup> the net Government contribution to both rural and non-rural R&D is much nearer parity.

This suggest the real differential is far below the 3-11 times claimed by the Commission.

The Commission claims that its estimates understate the true disparity in assistance to the extent that RDCs face a less restrictive definition of eligible R&D than other businesses. The impact of this does not seem to have been directly assessed in this report, however. A counter point is that, while RDCs may receive a slightly higher level of support than that offered other sectors under the general R&D tax and offset concessions, the RDC model also imposes additional obligations / restrictions in relation to the government contribution (see Table2).

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<sup>1</sup> In responding to previous DA correspondence the Commission suggested that the impact of the 175% tax concession on overall government support is small as only a small minority of companies has received the premium tax concession due to stricter eligibility. The number of firms may be small, but 2009/10 Budget Tables show that the 175% Tax concession accounted for over 30% of government revenue foregone through general tax concession arrangements in 2008/9 and 2009/10.

**Table 1: Estimated Government Contribution per \$100 of R&D Expenditure**

	Non-rural R&D	Non-rural R&D	Non-rural R&D	Rural RDC (low)	Rural RDC (high)
<b>Policy support measure</b>	\$125% basic deduction	\$175% premium deduction	Proposed 150% tax offset	matching contribution	matching contribution
<b>R&amp;D Expenditure</b>	\$100	\$100	\$100	\$100	\$100
<b>Government RDC contribution</b>				\$47.64 <sup>a</sup>	\$47.64 <sup>a</sup>
<b>Tax deductible amount for R&amp;D outlay</b>	\$125	\$175	\$150	\$52.36	\$52.36
<b>Tax revenue foregone</b>	\$37.50	\$52.50	\$45.00	\$0 <sup>b</sup>	\$15.71 <sup>b</sup>
<b>Net industry contribution</b>	\$62.50	\$47.50	\$55.00	\$52.36	\$35.65
<b>Net Government contribution</b>	<b>\$37.50</b>	<b>\$52.50</b>	<b>\$45.00</b>	<b>\$47.64</b>	<b>\$63.35</b>
	<p>a – Using PC estimate of average Government contribution per \$100 of rural industry contribution of \$91</p> <p>b – Low scenario reflects years when farmers have no taxable profits, so there is no scope for additional government tax revenue foregone through the deduction of levy contributions as business expenses. High scenario assumes farm paying tax at corporate tax rate (30%) so additional revenue forgone through deduction of levy contribution as business expense</p>				

**Table 2: Some Conditions Applying to Government R&D Contributions**

Condition of Support	R&D Tax Concession	R&D Tax Offset	RDCs
Cap on Expenditure Eligible for Govt Contribution	No	No	Yes
Compulsory industry participation (1)	No	No	Yes
Obligation to direct R&D towards Govt R&D Priorities	No	No	Yes
Obligation to publicly report R&D outcomes	No	No	Yes
Govt Contribution Refundable	No	Yes (2)	No

(1) It may be argued that RDC levies are voluntary (as farmers have the periodic right to vote for zero rate, but between votes participation is compulsory)

(2) For enterprises with turnover <\$20 Million

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There is also an element of greater variability in the rate of government contributions to rural R&D given the impact of movements in measured farm GVP over time on funding caps.

RDCs also bear a more direct proportion of the administrative costs associated with government R&D support as the cost of collecting levies incurred by the Levy Revenues Service is fully deducted from RDC levy income.

#### *Support as Percentage of GVA*

The other measure the Commission uses to show high relative levels of support for rural R&D is a comparison of government contributions relative to industry value added (pp157).

Given that value added per unit of output varies greatly across different sectors of the economy it is not clear that differences in this ratio are significant in themselves. Even allowing for this, the Commission comparison appears to have technical flaws.

It is unclear whether (like Table 7.1) the data used for the non-rural sector in this comparison includes only the 25% additional deduction for R&D expenditure rather than total revenue foregone by foregone. If so, the figure would seriously understate the real value of government R&D support for the non-rural sector as a percentage of value added.

In Chapter 1 of the report the Commission states that “rural industries” for this inquiry incorporate the processing arms of integrated industries such as meat, dairy, wine etc. This is logical since in these industries, R&D spend also covers the processing segment (e.g. for DA post farm R&D represents around 15-20% of total DA expenditure).

In its calculation for rural support the Commission appears to have only used farm level GVA. Were it to adjust its GVA denominator to more properly include the post-farm for integrated food processors like dairy, the measured estimate of R&D support for RDCs as a percentage of rural industry GVA would fall, most likely below 0.5%

For the non-rural sector the Commission compares the aggregate value of R&D tax concessions and offsets with the total value added for all non-rural industries. This approach generates a downward bias in the estimate as the denominator includes a range of economic sectors where the usage of R&D tax concessions is extremely limited (e.g. Public Administration, Ownership of Dwellings, Arts and Culture).

