Department of
AGRICULTURE
FISHERIES &
FORESTRY -
AUSTRALIA

Submission to the

House of Representatives
Standing Committee on
Industry, Science and Resources

Increasing value adding to Australia's raw materials

December 2000

Preface

The Department of Agriculture, Fisheries and Forestry – Australia (AFFA) made a submission to the first phase of the House of Representatives Standing Committee on Industry, Science and Resources' Inquiry into Increasing Value Adding to Australia's Raw Materials in September 1999.

The submission defined value adding as any process or service in the supply chain that adds to or enhances the market value of products to customers. This definition covers a wide range of activity including:

- transformation of raw products into highly processed or manufacturers products;
- supplying new products or different varieties
- increasing utilisation of by-products
- introducing quality assurance standards
- changing presentation to meet market requirements
- providing expertise and/or services, including advice on product use and improved delivery and distribution
- partially enhancing the value of products traditionally exported in their raw form
- managing the use of natural resources more efficiently and sustainably in order to attract price premiums
- promotion and marketing activities to differentiate Australian products.

In the submission AFFA concluded that value adding offers great opportunities for Australia's agricultural, fisheries and forestry industries, but that there are limitations to these opportunities in particular circumstances. The following factors need to be considered in determining whether or not to value add:

- is value adding practical (ie: does it make sense to value add)?
- is value adding appropriate (ie: the costs and benefits of adding value)?
- is there a market for the value added product (ie: is the value adding in response to customer demand)?
- is the market sustainable?

The definitions and principles of AFFA's first submission apply for this submission.

Executive Summary

The role of the Department of Agriculture, Fisheries and Forestry – Australia (AFFA) is to increase the profitability, competitiveness and sustainability of Australia's agricultural, food, fisheries and forestry industries and enhance the natural resource base to achieve greater national wealth and stronger rural and regional communities.

Value adding is one way of increasing the profitability and competitiveness of these industries. In order to promote rural growth, employment and diversification opportunities, AFFA supports and encourages increased value adding where this is commercially practical and sustainable and is consistent with consumer demand and market signals.

The wine, dairy and grains industries selected by the committee for closer examination in this inquiry are good examples of value adding within the agricultural sector. The wine and dairy industries are 'value-added' industries, while value adding opportunities are pursued in the grains industry where this meets customer demand.

The experiences of these industries suggest that the key factors identified by the committee do impact on the decision to value add, and therefore will influence the prospects for further value adding to Australia's raw materials.

Investment issues
AFFA's portfolio industries are generally capital intensive so investment is a key consideration for businesses operating in these industries. Investment has played a key role in driving competitiveness in the dairy industry, with Australian firms investing heavily in new processing facilities, product development and new corporate structures. Foreign investment has introduced a new element of competition into the domestic market and introduced international expertise into the industry. Clear market signals and sectoral forecasting have provided sound bases for strong investment in the wine industry. Confidence is vital to investment decisions.

Government and industry working in partnership should identify where its strengths and opportunities lie within the agrifood sector and direct some investment attraction activities to these areas. The focus should be to encourage companies to invest in Australian agrifood production where it is clear that it has a comparative advantage to supply export and domestic markets.

Access to efficient and competitively priced inputs and infrastructure
Access to competitively prices inputs and infrastructure is vital to the competitiveness of value added products. The process of microeconomic reform over the course of the 1990s has increased the competitiveness of some inputs; however, other inputs remain an issue frequently cited by value adders. Food processing firms in particular have expressed concerns about the impact of the cost of freight and the cost, availability and quality of packaging on their already narrow profit margins. Australian agrifood firms are generally relatively small by international standards and have less influence to negotiate the highly competitive freight rates that the world's food manufacturing giants can. Access to competitively prices inputs is a key determinant of the decision to add value.

Government regulation

Regulation is a key issue in creating an environment in which agrifood industries can increase their competitiveness and add the maximum value to products appropriate to the country's competitive advantages. A wide range of government regulation at local, State/Territory and federal levels applies to business operating in Australia. In some industries, firms are also subject to agreed industry standards or codes, which are in addition to general government regulation. Throughout the 1990s there was an increasing recognition of the costs associated with regulation and the impact this burden had on business, particularly small business operators.

Industry should take greater responsibility for its own future. Governments should continue to encourage and support greater industry involvement in self-regulation or co-regulation where this is appropriate.

Taxation

Like government regulation, taxation can have a major impact on business decision making and can be a factor in determining whether or not a firm value adds or exports. The introduction of the A New Tax System package will reduce business costs through, among other things, cutting company tax rates from 36 per cent to 30 per cent. This will provide a positive stimulus for further value adding of raw materials by the agricultural, food, fisheries and forestry industries and in particular for the export of value added products.

The need for innovation

Innovation is one of the areas which hold the most promise for increased value adding of Australia's raw materials. Australian firms often cannot compete with lesser developed countries on input costs, nor do they have the size and influence of their European and US competitors to influence investment decisions with the same leverage. Where Australian farms and firms are successful, it is primarily due to innovation. Firms in the wine and dairy industries have shown themselves to be adept at introducing and adopting innovative products, production processes and marketing practices. A key to successful innovation in the wine industry has been the willingness of each element of the value chain to invest in development focussed on other elements of the chain in the knowledge that an increase in competitiveness anywhere in the process will have a flow on effect to every member of the chain. Apart from innovation in existing firms there has been a proliferation of innovative small businesses in rural Australia driven by the desire to do something with excess or low value farm product or to capture greater returns by moving along the market chain producing.

Australia's agrifood industries need to develop a more innovative culture including an enhanced understanding and awareness of innovation, the improvement of links between firms and the national innovation system and an increased focus on meeting customer and consumer demands.

While recognising that there may be limitations on internet use in regional areas, the opportunities offered by the internet, for example as an affordable marketing avenue or as a cost-reduction tool, need to be more rigorously examined by agrifood firms.
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Labour and skills issues

Labour and skills issues are often a key determinant of the level of value adding, particularly where processing is involved. A highly skilled workforce has been an important part of Australian governments' pursuit throughout the 1990s of a society and economy able to fully participate in the new technology world.

Firms and industry organisations need to identify skills-gaps in the agrifood sector and to develop long term policies, including building the image of these industries as profitable and rewarding career choices, to overcome shortages these shortages.

Market access

The international market for value added agrifood products is distorted by high levels of support and protection in many major markets and by tariffs, tariff quotas, subsidies (both domestic and export) and technical restrictions such as labelling requirements. These arrangements have a considerable impact on Australian value added products in export markets either by restricting trading opportunities or reducing competitiveness. The overall intention of countries adhering to such policies is to discourage countries like Australia from exporting value added products and to instead value add to imported raw materials. Bilateral and multilateral negotiations and arrangements continue to have a crucial role in building exports of processed products, thereby increasing value adding in Australia.

