

Introduction

- 1.1 This inquiry has been undertaken following a request from the Minister for Industry, Science and Resources on 20 April 1999 asking the Committee to inquire into and report on the prospects of increasing value-adding to Australian raw materials.
- 1.2 The request from the Minister proposed a two-part assessment of this issue starting with an evaluation of the current state of value-adding in Australia, and how that compares internationally (see the terms of reference for further details). It was proposed that this work could then be used as a basis for providing an evaluation of a range of topics pertinent to this issue.
- 1.3 This report has been prepared following the Committee's completion of the first stage of the inquiry and details its findings on the question of the state of value-adding in Australia. It provides a broad evaluation of the amount and importance of value-adding of raw materials currently being undertaken in Australia (Chapter 2) and how this compares with other countries (Chapter 3). It also provides some indication of the trends occurring at the industry specific level, for a range of Australia's more important metals and agricultural industries (Chapter 4).
- 1.4 The report then discusses the factors underlying the success of value-adding activity in Australia (Chapter 5). This includes a discussion of the prospects for enhancing national welfare through the further processing of raw materials and of the dangers and benefits that could arise from encouraging this activity.
- 1.5 The report concludes with a discussion of the selection of possible measures which witnesses to the inquiry suggested could be adopted with a view to fostering further value-adding activity in Australia (Chapters 6 and 7). These include general measures such as providing a conducive

economic climate through to the removal of a series of impediments to industry development.

- 1.6 The Committee will examine a number of these proposals in more detail during the next stage of its inquiry. This stage will involve the examination of case studies covering the wine, dairy, grains, magnesium and aluminium industries. It will focus on considering how the issues identified in this report impact on the industries.
- 1.7 The Committee will use its case study findings to draw together a set of more general recommendations for the Government's consideration. The Committee is therefore also seeking comment on the observations made in this first report and any further general suggestions or commentary on the encouragement of raw material processing in Australia.

The need for an examination of value-adding in Australia

- 1.8 The evidence received to date clearly indicates that this examination of the state of value-adding in Australia is timely.
- 1.9 A range of witnesses noted the clear potential of enhanced value-adding to Australia. The Western Australian Department of Resources Development, for example, suggested in its submission that:
- The development of technologically sophisticated and competitive resource processing projects in Western Australia will ensure higher levels of investment, provide increased employment opportunities, create a highly skilled workforce and guarantee a strong economic foundation for future generations. The resources and resource processing industries, often located in remote, regional areas, have been a driving force behind regional development in Western Australia over the past three decades.¹
- 1.10 The Tasmanian Government added that:
- Increasing value adding is an important element of the Tasmanian Government's objectives to increase employment; increase the range and level of skills; to diversify the economy; and to increase exports and replace imports.²
- 1.11 The importance of this question is also reflected in the number of reports that have been produced either specifically on the question of value-adding or on closely related issues. The Department of Industry,

1 Western Australian Department of Resources Development, submission no. 37, p. 1.

2 Tasmanian Government, submission no. 36, p. 3.

Science and Resources (ISR), for example, listed a selection of some 21 reports relating to adding value to minerals, which have been published since 1979 (this list is reproduced in Appendix E)³.

- 1.12 While the existence of such a wide selection of reports appears to raise the question of the worth of revisiting this issue, the Committee agrees with the ISR assessment of this question:

While the issue of further value adding to Australia's raw materials has been the subject of a number of directly (and indirectly) related reports over the past decade or two, most of these reports are now somewhat dated and it is timely to revisit the issue, and to examine the progress made since then.⁴

- 1.13 Given the importance of value-adding to the future of the Australian economy and the time that has evolved since these reports, the Committee agrees that it is timely to revisit this issue and explore the progress made since these earlier reviews.

What is value-adding?

- 1.14 Before embarking on this review the Committee considered it important to first clarify its interpretation of the term 'value-adding'. In the Committee's experience, this term is used in a number of contrasting ways by different parties and it believes any study of this issue needs to be based on a clear understanding of how this expression has been interpreted.

- 1.15 In its submission to the inquiry, the Department of Agriculture, Fisheries and Forestry – Australia (AFFA) elaborated on the potential confusion that can be associated with the term 'value-adding':

There is no single accepted definition of the term 'value-adding'. It has been variously defined and is often misunderstood. The most common and enduring misconception is that value-adding is processing. The two terms are often, incorrectly, used interchangeably. Value-adding is much more than just processing.

AFFA and the former DPIE have maintained that value-adding encompasses any activity that adds to or enhances the value of products to customers.⁵

3 ISR, submission no. 28, p. 29.

4 *ibid*, p. 3.

5 AFFA, submission no. 34, p. 6.

1.16 While the Committee agrees with this broad interpretation of value-adding, it believes it is necessary to develop this concept further. As indicated by the Centre for International Economics (CIE):

Value adding is a concept that applies to both the individual firm and to national income accounting.

- For the individual firm, value added is the difference between the gross value of production and the cost of materials and services purchased. That is, it is the return to the firm's 'primary factors of production' – the labour, capital, natural resources and enterprise from which wages, interest and profits are met.
- Value added is a national income concept because the sum of the value added of all firms makes up Australia's GDP.

Achieving more value adding is, therefore, very important. The more value adding Australia can achieve in aggregate, the higher our national income and living standards.⁶

1.17 While the difference in these usages may not be readily apparent, the ISR submission well illustrates the potential impact of this distinction:

At any point in time, value added at the macroeconomic (or economy wide) level is essentially the sum of the value added accruing in each industry.

Although these two concepts therefore appear to be essentially the same in a static state, there is a critical difference when any change is introduced into the system... While a particular action may lead to an increase in the value added in an industry... this action does not necessarily lead to an equivalent change in value at the national level because of the impact of the introduced change on other industries. It may for example lead to an increase in the cost of the factors of production in those industries which compete for the same inputs and a subsequent decline in their profitability or a reduction in their throughput.⁷

1.18 The Committee believes that the fundamental aim of its work should be to enhance national income and living standards. It has therefore approached this inquiry into the prospects of increasing value-adding to Australian raw materials from the broader national perspective.

6 Centre for International Economics, exhibit no. 7, p. 3.

7 ISR, submission no. 28, p. 10.

- 1.19 While accepting that a range of potential measures aimed at encouraging further raw materials processing can lead to increased value-added in particular industries, the Committee believes governments should also take account of the broader impact of these measures. In particular, governments need to take account of the impact of the various options on Australia's overall economic output and living standards, before they are pursued in any meaningful manner.
- 1.20 In making this assessment, the Government would need to take account of the full range of factors including:
- the potential impact on consumers and other industries,
 - estimated revenues, royalties and taxes,
 - the direct and indirect employment effects,
 - the need for training and additional infrastructure,
 - the need for imported inputs; and
 - the effect on Australia's current account and foreign debt.
- 1.21 The Committee notes that differences between industries in the measurement of "value added" mean that comparisons should be made with some caution. For example, measures such as gross product to income ratios (see Table 4) tend to produce higher values for primary sectors when compared with other sectors. This issue is further examined in Chapter 2.