The Commission's *Trade and Assistance Review 2008-09* shows that usage of the general R&D tax concessions and offset schemes in recent years has been concentrated in the Mining, Manufacturing, Wholesale and Property and Business Services sectors.

It would appear that the level of support provided through general R&D tax and offset concessions when expressed as a percentage of GVA in these sectors is similar to the adjusted rural sector number above. For example in 2008/9 the mining sector drew \$318M in support from the 125%, 75% R&D Tax Concessions and the R&D Offset for Small Companies schemes. This represented about 0.4% of mining sector GVA for that year. The corresponding figures for the Manufacturing sector (excluding food processing) in that year were \$368M or 0.4% of sector GVA.

These estimates are very different to the Commission's finding. These estimates raise serious doubts about the Commission's claim that Government support of R&D undertaken by RDCs is disproportionately generous compared to other sectors.

#### ***Separability of Outcomes***

The Commission suggests that, following a reduction in public funding, RDCs should concentrate on research activities that focus on industry gains and productivity while public funding should be transferred to another body that will concentrate on socially beneficial



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research. This recommendation appears to rely on an overly simplistic view of the separability of industry versus social benefits from rural research projects,

In reality, most agricultural research will deliver a combination of public and industry benefits at the same time. There may be varying benefit flows from specific research projects, but the social and industry gains are often inextricably linked. These benefits are delivered jointly and tend to be non-rival in nature.

In jointly funded programs it is not logical to attribute a specific research outcome to one element of that funding (industry or government). It is the collective investment that delivers the outcome (both industry benefits and spillovers). Likewise it is the collective social benefit (industry and broader community gains) that is at risk if funding reductions lead to a curtailment of this R&D.

The reality is the PIERD Act envisages that there are shared public and private benefits from the joint government/industry funding of rural R&D programs. The Commission's recommendation does not seem to. Attempting to isolate R&D into industry specific and public good R&D outcomes/organizations and funding streams may create perverse outcomes. By raising the costs to industry to undertake research with embodied spillovers, it could reduce the quantum of socially valuable RD&E that will be undertaken.

### ***Increasing Levies to Replace Public Funding***

The Commission argues that a reduction on public funding can be largely offset by increased investment on the part of farmers through higher levies. It cites the high industry returns on investment in rural R&D as a driver of such outcomes.

As Mullen stated in his submission, the persistence of higher returns over decades from rural R&D can be seen as evidence of continued market failure and under investment from the viewpoint of industry and society in general. Since the benefits of R&D can vary across farms, across regions and across time (and can spill over to other sectors) it is likely that a uniform levy system will be set at a level which is below the true value of research to farmers as has been argued by Mullen and Alston.

Therefore, while the current levy funding scheme helps offset a degree of market failure in R&D investment across agriculture it cannot be expected that industry would automatically step in to fill the bridge as the Commission seems to assume.

The regional examples quoted by the Commission may not be applicable at the national industry level that RDCs must work at. From its discussions with stakeholders DA sees little evidence that farmers will be willing to increase levies to meet a shortfall in government support (because of the high discount factor they apply to R&D). In fact, given that many within industry see the current funding arrangements as a partnership with government there is a risk that the withdrawal of government funding would see diminished desire on the part of farmers to contribute to ongoing industry levies (particularly as the measured return to industry from this R&D must fall if it has to shoulder a higher portion of the total cost).

At the very least, the withdrawal of government funding, and the need to ration R&D funds, is likely to see that projects where social benefits are significant relative to expected industry benefits will receive lower priority and reduced potential funding. Dairy examples here would be areas such as Health and Nutrition and Dairy Education. In both these areas of research, while there are industry benefits, the majority of benefits are expected to flow to the broader social community. If government funding were withdrawn, or reduced, these types of socially beneficial R&D programs would come under increased pressure and we could see a reduction in socially valuable research to the detriment of the community overall.

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### ***The Role of R&D versus Other Factors***

The Commission suggest that, in the current debate, the impact of R&D in maintaining farm productivity may be overstated. DA understands the issue of the link between R&D funding and farm productivity will be addressed in detail by ABARE-BRS. Without going into this issue further, DA generally would argue that investment in farm R&D has been a significant driver of farm productivity and adaptation over recent decades. Reductions in farm R&D have the potential to adversely impact on future farm productivity and sustainability, especially given the more volatile and variable climate in which agriculture has to operate.