Introduction

The role of the Department of Agriculture, Fisheries and Forestry – Australia (AFFA) is to increase the profitability, competitiveness and sustainability of Australia's agricultural, food, fisheries and forestry industries (the portfolio industries) and enhance the natural resource base to achieve greater national wealth and stronger rural and regional communities.

Value adding is one way of increasing the profitability and competitiveness of these industries. In order to promote rural growth, employment and diversification opportunities, AFFA supports and encourages increased value adding where this is commercially practical and sustainable and is consistent with consumer demand and market signals.

The nature and extent of value adding in the portfolio industries was examined in AFFA's submission to the committee in 1999.

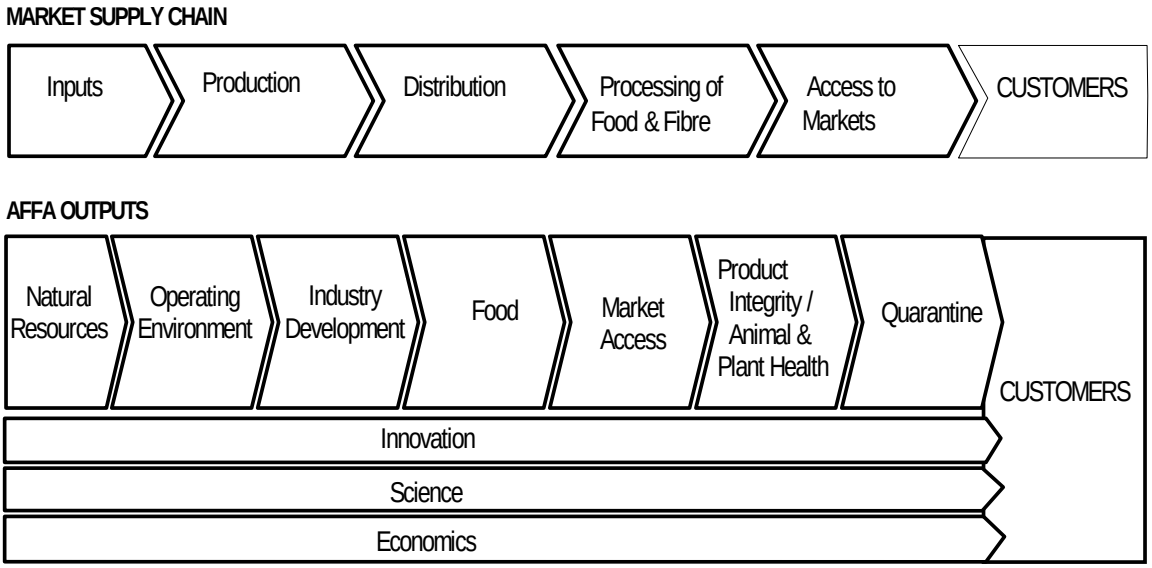
The committee has since sought submissions on the factors affecting the prospects for increased value adding of Australia's raw materials, identifying the following factors as the focus of this stage of the inquiry:

- investment issues;
- access to efficient and competitively priced inputs and infrastructure;
- government regulation;
- taxation;
- the need for innovation;
- labour and skills issues; and
- market access.

The committee has also identified five industries as case studies to demonstrate how these factors affect the prospects for increased value adding of raw materials in Australia. Three of these industries - wine, dairy and grains – are within the portfolio industries.

This submission will examine how the seven factors identified by the committee encourage or impede increased value adding by Australia's agricultural, fisheries and forestry industries. Examples of the experience of firms operating in the wine, dairy and grain industries will be used to illustrate the impact of each factor on the prospects for further value adding.

Since its first submission to the committee, AFFA has undergone a reorganisation to build a more customer and results-driven organisation. This has involved restructuring the department to better align our outputs with the operating environment of our portfolio industries. The following diagram, *AFFA Outputs in Context*, demonstrates how the department's outputs or business groups mirror the stages of the market supply chain.



AFFA's recognition of the need to align its business with the market supply chain enables the department to deal more directly with factors affecting portfolio industries along the entire chain. As such AFFA is keenly aware of the impact of the factors identified by the committee and is well placed to make this submission.

Investment issues

AFFA's portfolio industries are generally capital intensive, so investment is a key consideration for businesses operating these industries.

At the production end of the chain, the outlays required to purchase and sow/stock land each season are high, while the costs of diversifying into new products or processes can be prohibitive. Primary production faces risks, such as seasonal factors or variations in climatic conditions which increase the uncertainty of returns on investment.

The 1990s in particular saw a move by farmers and others in rural communities into value adding to capture greater returns further along the chain and to build local employment. However, access to start-up capital by such operators is often difficult primarily because the owners of these fledgling firms often lack the skills required to develop a coherent business case and market their products and ideas to financial institutions. As a result, these small-scale operators often have to fall back on their own resources to establish themselves. However, where the relevant business development skills are present, small value adders are generally able to access appropriate funding and compete successfully in niche markets for high quality products domestically and overseas. This supports the notion that difficulties in obtaining capital are primarily due to lack of appropriate business skills rather than any failure in the capital market.

The problems at the other end of the scale are quite different. Large established processors are under increasing pressure to become more competitive, especially if they want to compete in export markets. To do this they need to get bigger either through expansion of current operations, diversification or the purchase of existing companies. For example, over the past few years Australia's largest agrifood processor Goodman Fielder has increased its size and market share by acquiring a number of millers and bakers in

Australia and New Zealand, including Bunge Defiance.[1] However, Goodman Fielder is now facing a problem generic to Australian industries sensitive to economies of scale. The small size of the Australian market means that scale-sensitive industries have difficulties supporting more than one company supplying the whole of the local market. However, the *Trade Practices Act* limits acquisitions and mergers to protect consumers through ensuring that monopoly situations do not emerge. While the prevention of monopolies is essential in safeguarding consumer rights to low-price goods, scale-sensitive companies such as Goodman Fielder must now undertake high-risk export market development to develop economies of scale rather than being able to rely on further 'safe' expansion in its home market.

> *"The integration of the Bunge Defiance business, which led to the closure of five bakeries and three flour mills in Australia, generated more than $20 million in cost savings alone."*[2]
>
> *"…consolidation will result in a more efficient business, improves competitiveness and lower cost pressures on consumers prices."*[3]
>
> Goodman Fielder

The process of mergers and acquisitions among Australian value adders has also seen many purchased by foreign companies seeking to establish market share in Australia, as well as service local export markets in areas of Australian competitive advantage. For example, as part of the process of globalising its operations Italian dairy manufacturing giant Parmalat established an initial foothold in Australia by purchasing a Wagga-based dairy and followed this up by purchasing Pauls in Queensland.

