The Parliament of the Commonwealth of Australia

Getting a better return

Inquiry into increasing the value added to Australian raw materials

Second report

House of Representatives
Standing Committee on Industry, Science and Resources

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Canberra

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Foreword

This report completes an inquiry into the prospects of increasing the value added to Australian raw materials, which the Committee carried out at the request of the Minister for Industry, Science and Resources.

The inquiry was carried out in two stages. The first stage, an evaluation of the current state of value-adding in Australia, was the subject of a report to the House of Representatives in March 2000. That report was called *Of material value?*. It indicated that the Committee, in the second stage of the inquiry, would study five industries, the aluminium, magnesium, dairy, grains and wine industries, in order to identify drivers of successful value-adding in Australia and what was needed to overcome any impediments. This report is the result of those case studies.

Both reports relating to this inquiry have been unanimous. This reflects the often bipartisan way in which House of Representatives committees carry out their work. It lends weight to the fourteen recommendations contained in this report and to the more numerous conclusions reached in both reports.

There are actions the Commonwealth Government can take to increase value adding in Australia. For example, the Government should encourage and facilitate increased investment in new value-adding industries, where investors are excessively averse to risk, or too focussed on short-term returns. The Government should aim to raise business expenditure on research and development to 1 per cent of GDP by 2005. Bilateral and multilateral action to reduce tariff and non-tariff barriers must be heightened. High priority should be given to the provision of infrastructure to serve the needs of regional and rural communities and value-adding industries. These and other matters are raised in the Committee's recommendations. The Committee looks forward to the Government's response early in the life of the next Parliament.

I want to thank all the members of the Committee for their participation and cooperation during the course of the inquiry. In particular, I want to thank the Deputy Chair, Mr Allan Morris MP, who has served on the Industry Committee for most of the last fourteen years and who is leaving the Parliament at the end of the current term.

On behalf of the Committee I would also like to thank all those who contributed their time and knowledge to assisting both stages of this inquiry. The individuals and organisations that prepared submissions or appeared as witnesses at hearings are listed in the appendices to this report. Their input was crucial and is greatly appreciated by the Committee.

Geoff Prosser MP
Chairman

Membership of the Committee

Chair	The Hon Geoff Prosser MP	
Deputy Chair	Mr Allan Morris MP	
Members	The Hon Bruce Baird MP (to 21/6/99)	Mr Ian Macfarlane MP (from 22/6/00 to 8/3/01)
	Mr Mal Brough MP (from 21/6/99 to 8/3/00)	Mr Gary Nairn MP
	The Hon Alan Cadman MP (from 29/3/01)	Ms Nicola Roxon MP
	Mr Michael Hatton MP	Mr Cameron Thompson MP (from 8/3/00)
	Mr Tony Lawler MP (to 22/6/00)	Dr Mal Washer MP
	Mr Jim Lloyd MP (Chair from 2/9/99 to 17/2/00)	Mr Christian Zahra MP

Committee Secretariat

Secretary	Mr Paul McMahon
	Mr Richard Selth (from 1/7/00 to 22/12/00)
Inquiry Secretary	Mr Russell Chafer (to 11/2/01)
	Mr Stephen Boyd (from 14/2/01)
Research Officer	Ms Margaret Atkin
Administrative Officers	Mrs Gaye Milner
	Ms Jennifer Cochran

Terms of reference

On 20 April 1999 the Minister for Industry, Science and Resources asked the Committee to:

> inquire into and report on the prospects of increasing value-adding to Australian raw materials. The Committee should start with an evaluation of the current state of value-adding in Australia, and how that compares internationally. This would provide a base from which to evaluate the following topics:
>
> - incentives and impediments to investment;
> - intellectual property rights;
> - national/international marketing factors which may encourage or hinder Australian value-adding;
> - government intervention, both nationally and internationally;
> - the location of value-adding industries and projects in regional Australia;
> - resource licensing/permit arrangements;
> - the impact of vertical integration within particular industries; and
> - the Australian skills base and any associated impediments.