DA recognises that other factors such as changes in the scale of farming can be important to measured farm productivity. However, we do not see that these innovations / developments occur separately from R&D. There is, in fact, a strong interdependence between these other factors and the R&D system. For example, farm consolidation and the growth in average farm size may be a factor in maintaining farm productivity (even though it is not automatic that a large farm is more productive). But the expansion in farm size in dairy over the last decade has brought with it a new set of production system challenges including labour force management, the complexity of decision processes, feed systems and the cost effective use and management of different technologies. This has required ongoing and new R&D to assist farmers to understand, and take advantage of, the opportunities offered by issues such as scale and new technologies. Therefore, changes in the business environment are not independent of R&D. Sustainable changes in operating systems are often the product of close and iterative interaction between researchers, developers and farmers.

### ***Summary remarks***

From DA's perspective the recommendation on future funding of RDCs is central to the current review. However, we believe that a core basis of the Commission's recommendation (that government support of rural R&D is disproportionately generous compared to other sectors) is incorrect. The levels of support are similar after properly allowing for differences in specific funding mechanisms.

The Commission has also not demonstrated that additionality in terms of rural R&D differs significantly or adversely compared to other R&D schemes.

We see no case for significantly reducing current government support for rural industries either in absolute terms or relative to other sectors. Indeed there are strong grounds for retaining the current arrangements.

If implemented, the likely outcome of the PC's recommendation will be that the level of public funding of agricultural R&D will decline. This reduced funding is unlikely to be replaced from industry sources. This will create a significant risk that the flow of public benefits from rural research in the form of improved environmental and social outcomes will be diminished in future, particularly given the risk of ongoing market failure in rural R&D (which the Commission has recognised).

**Therefore, DA does not support the draft recommendation and believes it should be removed from the final report.**

A further point here is that, while the report rejects the proposition of shifting funding from one industry RDC to another, as drafted its proposal may have the same effect in the early part of the proposed transition. This is because industries where levy funding currently is in excess of the GVP cap would bear the adjustment in matching funds from the start of any phasing whereas those industries where funding was below the cap currently would not be affected until later years.

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## Additional Public Funding Principles in Rural R&D

The Commission recommends the incorporation of a range of additional funding principles in all rural R&D policies and funding programs in draft recommendation 5.1. It also suggests a range of conditions that should apply to RDC funding (under recommendations 8.1, 8.2).

Some of the principles and conditions set out in the report are un-controversial (e.g. the expectation that R&D funding and programs be consistent with other government policies and programs and should facilitate rather than hinder sector adjustment)..

DA already applies principles such as effective collaboration and coordination and a focus on effective adoption in its program design and implementation.

We would reject any inference that principles (in relation to issues such as transparency, accountability, facilitating adjustment etc) need to be made more explicit because of a failing in current DA practice.

It seems that the Commission's aim in recommending the introduction of these principles would be to give direction to policy implementers, to condition stakeholder expectations and provide a benchmark for evaluating RDC and other program performance. If it is intended that these principles will affect day to day decision making and assessments of RDC performance and funding they must be carefully designed. Otherwise deficiencies in their formulation could have significant, unintended consequences.

DA sees a risk that some of the proposed principles will increase uncertainty and debate about public funding rather than provide clarity or consistency for stakeholders and administrators.

The first principle re-states the objects of the PIERD Act with an extra 'additionality' clause. Recommendation 8.2 adds to this by stating that funding agreements for RDCs should be amended to add a specific additionality provision.

We have noted before that additionality is already implicit in the current PIERD Act's objectives. Adding this explicit clause is unlikely to improve outcomes or performance.

Given the difficulty of determining additionality except on a "common sense" basis it is hard to see how it would provide an effective "benchmark for evaluating (RDC) performance" or "promote accountability for outcomes". It could, in fact, create operational complications for industry RDCs.

The financial impact of the recommended additionality provisions on funding agreements is not clear. If the proposed principle or condition were applied too restrictively, this may unnecessarily restrict RDCs in terms of what public funding they can apply for.

Public funding (via matching funds) is provided after RDC investment occurs. If these provisions are adopted RDCs would have to show that R&D for which they are claiming matching funds would not have proceeded in the absence of the matching funds – a very hard case to prove. At a minimum, this principle will create an additional administrative and cost burden for RDCs and government departments in seeking to demonstrate how the (essentially abstract) principle had been complied with.

Similarly it is not clear how to interpret the principle to "...give appropriate recognition to the non-R&D drivers of performance improvement..." or what the implication of any decision should be on R&D funding. This ambiguity is important given the discussion above about the interdependence of R&D and other drivers of industry performance.