Further acquisitions, mergers and strategic alliances can be expected as firms seek to secure sufficient capital equity to improve the efficiency of their operations by establishing and operating large, cost-efficient processing plants with good distribution networks and sophisticated marketing strategies. Such developments are expected to further foster value adding through wider access to markets and in-house R&D funding for new product developments. Acquisitions, mergers and strategic alliances may also occur if foreign companies come to see Australia as a base for exporting to third countries, particularly in Asia.

> *"They've transferred some other business skills to us. It's nice to work with one of the largest yoghurt manufacturers in the world and one of the largest food businesses in the world because they have business skills … that are much more extensive than ours…"*
>
> Alan Tooth, Managing Director of Dairyfarmers, re a proposed partial merger with Danone[4]

Scale of operations is a critical issue in *cost-competitive* agrifood production throughout the chain. However, when value adders aim to compete on *value-based* factors, such as quality and product differentiation, competitiveness is often more successfully achieved in a small/medium sized company. As a result, while the merger of mid-size firms in the

[1] Goodman Fielder Annual Report 1999-2000. At the same time Goodman Fielder has shed non-core assets, such as the Steggles poultry operation.
[2] Goodman Fielder 2000 Concise Annual Report, pg 4
[3] "*Goodman Fielder consolidates its Australian milling and mixing operations"*, Goodman Fielder Media Release, 25 October 2000
[4] ABC Rural News, 15/5/00

processing sectors has led to fewer, more nationally focussed entities with larger facilities, there has been a simultaneous increase in the number of niche producers of specialty products such as cheese and yoghurt or boutique wines.

The Australian agrifood industries, particularly the primary industries, can be an attractive investment proposition for foreign capital. However, the rise of the south east Asian economies over the last two decades, combined with their willingness to offer investment incentives and protect local manufacturing industries through tariff escalation, has resulted in increasingly tough competition for regional investment, particularly in manufacturing industries. Recent government initiatives, such as the Strategic Investment Coordinator and the Major Projects Facilitation scheme, have been undertaken in recognition of this.

Where available, Australian government investment attraction tends to focus on high-tech industries and the services sector. However, Australia has comparative advantage in some agrifood production (eg wine and dairy) due to a range of issues such as:

- relatively cheap land, skilled labour, competitive inputs, and understanding and use of technology
- the perception of Australia as having a clean environment with an excellent record for agrifood safety, free from many diseases, radioactivity and other pollutants, and with a low GMO penetration.

"I have always felt that Australia should brand itself … The rainfall is clean, the oceans are clean, the wind is clean and therefore the agriculture can be very clean too and that's a branding of increasing value to the North."

Bob Bishop, Chief Executive, CSIRO[5]

Increased foreign manufacturing in Australia has a direct effect through growth in employment and exports. There are also positive spillovers for local industry through:

- skills transfer, including increased understanding of export issues, management, production capability etc
- increased demand in non-agricultural inputs, such as machinery and packaging, will drive down prices and enable local manufacturers of these inputs to develop scale in their own production facilities. It will also encourage them to focus on consumer requirements.

Government and industry working in partnership should identify where its strengths and opportunities lie within the agrifood sector and direct some investment attraction activities to these areas. The focus should be to encourage companies to invest in Australian agrifood production where it is clear that it has a comparative advantage to supply export and domestic markets.

Sound investment decisions require comprehensive, up-to-date information, including market forecasting. Poor investment decisions tend to be based on incomplete or imperfect information. This is particularly evident during periods of industry expansion when optimism about the prospects for growth and potential returns on investment tend to become exaggerated as demand for investment opportunities increases. This situation often leads to rationalisation and revaluing of investments in a particular firm or industry at

[5] Australian Financial Review, 3/10/00, pg 33

best, or a major shake out with business failures, investor losses and industry credibility tarnished at worst. There are several examples of this experience in the agricultural, fisheries and forestry industries, particularly in the so-called emerging industries, where investment is driven by tax considerations or based on unsubstantiated optimism about the market potential of a particular product. Dependable and realistic information about an industry or firm's market and potential return on investment is vital to avoid these problems and misallocation of resources in the economy as whole.

The recent experience of the wine industry is a good example of how comprehensive and realistic information has provided direction for investment decisions. The enormous success of the industry on export markets has led to a massive expansion of plantings. Wine and winegrapes were popular and fashionable. Extensive market research by the major companies and wine industry organisations, together with accurate information on current plantings, enabled the industry to forecast demand for particular wine styles and to encourage the planting of particular varieties. Ongoing market research and forecasting of the supply from current non-bearing plantings has enabled the industry to identify a potential problem of over-planting. Using this information investment advisors have lately been recommending that investors concentrate on processing facilities to meet the increased crop, rather than investing in further plantings.

> *"Providing an effective flow of information necessary for effective decision making is fundamental to the Corporation's stated mission of enhancing the operating environment of the Australian wine industry*."
>
> Australian Wine and Brandy Corporation[6]

The dairy industry – a case study in sectoral rationalisation

The Australian dairy industry has undergone substantial rationalisation over recent decades. Where over 29 000 farms existed in 1976, only just over 13 000 now remain. Smaller dairy farmers are finding their costs of production are no longer competitive and have had to increase the size of their operations or leave the industry. Similarly, the farmer owned co-operatives which dominate dairy processing, have consolidated with neighbouring co-operatives through mergers, acquisitions and alliances to become more competitive and achieve greater efficiency through economies of scale and rationalisation of costs.

Globalisation has created a highly competitive trading environment. Australian dairy companies and co-operatives have been the subject of takeover bids and mergers by international players who are seeking to gain a foothold and expand in the Australian market. Other companies and co-operatives have also made strategic alliances with international players. For example, Bonlac Foods and the New Zealand Dairy Board (NZDB) have signed a Heads of Agreement under which it is proposed that parts of each organisation's operations will be merged, and the NZDB will take a 25 per cent minority shareholding in Bonlac. This alliance is aimed at providing both organisations with the opportunity to strengthen their domestic and international positions.[7]

[6] Australian Wine and Brandy Corporation Annual Report 1999, pg 49

[7] Bonlac Foods & New Zealand Dairy Board; Joint Media Release "Bonlac and the NZDB examine trans-Tasman dairy merger", 28/4/00. Bonlac shareholders have yet to vote on the proposal.

Increased investment in new plant and equipment has also been a result of rationalisation where improvements in transport, storage and handling processes have reduced the need for production and processing of milk close to markets and has led to some factory closures and relocation of resources.

Investment has played a key role in driving competitiveness in the dairy industry, with Australian firms investing heavily in new processing facilities, product development and news corporate structures. Foreign investment has introduced a new element of competition into the domestic market and introduced international expertise into the industry.