List of abbreviations

AAC	Australian Aluminium Council
ABARE	Australian Bureau of Agricultural and Resource Economics
ADIC	Australian Dairy Industry Council
AFFA	Department of Agriculture, Fisheries and Forestry - Australia
AMC	Australian Magnesium Corporation
ANZFA	Australian and New Zealand Food Authority
APEC	Asia Pacific Economic Cooperation
ARWF	Australian Regional Winemakers Forum
ATO	Australian Taxation Office
AWB	Australian Wheat Board Ltd
AWBC	Australian Wine and Brandy Corporation
AWRI	Australian Wine Research Institute
BCA	Business Council of Australia
BERD	Business Expenditure on Research and Development
BSE	Bovine Spongiform Encephalopathy
CIE	Centre for International Economics

COAG	Council of Australian Governments
CPI	Consumer Price Index
CRCs	Cooperative Research Centres
CRCV	Cooperative Research Centre for Viticulture
DAA	Dairy Adjustment Authority
DFAT	Department of Foreign Affairs and Trade
DISR	Department of Industry, Science and Resources
DRDC	Dairy Research and Development Corporation
DTRS	Department of Transport and Regional Services
EC	European Community
ETMs	Elaborately Transformed Manufactures
EU	European Union
FMD	Foot and mouth disease
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GF	Goodman Fielder
GHG	Greenhouse Gases
GMO	Genetically Modified Organisms
GRDC	Grains Research and Development Corporation
GTR	Golden Triangle Resources
GVP	Gross value of production
GWRDC	Grape and Wine Research and Development Corporation
HEIAA	Heavy Engineering and Infrastructure Industry Sector Action Agenda

IC	Industry Commission
IP	Intellectual Property
ITRDC	Industry, Technology and Regional Development Council
NCC	National Competition Council
NEM	National Electricity Market
NIAC	National Infrastructure Advisory Council
PECA	Process Engineers and Constructors Association
OECD	Organisation for Economic Co-operation and Development
PSEs	Producer support estimates
QMC	Queensland Metals Corporation
R&D	Research and Development
RDCs	Research and Development Corporations
SLG	Strategic Leaders Group
SAMAG	South Australian Magnesium Project
TRIPS	Trade Related Intellectual Property Rights
UNFCCC	United Nations Framework Convention on Climate Change
WEA	Wheat Export Authority
WET	Wine Equalisation Tax
WFA	Wine Federation of Australia
WTO	World Trade Organisation

List of recommendations

Recommendation 1 (paragraph 2.79)

The Committee recommends that the Commonwealth Government take a pro-active role in facilitating investment in new value-adding industries, where excessive risk aversion and the desire of investors for short-term profits may be acting as impediments.

Recommendation 2 (paragraph 2.80)

The Committee recommends that the Department of Industry, Science and Resources include in the final *Light Metals Industries Action Agenda* a requirement to examine, and where possible respond to, support measures by foreign countries which may distort commercial investment decisions.

Recommendation 3 (paragraph 2.84)

The Committee recommends that the Department of Industry, Science and Resources implement a targeted research and development assistance package for the magnesium industry, aimed at ensuring that Australia benefits from expected future world growth of magnesium production.

Recommendation 4 (paragraph 2.90)

The Committee recommends that the Department of Foreign Affairs and Trade, through bilateral trade negotiations and, where possible, multilateral negotiations, seek to eliminate the use of tariffs and other trade barriers in the emerging international magnesium industry.

Recommendation 5 (paragraph 2.122)

The Committee recommends that the Department of Industry, Science and Resources include representatives of State Governments in its Strategic Leadership Group, which is responsible for developing an *Action Agenda* for the light metals industries.

Recommendation 6 (paragraph 2.145)

The Committee recommends that the Australian Greenhouse Office review Australia's needs and the applicability of the Kyoto Protocol. This review must include strategies for including emission targets for developing countries in the existing or future protocols and also the mechanisms by which Australia will transfer emission reduction and abatement technology to developing countries.

Recommendation 7 (paragraph 2.159)

The Committee recommends that the Commonwealth Minister for Transport and Regional Services ensure that, at the next meeting of the Ministerial Council on Regional Development, priority be given to the development of a long-term strategy for the provision of infrastructure to serve the needs of regional and rural communities and value-adding industries.

Recommendation 8 (paragraph 3.48)

The Committee recommends that the Commonwealth Government raise the current dollar-for-dollar funding ceiling (of 0.5 per cent of the industry gross value of production) for industry Research and Development Corporations to 0.7 per cent.

Recommendation 9 (paragraph 3.60)

The Committee recommends that the Minister for Agriculture, Fisheries and Forestry initiate an independent review of the dairy industry adjustment package. This review should assess whether the objectives of the assistance package were met and, if not, then further action should be recommended to ensure that the desired outcomes are achieved.