The principle on leveraging is also problematic. The Commission acknowledges that, of itself, leveraging can be beneficial. DA would have numerous examples of programs where

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we have effectively leveraged outside knowledge and funding to generate significant industry and social benefits.

The Commission seeks to distinguish between beneficial leveraging and “non value-adding cost shifting”. It is not clear how such a distinction will be drawn in practice, or how it can be applied to single out ‘leveraging that is ‘administratively costly’ from productive, beneficial leveraging. So how will the principle guide policy or funding?

There is a also question for DA in how the high level principles set out under draft Recommendation 5.1 are meant to interact with the proposed conditions for RDC funding under draft Recommendation 8.1. From DA’s perspective the conditions set out in 8.1 are largely operational now.

However, the interpretation of these conditions, should they become explicit parts of future funding agreements, may equally raise practical issues and administrative costs for RDCs.

While the need for balance in an R&D portfolio is clear, who will decide that this condition has been met? It is not automatic that long- term R&D is riskier and higher return than some shorter term programs. For dairy, the last decade has shown that industry circumstances and challenges can change dramatically and rapidly. So RDCs need the flexibility to adjust their programs over time to best deal with emerging challenges, not be forced to follow a prescriptive formula of program balance by time horizon risk.

Independent performance reviews are important, but their costs (financial and in terms of industry resources) are not insignificant. So the frequency and role of such reviews must be clear. In DA’s case the recommendation in the draft report for 3 yearly reviews is actually tighter than our current arrangement (which requires a review to be held in advance of each industry levy poll, which can occur within a 3-5 year cycle that is agreed with industry stakeholders).

The Commission’s intent to provide broad guidance to rural R&D policy and funding decisions by Government is reasonable. But its suggested approach appears too prescriptive and may add additional dead weight costs to rural R&D rather than deliver noticeably improved outcomes.

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## The Creation of Rural Research Australia

The draft report indicates that industry RDCs focussed on industry specific, adaptive, productivity improvement research may not be appropriately structured to address the government's desire for more 'cross-cutting', blue sky and public good R&D. Its solution to this is to reduce the level of matching Government funding to industry RDCs and to divert some of these funds into cross-sectoral, blue sky and public good R&D through a new, non-industry specific RDC (RRA).

DA will leave the main comment on this recommendation to the Council of Chairs of RDCs. But we do not accept the perception that industry-based RDCs are unable to undertake adequate levels of strategic 'cross-sectoral R&D'.

A central part of our business model is based on improving understanding of the dynamics and drivers of change across the supply chain and building industry capability to effectively address this change. This business model embodies both high levels of consultation and engagement with industry stakeholders, government and other industries.

DA sees collaboration as a key business tool to help deliver cost effective outcomes to these challenges. For this reason we have been an active supporter and participant in both the CCRDC and the National Primary Industries R&D Framework- in the latter both in helping to shape an industry-specific R&D strategy but also cross sectoral strategies relating to water, animal welfare, extension and climate change.

We acknowledge the need for increased collaboration and engagement on cross sectoral issues such as climate change. We accept that these issues have impacts and dimensions that operate well beyond the boundaries of individual industries. But we reiterate that strong industry aligned RDCS have an important role to play in ensuring that these issues are addressed in a way that improves Australian sustainability.

The outputs from specific pieces of rural R&D are likely to be best delivered and adopted when they are incorporated within an overall industry-based information system that is both attractive and understood by farmers and that allows them to profitably adapt their business practices to achieve desired outcomes.

An example of this can be seen from our Confidence to Grow Climate initiative. In 2008/9 Dairy Australia and CSRIO jointly funded basic research to identify the projected changes to 2030 in climate patterns across a range of dairy production regions. The general findings of this research, while valuable, were not in themselves, sufficient to generate meaningful adaptation or adjustment at farm level. This needed a second stage effort by DA to evaluate and interpret the expected changes in regional climate in terms of its effect on regional milk production, animal performance, feed base and markets. This process enabled DA to generate meaningful and relevant information for farmers that they could use to adopt their specific farm systems and animal management practices to build and maintain farm resilience in a more volatile environment.

From DA's perspective there is a real risk that the development of appropriate farm system adjustments and change will be impeded if the responsibility for research is arbitrarily split away from industry RDC's to a more general body RDC such as RRA.

The Commission has identified that shifting resources from industry RDCs to CSIRO or DAFF is not likely to deliver greater returns on investment.

Similarly, it is not at all certain that such the proposed shift in resources from industry RDCS to RAA will result in higher social returns on public and industry investment.