The wine industry – a case study in sectoral expansion

The wine industry is experiencing massive expansions in the industry with the area planted to grapes growing by an annual average of 14 per cent from 1995 to 1999. These plantings are expressly to fulfil the export markets developed, in the first instance, by the four dominant players (BRL Hardy, Mildara Blass, Southcorp and Orlando), and now also by smaller wineries exploiting the established Australian image. In excess of $1.2 billion has been invested in establishment of vineyards, with a similar amount set aside for processing and winery equipment. These investments take place in rural areas across Australia with substantial flow-on benefits to regional economies.[8]

The top four companies, three of which remain Australian owned, crush about 55 per cent of Australia's total grape intake, with the top 20 crushing around 90 per cent. The growth of the industry has been driven in part by development of industry-wide strategic planning – *Strategy 2025*. They are expanding rapidly, including through acquisition of overseas operations in recognised wine-producing regions such as France and California.

Investment in the Australian wine industry has extended to the share market, with a significant increase in the number of wine companies listed on the Australian Stock Exchange over the last decade. There are also a large number of major companies which are either privately owned or not separately listed. Wine companies have strongly out-performed the All Ordinaries and Industrial indices since 1995, with market capitalisation growing from about $1 billion in 1992 to $4 billion in 1999.[9]

The drivers of increased investment in the wine industry have been:

- overseas marketing, including the development of a generic Australian image
- industry champions driving a strategic approach to sectoral growth
- sectoral forecasting, enabling considered investment decisions at all levels of the value chain.

The grains industry

Deregulation in the grains industry in the 1990s in the areas of marketing and storage, handling and transport has opened up new investment opportunities. Several multi-million dollar projects are underway. For instance, AWB Ltd has a number of joint venture/alliance type of arrangements in place including the Melbourne grain export

[8] Prime Minister's Science, Engineering and Innovation Council *Occasional Paper Number 3*: *The Australian Wine Industry – Success Through Industry Leadership, Planning & Innovation*, February 2000, p6
[9] Prime Minister's Science, Engineering and Innovation Council, *op cit*, February 2000, p7

facility with Australian Bulk Alliance (Grainco and the SA Cooperative Bulk Handling (now Ausbulk Ltd)), AWB Seeds (with Revell, IAMA) and Graingene (with the Grains Research and Development Corporation) for developing and commercialising new varieties and seeds; Agrifood Technology (quality testing etc) and an alliance with SGS Australia for seed testing and certification; an alliance with Co-operative Bulk Handling Ltd (WA) which would combine marketing and storage/handling and financial services if CBH undertakes a compatible restructures .

In addition, AWB Ltd has an arrangement with the Adelaide Bank for administration of pool harvest payments and additional financial products and services to growers. It has a long term agreement with Australian Transport Network (owners of Tasrail) to provide rail services in NSW and Victoria for the transport of 300,000 tonnes of grain annually from Dimboola and Junee.

Another example is the development of Graintrust, a partnership between ABB Grain Ltd Australian Field Crop Association, Combined Rural Traders/Town & Country, Grainco, NSW Grains Board, Paramount Seeds (a subsidiary of Elders) and the Grain Pool of WA. Graintrust is an integrated grain management company involved in development multiplication and distribution of new seed varieties as well as the whole marketing chain.

This investment, like that in the wine industry, demonstrates strong investor confidence in the future prospects for the industry.

Access to efficient and competitively priced inputs and infrastructure

Access to competitively priced inputs and infrastructure is vital to the competitiveness of value added products. Input costs are often cheaper in developing countries against which Australia competes, while firms in the US and EU can often achieve cheaper unit costs than Australian value adders because of the economies of scale associated with greater throughput. However, the process of microeconomic reform in Australia over the course of the 1990s has increased the competitiveness of some of the inputs required for value adding.

> *"A profitable and competitive domestic business is … dependent on a prosperous domestic business environment. This means that structural inefficiencies that raise costs must be removed by micro-economic reform to improve the domestic business environment and, as a consequence, improve local business profitability."*
>
> Prime Minister's Science and Engineering Council[10]

The Productivity Commission Inquiry, *The Impact of Competition Policy Reforms on Rural and Regional Australia*, concluded that the National Competition Policy and associated microeconomic reforms have increased efficiency in infrastructure provision in terms of minimisation of waste, better utilisation of capacity and, in many cases, reductions in prices. The Productivity Commission found that rural and regional Australia has benefited from competition policy with prices for:

- gas having falling by 22 per cent on average;
- rail freight falling 16 per cent;

[10] Prime Minister's Science and Engineering Council, *Food Into Asia: The Next Steps*, June 1994, pg 15

- port authority charges down 23 per cent; and
- STD phone call costs down 25 per cent.[11]

The introduction of the new tax system has resulted in further savings in some of these areas, for example in the cost of rail freight as a result of reduced rail fuel costs.

There is some debate about the effective value of some of these savings. For example, although rail freight costs may have dropped, the winding back of rail services during the 1990s to increase efficiency has reduced access for many rural and regional centres. Similarly, while the cost of utilities such as power has decreased in rural areas as a result of the reforms there is growing concern about future access to infrastructure. In some cases existing infrastructure is aging and replacement costs are prohibitive. A recent report found that the emphasis on securing a commercial rate of return or full cost recovery on infrastructure investment is perceived to have created a bias against future provision of infrastructure by the public sector, particularly in the rural areas.[12]

Freight costs, both domestic and international, are an ongoing issue in the agrifood industries, although efficiencies and savings have been introduced as a result of reforms in the transport sector, including on the waterfront. Nevertheless, by international standards Australia is not a particularly large user of sea and air freight, and most of what is used is for bulk commodity exports. As a consequence, Australian exports of value added products are at a disadvantage to their European and North American competitors in terms of the frequency and cost of these services.

Packaging costs often make up a sizeable proportion of the final price of value added products. Australian industry has long complained about the cost and quality of packaging manufactured in Australia. These comments have ranged from the complaints about the cost of cardboard cartons used for packing fruit to the lack of suppliers of glass jars. Some firms have resorted to importing plastic containers for dairy products claiming that locally made containers are of poor quality. In a recent study food processing firms claimed that Australian packaging cost on average around ten per cent more than foreign competitors would pay.[13]

Freight costs are an unavoidable element of the agrifood industries, acknowledged as such by most industry players. The cost, availability and quality of packaging is also likely to remain an issue of concern. Minimisation of these costs (including the costs associated with damaged product) is of paramount importance in order to build competitiveness.

Government regulation

A wide range of government regulation at local, State/Territory and federal levels applies to business operating in Australia. In some industries, firms are also subject to agreed

[11] Productivity Commission, *The Impact of Competition Policy Reforms on Rural and Regional Australia*, Canberra, October 1999
[12] Rural Industries Research and Development Corporation, *Infrastructure Pricing, Provision and Process - Implications for Rural Australia*, 1999
[13]. INSTATE Pty Ltd, *Exporting Australian Processed Foods – Are We Competitive?*, Canberra, AusInfo, 2000, p33

industry standards or codes, which are in addition to general government regulation. Industry self-regulation and co-regulation are not examined in this submission.