Recommendation 10 (paragraph 5.36)

The Committee recommends that the Commonwealth Minister for Industry, Science and Resources ensure that the issue of harmonisation of State legislation relating to the wine industry is an agenda item at the next meeting of Australian Industry Ministers.

Recommendation 11 (paragraph 5.45)

The Committee recommends that the Commonwealth Government in 2002 review the combined effect on the wine industry of all taxation impacts, including the wine equalisation tax.

Recommendation 12 (paragraph 5.68)

The Committee recommends that the Department of Industry, Science and Resources review all tariffs on imports that affect the wine industry and, where there is no overriding reason for their continuation, they should be set at zero immediately.

Recommendation 13 (paragraph 6.49)

The Committee recommends that the Commonwealth Government aim to ensure that its research and development programs provide sufficient incentive for business to invest in additional R&D, such that the level of business expenditure on R&D rises to 1.0 per cent of GDP by 2005.

Recommendation 14 (paragraph 6.99)

The Committee recommends that the Treasurer establish a public inquiry into the existing zonal taxation system focusing on:

- options for developing a business zonal taxation system:

⇒which would encourage investment in value-adding and research and development activities in rural and remote areas; and

⇒which would promote economic growth in rural and remote communities; and

- options for enhancing the zonal taxation rebate for individual taxpayers.

Executive summary

This report completes the Committee's inquiry into the prospects for value-adding to Australia's raw materials.

A first report, *Of material value?*, was presented to the House of Representatives in March 2000.[1] The first report looked at: the importance of raw materials processing in Australia, the current state of value-adding, factors important to the success of value-adding, and ways of encouraging further raw materials processing.

This second report contains the results of five case studies the Committee conducted into the aluminium, magnesium, dairy, grains and wine industries. These industries were selected because they reflected a range of levels of maturity and of value-adding performance. The Committee has sought to identify lessons to be learnt that would improve performance across industry generally. Fourteen recommendations have been made for Government action. These appear at the front, as well as in the body, of the report. The Committee's main observations are contained in 'Conclusions' sections in each chapter.

Chapter 1: Introduction

This chapter briefly summarises the first report, contains some background information about each of the industry case studies, and outlines two key policy statements, *Investing for Growth* (1997), and *Backing Australia's Ability*.

Chapter 2: Aluminium and magnesium industries

These two light metals industries are at quite different stages of development but have much in common.

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1 The first report may be accessed on the internet at http://www.aph.gov.au/house/committee/isr/Val_Add/contents.htm

Australia is the world’s largest miner of bauxite, accounting for about 40 per cent of production. It is also the world’s largest producer of alumina with about 30 per cent of production. However, it accounts for only about seven per cent of the world’s aluminium production. About 70 per cent of Australia’s bauxite is processed into alumina in Australia, but only 20 per cent of Australia’s alumina is processed domestically into aluminium.

The total value of export earnings by the aluminium industry in 1998-99 was $6.3 billion—$2.9 billion from alumina and $2.8 billion from aluminium metal. Only $350 million was earned from the export of semi-fabricated products. There is a substantial amount of value-adding that already occurs in the aluminium industry—about $3.1 billion in 1997-98—but there is considerable potential for that to be increased.

The magnesium industry worldwide is very small compared to the aluminium industry—about two per cent of its size in terms of metal production. Australia currently does not produce commercial quantities of magnesium, but there are nine projects under consideration. The potential gains from further processing are very substantial since magnesium raw materials retail for around $50 per tonne while the metal retails for around $1 500 per tonne.

Among the features that the aluminium and magnesium industries have in common are:

- they have a need for large amounts of patient investment capital, particularly the magnesium industry which is at a very early stage of development;
- they have a need to be at the cutting edge in terms of technology, therefore support for research and development is very important;
- they face issues of international competition, including the type and level of assistance provided by foreign governments to their industries;
- they are both highly energy intensive; and
- they face high costs of coastal shipping.

Investment finance

Australia has an excellent opportunity to be at the forefront of expected world growth in magnesium. It has effective infrastructure and microeconomic reforms are advancing to ensure that Australia is sufficiently competitive to attract capital. However, it is insufficient for governments to argue that provided economic settings are competitive then companies will invest in Australia.

The Australian Government, alongside industry, must monitor world market developments to ensure that Australia is best positioned to benefit from expected future growth. The provision of a loan guarantee for the AMC project, announced in August 2001, provides an example of one way that governments could contribute to the development of new value-adding industries, when investment finance is difficult to obtain.