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## Other issues

### ***Implicit subsidies***

There is an implication in the report that RDCs may be securing above average support through the level of public funding of R&D (compared to other countries) and by implicit subsidies embodied in their collaborative arrangements with research providers.

DA understands that there has been further work done on the public/private share of RD&E and so the initial comments made here by the Commission may be amended.

On the implicit subsidy issue, Recommendation 8.5 suggests that the implicit subsidy to agricultural producers provided by government from the public funding of core science infrastructure such as CSIRO and higher education facilities such as universities be more explicitly presented in future evaluations of RDC programs.

RDCs, as purchasers of research services, are not responsible for decisions made by research providers about the cost at which they provide services. As corporate entities RDCs are responsible to their stakeholders to engage with research providers and to make the best use of the available funds to implement their research plans.

We recognize that one threat to the RDC model is a reduction in the capacity of local research providers within CSIRO and State Departments. From DA's perspective, our current relationships with researchers are mutually beneficial and contribute strongly to the quality of the R&D and to its adoption by producers.

We do not see from the report any evidence that the level of implicit subsidy provided to agriculture from the provision of general government support for science and education is higher or lower than that provided to other sectors. The report itself simply states that the level of support for agriculture is unlikely to be less than that for other sectors.

In the absence of more specific evidence of a differential it is difficult to see why the Commission would expect RDCs to take on this extra level of accountability and measurement. Such an exercise must be subject to many assumptions.

In fact, a counter argument could be made that through their funding and long term arrangements with researchers RDC's such as Dairy Australia play an important role underpinning and supporting the ongoing maintenance of capability in specific research bodies, universities and government agencies.

Therefore, it is unclear whether or not this implicit subsidy operates as the report implies.

### ***Separate Levies***

The commission has sought input as to whether there is a case for maintaining separate levies for R&D versus other industry activities or whether there are benefits to be had by allowing levies to cover both activities.

As the Commission would be aware, since its formation all DA's activities, both RD&E and other industry service functions, have been funded through a common industry levy<sup>2</sup>.

This arrangement recognises that industry circumstances can and do change over time. A common levy maintains and maximises the ability of the industry service body to redirect funding as circumstances change and deal with emerging challenges - which may, or may not, require an R&D component in terms of the most effective industry response.

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<sup>2</sup> Although only eligible RD&E investments can receive government matching funds payments.

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The use of the common service levy maintains operational flexibility. From a dairy industry perspective this is likely to deliver closer RDC and stakeholder alignment which, in turn, will help deliver more focused and sustainable outcomes over time. It also allows more effective use of available reserves than may be the case with separate funding pools.

### **Government members**

Commission recommendation 8.4 suggests that the PIERD Act and statutory funding arrangements be amended in the case of industry RDC's to allow for the consensual appointment of government members to the board.

From DA's perspective, a key part of our success as an organisation is the role played by our broad skills-based board. We see this as superior to operating with a representative Board structure.

Over the past seven years DA's Board selection criteria and selection arrangements, which closely involve industry stakeholder groups, have worked well.

We recognise that understanding government issues and objectives is important for industry level bodies like DA. We also recognise that maintaining clear and regular communication with government is essential to the effective implementation of industry R&D programs.

DA currently undertakes regular reporting and dialogue with the Minister for Agriculture Fisheries and Forestry, his staff and with senior managers of DAFF and other departments.

This dialogue is important in keeping both sides aware of DA's work program and how it interacts with the broader policy and social objectives of government. The understanding developed in this process has been instrumental in the Department's willingness to use DA as an implementing agency for several major government research and industry support programs in recent years (such as *Feed Fibre Future*, *Dairying for Today*, *Planning for Tomorrow*).

The Commission recognises the legal aspects of appointing current government employees to corporations law company boards (such as DA) It suggests the arrangement would require a change in the funding agreement for bodies like DA who would then have to change their constitution to abide by the new agreement. This raise questions over the ability of bodies to commit to agreements outside the scope of their current constitution.

While recognising, the Commission's intentions, changing funding arrangements to appoint a government member outside the standard Board provisions selection criteria and process is not a priority.

### **Processor levies**

A recommendation of the draft report is that R&D levies on processors not be extended beyond existing arrangements. DA is not advocating the imposition of levies on dairy processors. But as a general comment, we would note that the appropriate funding base for industry level activities is very much determined by the internal structure of industries and by the likely benefit flows of industry level activities. As industries change the most appropriate basis for funding industry-level structures may also change.

This is an issue for each industry, who will need to periodically consider whether the existing industry funding model remains appropriate to their evolving industry structure and membership. However, any move to change industry funding arrangements must be able to show clear evidence that there is widespread current industry support for the proposed change.