Firms in the portfolio industries are subject to regulations including:

- public health and safety, including food standards;
- worker's compensation
- occupational health and safety
- unfair dismissal
- industrial awards
- environment
- planning
- superannuation
- taxation
- trade practices, including pricing and labelling.

Throughout the 1990s there was an increasing recognition of the costs associated with regulation and the impact this burden had on business, particularly small business operators. Successive federal governments and most States and Territories have attempted to wind back regulation, by reducing the extent of regulation or the costs involved or encouraging industry self-regulation.

Until recently many industries within the AFFA portfolio, especially the large, long-established industries, have had extensive legislatively-based industry arrangements in place covering representation, levies and charges, research and development and marketing and promotion. A number of steps have been taken to reduce regulation. Statutory marketing arrangements have been progressively wound back in several industries, the most significant being in the wool, red meat and grains industries. Industries have been encouraged to take more responsibility for their own future. To this end, industry self-regulation has been introduced. In addition, AFFA engages in extensive consultation with affected stakeholders on regulatory changes.

> *"The major manufacturers … believe regulations are holding back the industry, restricting their opportunities and limiting returns for their dairy farmers. They believe regulations distort market signals, which create inappropriate investment strategies at both the farm and the manufacturing level. This affects the companies; domestic and international competitiveness and their ability to increase domestic sales of value added products. This in turn is reflected in the price to farmers."*
>
> Australian Dairy Industry Council[14]

A major area of regulation within the portfolio is the primary industries levies legislation, which provides the legislative mechanisms for the imposition, collection and disbursement of levies. These levies are used to fund research and development, animal and plant health and promotion for industries. While levy rates are determined by industry, the department has introduced principles and guidelines which are intended to ensure that there has been adequate consultation within industry before a levy is introduced or increased. This process is to ensure that all members of a particular industry have an opportunity to consider the potential regulatory impact of levy changes. A Regulation Impact Statement

[14] Australian Dairy Industry Council Inc Annual Report 1999, pg 3

is also required for significant levy changes and for other legislation which has an effect on industry to ensure that businesses are aware of and have the opportunity to comment on regulation which may impact on their operations.

Government regulation in the Australian food industries has traditionally focussed on two areas:

- consumer health, safety and deception issues; and
- sector-specific pricing and sales.

Health and safety issues are regulated under the *Australian Food Standards Code* and enforced at State and Territory level. Consumer deception is covered under the *Trade Practices Act*. The Australia New Zealand Food Authority (ANZFA) and the Australian Quarantine and Inspection Service (AQIS) are responsible for the sanitary regulation of commercial food products entering Australia for human consumption. AQIS and the newly formed Biosecurity Australia are responsible for the mitigation of import risks with regard to the importation of items of potential animal or plant quarantine concern.

On 3 November 2000, the Council of Australian Governments (COAG) agreed to implement a new food regulatory system for Australia and a new *Model Food Act* in a whole-of-government response to the recommendations of *Food: a Growth Industry*, the report of the Food Regulation Review. The new arrangements will reduce the food regulatory burden for agrifood businesses through a nationally consistent approach to food regulation designed to simplify and improve the efficiency of domestic food regulatory processes while protecting consumer health and safety.

Regulation of pricing and sales has been undertaken by government in a variety of agrifood sectors, especially at the commodity level. As this activity confuses market signals and encourages inefficient production, governments have been gradually withdrawing or privatising these regulatory bodies. The resulting increase in the overall competitiveness of the industries concerned is expected to outweigh the short-term costs. However, there can be significant disruption associated with this process.

Inconsistent and excessive regulation has a significant negative impact on the agrifood industries. A study undertaken as an input into the Food Regulation Review found that the regulatory burden associated with food-specific regulation on small agrifood businesses averaged at 0.28 per cent of turnover with smaller companies having a burden much higher than the average (0.63 per cent)[15]. While this may not seem immediately significant, it has an impact in an industry where profits margins are low, tending to be around 5 per cent of turnover pre-tax.

Regulatory burden was defined as the "direct and indirect costs faced by firms in meeting Government regulations … where these exceeded costs perceived by those firms as being incurred in the normal course of business."[16] Agrifood firms tend to view compliance with most of the health and safety regulations as sound business strategy – a pre-competitive activity in which they would participate even without regulation. However, the cost associated with regulatory compliance in excess of this level of regulation was significant,

[15] *Overcooked: A Study of Compliance Costs for Small Business*, 1998, Commonwealth of Australia. It should be noted that this was a very limited study, interviewing on 37 firms, but that the results are considered to be consistent with the wider industry regulatory burden.
[16] *Ibid,* pg 2

especially in terms of unnecessary capital expenditure (eg replacement of equipment before it had ended its useful working life) and time lost complying with excessive regulatory requirements. This latter category accounted for over 40 per cent of the regulatory burden. 37 small to medium sized firms (manufacturers and retailers) were found to have expended over $500 000 on excessive regulation in one year.

The interviewees noted that the burden from agrifood-specific regulation was small in comparison with the burden imposed by other government regulations such as:

- worker's compensation
- occupational health and safety
- unfair dismissals
- industrial awards
- superannuation
- taxation, including its complexity and, where applicable, payroll, wholesale sales tax, capital gains and fringe benefits tax.[17]

Regulation is a key issue in creating an environment in which agrifood industries can increase their competitiveness and add the maximum value to products appropriate to the country's competitive advantages.

Industry self-regulation – the Australian Wine and Brandy Corporation

The wine industry in Europe is heavily regulated. Every aspect of grape growing and wine making is subject to regulation. The Australian wine industry, by contrast, is government regulated on certain issues such as health and safety, consumer deception and export conditions, but is self-regulated on issues such as wine-making practices and grape-growing. This distinction allows the Australian wine industry to pursue technological innovation to meet the changing demands and tastes of consumers in a globalised market.

The Australian Wine Export Council (AWEC), a committee of the AWBC, is responsible for collaborative marketing campaigns and has offices in the United Kingdom, Ireland, the United States, Canada, Germany and Japan. Collaborative marketing has been a major factor in the growth of exports. Australian wine exports topped A$1.2 billion in September 2000 (from A$174 million in 1991), and Australian wine now holds 17 per cent of the competitive UK market, 23 per cent of the Irish market and 32 per cent of the New Zealand market[18].