The Committee recommends that the Commonwealth Government take a more pro-active role in facilitating investment in new value-adding industries (see recommendation 1).

The Committee also recommends that the *Light Metals Industries Action Agenda* include a requirement to examine and respond to support measures by other countries (see recommendation 2).

Research and development

While the 175 per cent premium rate for additional R&D is a positive measure, the Committee is concerned that perceptions exist that the Australian Government is not committed to, or providing, sufficient incentive for R&D. It is essential that Australia provides a competitive R&D framework.

There is a legitimate role for Government in fostering certain industries and the magnesium industry is a strong example. The Government should develop a targeted approach to assisting the magnesium industry to competitive technological and R&D outcomes (see recommendation 3).

International competition

It is essential that the Australian Government monitor the taxation regimes and other industry assistance programs offered by competing countries. The Australian Government must continue to monitor and assess its industry assistance framework against the performance of comparable governments.

The Committee considers tariffs to be a significant potential impediment to the development of the Australian magnesium industry and every effort should be made to encourage the USA, the EU and other countries to eliminate these tariffs and other trade barriers (see recommendation 4).

Energy

One of the key inputs for the aluminium industry is competitive power costs. It is estimated that power accounts for about 25 per cent of total aluminium production costs. The aluminium industry alone consumes 16 per cent of all Australian electricity consumption. Competitively priced energy is absolutely imperative for the aluminium industry and has been one of the foundation stones of the successful growth of the industry. The availability of competitively priced power is a major factor influencing where industries decide to locate alumina refineries.

The Committee investigated claims that there is a lack of generating capacity in the national electricity market (NEM) which is becoming an impediment to new value-adding investment in minerals processing plants in Australia. The Committee takes seriously the concerns about the NEM. It is unacceptable that there may be problems of supply and extreme price fluctuations. The Committee supports the initiative by the State Governments of NSW and Victoria to create a policy forum to examine the operation and performance of the NEM.

The Committee received expressions of concern about the inconsistent activities of State Governments and the influence this may be having on the NEM. The Committee notes that the Strategic Leaders Group (SLG) which advises on the development of the Action Agenda for the Light Metals Industries does not include State Government representatives. In view of the fact that energy provision is a key input to the light metals industries and the State Governments have important responsibilities in this area, it is not clear why representatives of State Governments are not on the SLG. The Committee recommends that representatives of State Governments be included in the SLG
(see recommendation 5).

The Kyoto Protocol

The Kyoto Protocol on greenhouse gas emissions was one of the most contentious issues raised in the inquiry. Agreements to restrict greenhouse gas emissions will have an impact on the light metals industries. In contrast, the use of lightweight metals such as aluminium and magnesium, in the automotive market for example, has significant environmental benefits.

The Kyoto Protocol on greenhouse gas emissions was a useful first step in addressing global warming. However, evidence to the Committee suggests that the Protocol has serious flaws that require attention before Australia should ratify the protocol. The most serious criticisms relate to the exclusion of developing countries from the protocol. The light metals industries suggest that this omission could lead to industry moving to developed countries. DISR suggested that this could lead to a worse greenhouse outcome because Australia is among the most energy efficient producers in the world. The exclusion of developing countries is the major reason for the United States Government rejecting the Protocol.

The Committee also notes that the Protocol does not give enough recognition to countries which produce lightweight materials which, for example, help to improve efficiency in automobiles.

The Committee suggests that reform of the Kyoto Protocol, or the development of a new agreement, is necessary and must include developing countries. In order to persuade developing countries to agree to meet emission targets, those targets will need to be generous. Developed countries must also be prepared to assist developing countries, including through the provision of emission reduction and abatement technology. In the meantime, it is essential that the light metals industries continue to find further efficiencies in their production methods.

The withdrawal of the USA from the Protocol has placed a serious impediment in the way of the Protocol being ratified, and no early conclusion to this problem is expected. The Australian Government should take this delay as an opportunity to review its needs and the applicability of the Protocol, taking into account the concerns raised in this report (see recommendation 6).

Infrastructure

The provision of suitable infrastructure is a major factor when considering investing in the light metals industries. Whether it is provided through public or private means, infrastructure should be seen as an investment rather than short-term financial expenditure. Commonwealth and State Governments should seek to develop flexible and creative responses to industry assistance relating to the provision of infrastructure.

The Committee notes that, through the Council of Australian Governments, infrastructure issues are being examined as part of the ongoing dialogue between regional development ministers. A key objective for this Ministerial Council should be to undertake an audit of government and industry provision of infrastructure, and assess outcomes arising from policy commitments, relating to infrastructure, made in the *Investing for Growth* statement. The Committee recommends that, at the next meeting of the Ministerial Council on Regional Development, priority be given to the development of a long-term strategy for the provision of infrastructure to serve the needs of regional and rural communities and value-adding industries (see recommendation 7).

Microeconomic reform

It is essential that the Government continue with its micro-economic reform agenda. It is essential that industry has access to competitively priced inputs, and that government regulations and taxes provide for long-term growth. The Committee agrees with the view that microeconomic reform is one of the key areas where the Government can assist industry to respond to competitive challenges.

Cultural barriers

The Committee is concerned that an attitude of avoiding further processing—a form of historical conditioning—may still be present in Australian industry. The Committee suggests that the Department of Industry, Science and Resources note the concerns raised about cultural barriers and ensure that the final *Light Metals Industries Action Agenda* addresses this matter.

Coastal shipping

While the removal of cabotage is a highly sensitive matter, particularly amongst unions and local ship owners, the Committee supports measures to reduce the cost of freight between Australian ports.

Chapter 3: Dairy industry

The dairy industry is a significant value-adding industry. In 1999 farm milk production valued at about $3 billion was converted into ex-factory product worth about $7.5 billion. It is Australia's third largest agricultural industry and the largest processed food export industry with exports totalling about $2.4 billion in 2000. Australia accounts for less than two per cent of world milk production but ranks third in world dairy trade.

In recent times, the industry has been subject to significant change through the impact of deregulation. During the past twenty years, rationalisation of the dairy industry has resulted in fewer farms and increased productivity. Farm numbers declined from about 29 000 in 1976 to about 13 000 in 1999. At the same time, milk yields have almost doubled.

Increasing globalisation has created a more highly competitive trading environment. At the same time, the international market is subject to significant market distortions through the use of subsidies and tariffs, which restrict market access and market competitiveness.

Evidence to the inquiry suggested that value-adding opportunities in the dairy industry will continue to grow. This is mainly a result of projected export growth and the development of new products.

The key challenges to the dairy industry identified in the inquiry include:

- globalisation and trade barriers;
- competitively-priced inputs and infrastructure;
- research and development (R&D); and
- deregulation.

Globalisation and trade barriers

The future prospects of value-adding in the dairy industry are reliant on international markets creating sufficient demand. The domestic market, by itself, is not sufficient to support large-scale, value-adding enterprises.

The outcome from the Uruguay Round of multilateral trade negotiations brought agrifood products more directly within the multilateral trade rules, removing a wide range of trade barriers and placing limits on subsidy use. Notwithstanding this development, while these negotiations were a step forwards and improved access to a range of markets, trade liberalisation for agrifood products has not moved as fast as anticipated and the fundamental need for reform still exists.

The Committee is pleased with the reports of the efficiency and competitiveness of the Australian dairy industry. The effect of tariff barriers and subsidies, however, distorts world prices and affects Australia’s access to markets. The Committee notes and supports the government’s efforts, through bilateral and multilateral negotiations, to reform the international market for agrifood products. The Department of Foreign Affairs and Trade must continue to place a high priority in achieving reform in this area.

Competitively-priced inputs and infrastructure

There are a range of inputs such as transport, energy and water resources which influence the dairy industry. While the evidence suggested that some improvements in energy and infrastructure have resulted from past microeconomic reforms, further progress is necessary.

The Department of Agriculture, Fisheries and Forestry – Australia (AFFA) drew attention to problems with future access to infrastructure and ageing of existing infrastructure. The provision of effective infrastructure is essential and the concerns raised by the dairy industry are not unlike those raised by the light metals industries examined in Chapter 2. As part of that examination, the Committee recommended that the Commonwealth Minister for Transport and Regional Services ensure that, at the next meeting of the Ministerial Council on Regional Development, priority be given to the development of a long-term strategy for the provision of infrastructure to serve the needs of regional and rural communities and value-adding industries. Such a strategy should include the needs of the dairy industry.