Regulatory adjustment – the dairy industry

The dairy industry is in transition. It has traditionally had a far higher level of prescriptive regulation than some other agrifood sectors. Until recently, State governments regulated the market milk sector to ensure an adequate supply of fresh milk all year round. This was achieved through State legislation under which statutory authorities had responsibility for regulating the production, processing and distribution of market (drinking) milk in each State. The statutory authorities also had responsibility for ensuring that milk and some milk products sold within a State met standards of wholesomeness and purity in the interests of public health.

[17] The study predates the introduction of the GST.
[18] http://www.wineaustralia.com.au/Default.htm

Commercial pressures to allow free flow of fresh milk across state boundaries necessitated change in the way the industry was regulated. In order to facilitate this change, the Domestic Market Support (DMS) scheme was established on 1 July 1995 to assist the Australian dairy industry undertake reform as it moved towards becoming more competitive in the global trading environment. Financed by levies on market milk and on manufactured milk products sold domestically, the DMS provided support payments to farmers for production of manufactured milk. The scheme ended on 30 June 2000

By 1 July 2000, all State parliaments had passed legislation removing the farm gate pricing arrangements controlled by the State statutory authorities. In response to an industry proposal, the Federal Government has provided a major assistance package to enable farmers to adjust to a fully deregulated environment. The Commonwealth package, estimated to cost $1.78 billion, provides eligible dairy farmers with quarterly structural adjustment payments over eight years or the option of a tax free exit payment of up to $45,000 where farmers wish to leave agriculture. The package also provides $45 million in wider support to dairy communities through the Dairy Regional Assistance Program.

Australia has a recognised comparative advantage in dairy production. For instance, although accounting for less than two per cent of world milk production, Australia ranks third in world dairy trade, accounting for 13 per cent of dairy product exports[19].

The move to a deregulated environment will assist in lowering costs of production and creating more efficient scale of operations, thereby providing value adding firms with access to more competitive, lower cost dairy inputs. This will have a flow-on effect to a wide range of processed food products requiring minimally processed dairy ingredients (eg milk powder).

By deregulating, the Australian Government aims to encourage the dairy industry to develop into a more robust, competitive sector able to respond quickly and efficiently to changing market forces.

Single desk selling - privatisation of the Australian Wheat Board and other statutory bodies

Statutory wheat and grain marketing arrangements were largely introduce over 60 years ago. In the 1990s there has been a progressive reduction in the compulsory acquisition powers of various Commonwealth and State statutory bodies.

Following privatisation of the Australian Wheat Board in July 1999 the Government's involvement in wheat marketing now relates to provision of the single desk. The legislation has established a Wheat Export Authority (WEA) to oversight these arrangements and to control the export of wheat through the issue of permits. The WEA is a statutory authority which is independent and separate from the holder of the single desk, AWB (International) Ltd.

This legislation, the Wheat Marketing Act 1989, is currently being reviewed under the National Competition Policy. The terms of reference for the review ensure that its scope is

[19] Australian Dairy Corporation, 1999, *Australian Dairy Industry in Focus*, pg 4. The top two traders in dairy products are the EU (37%) and New Zealand (31%).

broader than just a consideration of economic issues associated with single desk selling of wheat. Social issues, as well as economic and regional development including employment and investment growth, will also be addressed by the review Committee.

There has been a reduction in the regulation of grain marketing and associated matters such as storage and handling and transport by the various States in recent years in response to National Competition Policy reviews and/or microeconomic reforms aimed at improving the competitiveness of the industry. Much of the impetus for change has come from industry as it recognises the need for increased commerciality, including integration of market chain activities through joint ventures and alliances. This has resulted in most storage and handling bodies now also being involved in grain marketing and operating in other States as well as where they were originally established.

Taxation

Like government regulation, taxation can have a major impact on business decision making and be a factor in determining whether or not a firm value adds or exports, for example. The tax reform process implemented in Australia since 1999 has comprehensively changed the tax system and will provide a substantial boost to the international competitiveness of the AFFA portfolio industries.

The Government's tax reform initiatives, including the *A New Tax System Package* and business tax reforms will reduce business costs through company tax rates falling from 36 per cent to 30 per cent. In addition the replacement of the Wholesale Sales Tax and a number of other indirect and inefficient taxes with the GST will give a boost to businesses involved in value adding and export. Since the GST is not paid by businesses on inputs or by exporters, these changes avoid input taxes cascading through the stages involved in any particular value adding process. These measures should increase the competitiveness of Australian value added exports in world markets by effectively reducing their production costs.

The uniform rate of GST applying to most sectors of the economy helps to avoid investment decisions being made on the basis of taxation rates. Similarly the introduction of capital gains tax reforms will promote investment in innovative Australian firms and remove impediments to foreign investment.

AFFA has played a major role in preparing the portfolio industries for the introduction of the new tax system through its Rural GST Start-Up Assistance Program, which provided some 2,500 seminars and workshops with 150,000 places nationwide for farmers and rural business to build awareness and understanding of the GST.

The introduction of the *A New Tax System* package will provide a positive stimulus for further value adding of raw materials by the agricultural, food, fisheries and forestry industries and in particular for the export of value added products.

Wine industry arrangements

Under new arrangements which entered into force on 1 July 2000, wine and wine products will be subject to a 29% wine equalisation tax (WET) and the GST of 10%. This replaces the former taxation regime whereby such products had a 41% wholesale sales tax (WST).

WET maintains the price differences between cask wine and full strength, packaged beer that is purchased for consumption away from licensed premises.

To ensure that small winemakers are not adversely affected by the introduction of WET, the Commonwealth has introduced a WET rebate scheme to complement the States' schemes to provide winemakers with assistance of 15% of the wholesale value of cellar door and mail order sales to unlicensed people.

- The Commonwealth scheme provides a 14% rebate on cellar door and mail order sales up to a wholesale value of $300 000 per year.
- This rebate then tapers to zero for sales with a wholesale value between $300,000 and $580,000 per year. Sales with a wholesale value above $580,000 attract the 15% State subsidy alone.
- The combination of the previous State subsidy and the new Commonwealth assistance will mean that cellar door and mail order sales up to a wholesale value of $300,000 per year are effectively WET free.

For many small wineries these arrangements effectively mean that no WET will be paid.

Tax provisions allowing for accelerated vineyard depreciation have assisted the industry to meet its growth targets. There has, however, been some concern that rapid expansion of vine plantings in recent years, both in Australia and elsewhere, may result in significant falls in some grape prices. In the context of the Ralph Inquiry into Business Taxation, the Government made a commitment to preserve all specific primary producer tax concessions including the current tax provisions for vineyard establishment. The construction of production and storage facilities currently occurs without special tax provisions.