In relation to energy needs, it is not acceptable that some areas are insufficiently supplied. The Australian Dairy Industry Council (ADIC) identified certain areas in Victoria where this is a problem. The provision of competitively priced energy should be a given. It is unacceptable that in a first-world country such as Australia problems of supply are being reported. In Chapter 2, the Committee examined the energy needs of the light metals industries. The Committee noted that the National Competition Council forwarded a review of the national electricity market to the Treasurer at the end of July 2001 and intends to conduct an examination every year. The Committee suggests that the concerns of the dairy industry should feature in those examinations.

Research and development

R&D in the dairy industry is focused around the work of the Dairy Research and Development Corporation (DRDC), which administers industry funded R&D. The role of the DRDC is to maximise the economic, environmental and social benefits to stakeholders through targeted investment in R&D.

The Australian dairy industry must continue its research and development effort. The Australian Government is making a contribution through such initiatives as the provision of tax concessions on R&D expenditure, and through contributions to R&D corporations generally matching industry levies on a dollar-for-dollar basis up to a maximum of 0.5 per cent of the industry’s gross value of production.

The Committee is concerned that, in respect to the DRDC, the 0.5 per cent ceiling may soon be reached and therefore proposes that the Commonwealth Government’s dollar-for-dollar funding should continue to 0.7 per cent of the gross value of production. While the Committee has not received evidence on the operation of the ceiling with respect to other R&D corporations this premise should also apply to them (see recommendation 8).

Deregulation

Deregulation has been a major driver of change to the dairy industry in recent times. Prior to deregulation, State governments regulated the milk market to ensure an adequate supply of fresh milk throughout the year. In response to commercial pressures for deregulation, all State Governments by 1 July 2000 had passed legislation removing farmgate pricing arrangements.

In response to industry concerns about the effects of deregulation on producers, the Federal Government introduced an assistance package estimated to cost $1.78 billion.

The Committee received no evidence discussing the effectiveness of the assistance package. This is mainly because the assistance package was introduced towards the end of the inquiry. The Committee suggests that a post-delivery review of the package is necessary. The review should ensure that administration of the scheme has been cost-effective and that the scheme's objectives have been met. Where it is found that some of the scheme's objectives have not been achieved, then the review should recommend ameliorative action (see recommendation 9).

Chapter 4: Grains industry

The examination in this chapter addresses the grains industry in general, with particular focus on the wheat industry reflecting the nature of the evidence received and the size of the wheat industry. The outlook for world wheat trade is promising in the short to medium term, and in the longer term it is expected that world population growth will drive demand for grains such as wheat.

The bulk of grain production occurs in central Queensland, New South Wales, Victoria, South Australia and through the southern part of Western Australia. Wheat is by far the biggest grain crop produced in Australia both in terms of grain produced and value. Approximately 75 per cent of wheat produced is exported in raw form. Wheat makes up approximately 65 per cent of the total value of crop exports.

Wheat exporting and marketing is operated through a single desk arrangement. The Committee notes that a government decision has been made to retain the wheat single desk and that the Wheat Export Authority (WEA) will, before the end of 2004, assess the performance of the Australian Wheat Board (AWB) with regard to its use of sole wheat export rights. The Committee considers that the WEA, as part of its review, should take into consideration the impact of single desk export arrangements upon the domestic food market.

In the domestic and export markets, value is added through product innovation. The focus of wheat exports has been on value-adding through producing special varieties of wheat in response to consumer needs, and through having better quality assurance.

The international market for wheat is extremely competitive and distorted by the actions of tariffs and subsidies. One of the key impediments affecting the wheat industry is the provision of economic subsidies by other countries. The impact of government subsidies can include lowering world prices and distorting market signals. Governments of the European Community and the USA are the main offenders.

The use of government subsidies, particularly by the USA and EC, to support wheat farmers is a blight upon international trade. The market is distorted, market signals become unclear and ultimately world prices are depressed. The extent of subsidies was particularly high during the 1980s, and it is alarming that current subsidies are again reaching those levels. In response to government subsidies, the Australian Government must continue to argue for an end to subsidies at international fora such as the World Trade Organisation.

Chapter 5: Wine industry

The Australian wine industry is a model industry in that significant production growth and export sales have been achieved, particularly over the last ten years. This success is not just the result of having a quality product, although the quality of Australian wine is extremely good. It is more about having knowledge of, and responding to, consumer needs, applying expert marketing, recognising the importance of R&D, and overall having an innovative approach to winemaking and sales.

The performance of the Australian wine industry provides valuable lessons for other industries. In particular, other industries should note the wine industry's quality approach to production, its organisation and structure, and its marketing and sales strategies.

The Australian wine industry has proven to be a successful value-adding industry. Wine exports have risen from $10.8 million in 1986 to over $1 billion in 1999. The $1 billion export mark was reached five years ahead of schedule. The value of wine exports in 2005 is expected to reach about $3.1 billion.

The quality of purpose or unity of vision is identified as a major feature of the Australian wine industry, which sets it apart from other wine producing countries. The focus on continuous improvement is another feature of the Australian wine industry. The recent successes of the Australian wine industry are not due to geographic, soil or climatic advantages over its competitors. The successes are due more to the contribution of effective R&D, training, and the overall innovative quality of the people in the wine industry. In particular, the industry is renowned for accurately assessing consumer needs and producing new products and styles together with expert marketing. In addition to product quality, Australian wine offers consistently good value for money.

Consistency of State government legislation

The Committee notes industry concerns about the application of inconsistent State Government legislation. Compliance costs can be increased where there are a range of different State regulations. The Australian Industry Ministers' meeting is the appropriate forum for addressing the concerns of the Wine Federation of Australia about inconsistent state legislation (see recommendation 10).

Wine Equalisation Tax

The wine equalisation tax (WET) was introduced as part of the new taxation system on 1 July 2000. Prior to this date, a 41 per cent wholesale sales tax applied to wine and wine products. Under the new taxation system, these products are subject to a 29 per cent wine equalisation tax in addition to the GST of 10 per cent.

A WET rebate scheme will help to ensure that small winemakers are not adversely affected by WET. This will complement the States' schemes to provide winemakers with assistance of 15 per cent of the wholesale value of cellar door and mail order sales to unlicensed people.

While the WET was criticised, it had not been in operation for more than six months when the Committee received evidence about it. Subsequently there have been a number of representations made to the Government concerning the WET. The Committee believes that, in time, the combined effect of the various taxation treatments impacting on the wine industry should be reviewed (see recommendation 11).

Funding for research and development

Research and development have played, and will continue to play, a major role in the success of the Australian wine industry. Two of the key initiatives, partly funded by government, which support R&D are the Cooperative Research Centre for Viticulture (CRCV) and the Grape and Wine Research and Development Corporation.

The Committee notes that the Government has expanded its support for the cooperative research centres program through commitments made in the *Backing Australia's Ability* policy statement. In relation to the RDCs, the Committee has recommended an increase in the current dollar for dollar funding by the Commonwealth (see recommendation 8).

Market access

Tariffs and non-tariff barriers are impediments that affect many industries including the world wine market. While tariffs are relatively low in most countries, the impact of non-tariff barriers is significant. The Government must continue to negotiate reform to tariffs at international fora.

The Committee notes the concerns by the WFA about the adverse impact that Australian tariffs are having on the importation of certain wine-making products such as oak barrels and coopers products. The removal of 'nuisance tariffs' is one area where government can act decisively. A number of such tariffs were removed following a general review in 1999. A further review of tariffs affecting the wine industry should be undertaken (see recommendation 12).

Chapter 6: Summary of the key value-adding issues

A recurring theme in the inquiry was 'quality'. Regardless of industry, consumers are interested in product quality, as well as value for money. Continual improvement in production processes is the key to achieving cost competitiveness and product quality. Quality also underpins, and is essential in, design, process and marketing. Successful industries have all targeted quality in every aspect of their operations. The five industry case studies also all identified competitively priced inputs, such as energy, and good infrastructure, such as means of transport, as essential.

Innovation

The evidence is unanimous in its support for, and the priority that should be placed on, innovation in adding value to Australia's raw materials. Innovation is essential to any successful industry. It arises from human creativity, skill and research that feed the stock of knowledge. The diffusion of knowledge, aided by linkages within industry and within the economy generally, further stimulates creativity and encourages the commercial application of that knowledge. A strong focus on the market—the needs of consumers—and marketing are also essential.

The Committee strongly urges the Government to ensure that its programs and initiatives that support innovation continue to be effective.

The research and development tax concession

The R&D tax concession is a positive initiative that has had a net social benefit for Australia. The major area of concern by industry is the reduction of the R&D tax concession from 150 per cent to 125 per cent. The Committee takes these concerns seriously though it is necessary to note that since these criticisms were made the Government has introduced a premium 175 per cent tax concession for additional R&D activity. Companies will be able to claim the new premium concession in respect to expenditure made in the 2001-02 year.