The need for innovation

Innovation is one of the areas which hold the most promise for increased value adding of Australia's raw materials. Australian firms cannot compete with lesser developed countries on input costs, nor do they have the size and influence of their European and US competitors to influence investment decisions with the same leverage. Where Australian farms and firms are successful, it is primarily due to innovation. This is particularly true in the agricultural sector and is becoming increasingly apparent in the food sector, where there has been a proliferation of small businesses in rural Australia, many of which have literally begun operations in their own kitchens, producing for local niche markets.

The driving force for many of these businesses has been the desire to do something with excess or low value farm product or to capture greater returns by moving along the market chain. Small-scale manufacturing equipment is not produced in Australia and equipment produced overseas is often too large for the immediate (or even medium term) requirements of these fledgling processors. Some processors purchase available machinery with a capacity considerably greater than their medium term needs and at considerable expense to their business. Others employ innovation to overcome this problem – for instance, one small company is producing high-quality cakes and puddings using an Italian cosmetic machine for mixing and portion control.

Fledgling value adders are hampered by lack of access to appropriately scaled machinery. The debt levels incurred in purchasing machinery of considerably larger scale than is

required for their immediate, or medium term, requirements can be prohibitive. However, there is currently no culture of sharing these costs across a number of companies.

An interesting area of innovation is the use of the internet and e-commerce. Internet marketing offers a significant cost saving, because there are fewer overheads involved. Several companies in the wine industry have moved into e-commerce, including some which have been established for the specific purpose of marketing wine through the internet. For example, the wine merchant Wine Planet operates as both a traditional retail outlet and as a dot com. The company's website commenced in June 1998. Since August 1999 monthly revenue from on-line sales has exceeded traditional sales.[20] Several small businesses involved in producing high quality, high value products for niche markets also use the internet, as it provides them with very low cost advertising with a modern, professional image.

While direct marketing is the most visible use of the internet, its primary role in increasing value adding to Australian raw materials is through the cost reductions it can create at all levels of the value chain. Areas of potential application include warehouse management and just-in-time ordering, freight control, invoicing and payments, and communication between all parties in the chain. Despite this, the internet is generally under-utilised throughout the agrifood industries. In rural areas this is often attributed to inadequate infrastructure but as most non-metropolitan value adders are located in or near regional centres, this justification does not fully explain the currently low uptake of e-technology as a tool to reduce input costs.

"We recognise that emerging technologies could radically alter customer relationships. Foster's is taking the initiative to use technology on three levels – firstly, to enhance customer service, secondly, to improve internal efficiencies and thirdly to develop new products and services for consumers."

Foster's Brewing Group[21]

As a cost-reduction tool, the internet is not fully appreciated by the agrifood industries. Addressing this would result in an overall increase in the cost competitiveness in many, if not all, agrifood sectors.

Because of the outlay in time and/or money required, Australian agrifood producers typically under-invest in innovation, including R&D. However, innovation is crucial to the Australian industry improving its performance and building a sustainable trading base in the global agrifood market. Firms must develop new strategies, products and processes to meet the emerging expectations of global consumers, retailers and processors. In addition, improvements in production, processing, storage, transport and marketing provide increased economic, environmental and social benefits to the industry and the community as a whole.

[20] Wine Planet Holdings Limited, 2000
[21] Foster's Brewing Group Ltd Concise Annual Report 1999, pg 4

"We must also invest in research and development if we are to stay ahead of the competition and successfully launch new products that satisfy consumer demand of healthier food products, more convenient meal solutions and indulgence."

Goodman Fielder[22]

"Competitors have now taken up Meadow Lea Foods technology in their own brands. The challenge is to keep innovating and maintaining a 'speed to market' advantage."

Meadow Lea Foods[23]

Australia's agrifood industries need to develop a more innovative culture including an enhanced understanding and awareness of innovation, the improvement of links between firms and the national innovation system and an increased focus on meeting customer and consumer demands.

The Government has recognised the potential of innovation in increasing the competitiveness and profitability of Australian agricultural, food, fisheries and forestry industries by establishing programs like the Farm Innovation Program under the Agriculture – Advancing Australia package, the New Industries Development Program and the Food and Fibre Chains Program.

The Farm Innovation Program is two-year pilot program which was introduced in the May 2000 Federal Budget. It is delivered by AFFA under the *Farm Innovation – The Key to Success* initiative and is already attracting strong interest. The program encourages the adoption of innovation in the rural sector by providing grants to eligible farming, food, fishing and forestry businesses to adopt innovative practices, processes and products. Applicants need to be registered businesses with an annual turnover of $50,000 to $3 million in any of the previous three years.

The New Industries Development Program aims to assist in enhancing the capability of Australian agribusiness in commercialisation of new agribusiness product, services and technology. One of its elements is the Pilot Commercialisation Project which offers financial funding to help Australian agribusiness enterprises and their commercial partners to reduce the risks inherent in initial commercialisation. Funding assists in taking a new product, service or technology from initial market assessment and R&D (laboratory or trial crop stage) through to formation of chain relationships, pilot trials and development of business strategies and proposals to a state of readiness for full-scale commercial investment.

The Food and Fibre Chains Program is managed by Agri Chain Solutions Ltd, a subsidiary of Supermarket to Asia Ltd and seeks to improve the competitive performance of Australia's food and fibre industries by helping businesses implement superior chain management practices. The primary purpose is to building sustainable trade through efficient customer focused demand chains. The program provides grants to businesses to assist in the implementation of customer-focused, innovative business/marketing plans and disseminates chain management lessons to the wider community. Eligible food and fibre businesses include primary producers, providers of input products and services, processors,

[22] Goodman Fielder 2000 Concise Report, pg 18
[23] AFFA Case Study – Meadow Lea Foods, 2000

manufacturers or marketers of food and fibre products, transporters, distributors and customers.

Twelve rural-industry based Research and Development Corporations (RDCs) operate within AFFA and are generally funded on the basis of the Government matching industry R&D levies. The Government's contribution is designed to provide an incentive for the primary sector to increase its R&D funding and to become more involved in R&D priority setting and the adoption of outcomes. It also recognises that activities funded by the RDC generate a mix of public and private benefits. Total annual RDC expenditure tends to be over $300 million, with just under half of that amount being provided by the Government.

The wine industry – leading edge innovation

The Australian industry has a strong reputation for technical R&D and is acknowledged as being at the forefront of innovation in the world wine industry. In the absence of the regulatory restrictions which apply in some of the European wine producing countries, the Australian industry has been able to develop effective and efficient methods of grapegrowing, winemaking and marketing. It has also enabled the industry to respond to changes in consumer expectations and preferences.

Much of the industry's R&D is generic and benefits the industry as a whole. Primary R&D bodies include:

- the Grape and Wine Research and Development Corporation which is funded by an industry levy matched by Government funding. It facilitates innovation within the industry, as does the drive provided by collective industry commitment to research and development.