As the premium concession has only just been introduced, the Committee is reluctant to propose changes to the R&D tax concession system. A thorough policy evaluation, however, should be undertaken at the end of three years from the initiative's commencement to ensure that the combination of the 125 and 175 per cent premium tax concessions are achieving the Government's innovation objectives.

The Committee notes that the Australian National Audit Office has identified the R&D tax concession arrangements as a potential audit for 2001-02.

Business expenditure on research and development

Australian business expenditure on R&D (BERD) fell from 0.86 per cent of GDP in 1995-96 to 0.64 per cent in 1999-00. The CSIRO reported that most OECD countries increased their BERD during the same period. The Committee finds it unacceptable that Australia's BERD is falling. It is essential that the Government ensures that its R&D programs provide effective incentives for private sector investment in R&D.

The Committee suggests that the Government should set itself R&D performance targets, and that a more strategic approach to the R&D framework is needed. For example, the Government should aim to ensure that the level of BERD rises to at least 1.0 per cent of GDP by 2005 (see recommendation 13). If this target is not reached, then the Government should undertake a major review of its programs.

Research and Development Corporations

Research structures such as the Research and Development Corporations (RDCs) provide strong support for rural industries. The RDCs operate within AFFA and are generally funded on the basis of the Government matching industry R&D levies. The Committee restates its previous support for the R&D Corporations model (see recommendation 8).

Gene technology

It is essential that industry conduct research into genetically modified organisms (GMOs). In addition, industry should also monitor the research and trends in marketing of GMOs in overseas markets. Australia must ensure that its competitive position is not undermined and that it can benefit from any value-adding initiatives arising from the safe and controlled development of GMOs, subject to market acceptance.

At the same time, the Committee acknowledges the public apprehension that exists regarding GMOs. The Committee is confident that the *Gene Technology Act 2000* provides a sufficient framework for managing the risks associated with gene technology. The Committee notes that the *Gene Technology Act 2000* will be subject to a Ministerial Council review five years from its commencement. This will provide an opportunity for industry and other interested groups to examine the operation of the Act and ensure that it is achieving its objectives.

Intellectual property

A reliable and effective intellectual property (IP) framework is essential for giving confidence to industry, particularly those involved in conducting R&D. The Committee notes the Government’s 2001 *Backing Australia’s Ability* statement acknowledged the need for a strong IP protection regime.

The Committee received generally favourable comments about the Government’s IP initiatives and the performance of DFAT in managing IP issues in international fora such as the WTO. The Committee suggests that DFAT take note of the Wine Federation of Australia’s (WFA) concern relating to the Agreement on Trade Related Intellectual Property Rights (TRIPS). The WFA was concerned that if TRIPS were reopened, based on negotiations to allow recognition of traditional expression as a form of IP, then it would have wide ramifications for the wine industry.

Taxation issues

The taxation framework encompassing corporate taxation rates, deductions, and concessions can have a significant influence on business decisions. As part of the first report, it was noted that the focus of evidence was centred on the claim that competitive fiscal regimes are required to compete internationally and to attract investment to Australia.

The Committee, in its first report, noted that while tax incentives offered by countries could divert investment in raw material processing away from Australia, Commonwealth and State Governments also offer some incentives for potential projects. Industry was generally supportive of the direction of tax reform in recent years including the overall outcome of the recent business tax review. However, some groups, particularly from the mining sector, criticised the elimination of accelerated depreciation.

As part of the first report, the Committee sought additional evidence on proposals for enhancing the taxation regime and, in particular, how certain taxation measures could enhance value-adding outcomes. One of the issues that were debated in the second stage of the inquiry was zonal taxation.

One of the Committee’s objectives as part of this inquiry was to examine the issue of value-adding industries and projects in regional Australia. Much of this assessment has been implicit throughout this report. The aluminium and magnesium industries, for example, conduct much of their mining efforts in regional and remote areas. This activity may influence the economic standing of regional communities.

The Committee suggests that the concept of zonal taxation should be examined further to see if there is merit in extending it from individuals to companies.

The Committee notes that zonal taxation systems do have administrative complexities. At the same time, there has not been a public inquiry into zonal taxation since 1981. The Committee suggests that a new inquiry with wide ranging terms of reference is needed (see recommendation 14). Its two key objectives should be to recommend a system that provides incentives for business investment focusing on value-adding and R&D activities and which has growth benefits for rural and regional communities.