- the Australian Wine Research Institute, established as an industry initiative 1955 to undertake research for the Australian wine industry. The Institute is totally accountable to its industry-led governing body and to its main investor, the Grape and Wine Research and Development Corporation; and

- the Cooperative Research Centre for Viticulture (CRCV), which has now been funded for a second seven-year term. The ability of a Cooperative Research Centre to commercialise its research played a large role in the Government's selection process. The continuation of the CRCV provides a unique opportunity for business to work in partnership with research institutions and to focus research relevant to industry's needs.

A key feature of the Australian wine industry has been its ability to vertically integrate innovation. All elements of the chain appreciate and focus on the requirements of up and downstream links and research, education and technology dissemination occur within the whole value chain rather than being restricted to those companies immediately concerned. A mutually beneficial partnership has evolved between industry, researchers and educators as has a clear definition of the complementary roles of individuals and agencies.

As a result, the industry is quick to develop and commercialise innovations which will improve the cost and quality-competitiveness of the final product. In the field of grapegrowing, for example, Australia has developed new technologies such as mechanical harvesting and there has been a continuous improvement in viticultural irrigation

techniques with more vineyards discontinuing furrow and overhead irrigation in favour of advanced drip and subsurface irrigation combined with mulching.

A key to successful innovation in the wine industry has been the willingness of each element of the value chain to invest in development focussed on other elements of the chain. A shared understanding of the production process has encouraged the acknowledgment that an increase in competitiveness anywhere in the process will have a flow on effect on the competitiveness of every member of the chain.

Dairy – increased product range through innovation

The dairy industry has identified the need for diversification to increase sales of milk-based products. As a result, R&D undertaken by value adders has been focussed on the development of a broad range of new products covering an increasing number of market segments. Additionally, through scientific advancements, raw milk is being broken down into component parts, thereby enabling the dairy industry to branch into a variety of non-traditional markets such as pharmaceutical products and sport dietary additives.

Innovation has occurred throughout the value chain, reflected in the growing range of competitive, market-driven products and the associated increased consumer base. Consumers have a high level of confidence in existing products, while value adders have reduced manufacturing costs and improved industry sustainability. The capacity of firms to track and adapt to changes in consumer trends, such as nutritional value and environmental awareness, has also been a feature of the industry's success to date.

Improving product quality has been considered as important as developing new products and processes. Australia currently exports over 50 per cent of annual milk production. Quality assurance has been an essential factor in maintaining and growing market share in an increasingly competitive global market. Increasing moves towards efficiency and cost effectiveness and development of new products are required to maintain equal if not better quality than current products.

A major catalyst for innovation through the provision of funding for research and development is the Dairy Research and Development Corporation (DRDC). The DRDC provides funding for a broad range of activities across the entire value chain. Specifically the DRDC provides R&D funding to:

- improve productivity and prosperity in farm management;
- improve efficiency, product quality and product development;
- foster international competitiveness and profitability through industry performance; and
- facilitate industry leadership and management.

Funding for DRDC activities is sourced from an industry R&D levy paid by producers and significant grants from dairy manufacturers. The Federal Government provides matching dollar for dollar funding for industry contributions up to 0.5 per cent of the gross value of milk production.

The dairy industry is in the process of becoming a modern, dynamic success story. A key factor in the sector's success will continue to be the development of a wide range of innovative products designed specifically to capture key elements of the market.

Grain – Innovation

Innovation is seen as a key factor in the future competitiveness of the rains industry. One of the four investment objectives of the Grains Research and Development Corporation (GRDC), which operates under the Primary Industries and Energy Research and Development Act 1989 and is funded by grain growers through a levy on grain deliveries and by matching funding from the Commonwealth, is to strengthen the links between producers, processors and marketers to ensure the industry meets the requirements of discriminating buyers. Such research includes grain processing qualities and storage of grain. The GRDC, which has an annual research budget is around $100m is also involved in partnerships and alliances such as Graingene, a strategic alliance to capture the benefits of biotechnology for the grains industry. Investments have also been made in projects conducted by the Co-operative Research Centre for Quality Wheat Products and Processes.

There are also other areas of innovation such as the financing and marketing options offered to growers by AWB Ltd following its privatisation. Growers can now choose payment options with or without underwriting and advance payments and in $US or $A. There are also innovative pool options where growers can undertake their own risk management of prices and foreign exchange. A number of forward pricing and multigrade marketing options are now available to growers from statutory and private marketers.

Labour and skills issues

Labour and skills issues are often key determinants of the level of value adding, particularly where processing is involved. The last several decades have seen a trend in manufacturing worldwide of firms moving offshore to locate their processing facilities wherever the supply of labour and other inputs is cheapest. Labour in these countries is often unskilled or has very low skill levels. This phenomenon has been particularly noticeable in the development of the Asian economies since the 1960s.

Australian labour costs are high, relative to those in many competitor countries. High skill levels in the labour force mitigate the effect of higher labour costs by facilitating high and rapidly growing productivity and, in many cases, allowing producers to focus on innovation and product quality.

"…tertiary scholarships, marketing workshops for growers and overseas study tours … are contributing to the long-term viability of our members' businesses. PWA will continue to prioritise the development of the next generation of producers and industry leaders as vital to the future prosperity of the grains sector."

Prime Wheat Association Ltd (PWA)[24]

The proportion of skilled workers in total employment in Australia since 1978 has increased significantly.[25] This has largely been due to the demands of technological

[24] Prime Wheat Association Ltd 1999 Annual Report, pg 5

change. Productivity Commission research found that for most industries, there is a positive association between the amount of software, machinery and equipment used and the demand for skilled workers.[26] This suggests that value adding involving processing requires a more highly skilled workforce, something which could give Australia a competitive advantage over its competitors, not just in the food sector, but also in timber and fibre processing.

A highly skilled workforce has been an important part of Australian governments' pursuit throughout the 1990s of a society and economy able to fully participate in the new technology world. However, there are still improvements to be made. Production and processing industries must develop and maintain skilled workforces to enable Australia to build global competitiveness. The level of education and training in the AFFA portfolio industries has traditionally been quite low, particularly in primary production, which has generally relied on 'on the job training'. Similarly, Australian firms have generally not rated well in management skills.

The food processing sector, in particular small and medium enterprises, has weaknesses in:

- management – both managing the export process (mostly through inexperience in many cases) and in managing people;
- technical skills - for example in product and process innovation, packaging design, and use of e-commerce.

A significant reason behind this lack of skills is that, apart from the wine industry, the manufacturing industries are not seen as an attractive place to build a career. Other industries are seen as more exciting and dynamic, attracting the best and brightest students with the promise of high rewards. Although the wine industry has consistently been seen as an interesting career, much of the agrifood sector, particularly within the primary industries, is losing its next generation managers to more exciting, city-based careers, further depleting the skills base.

> *"The dairy industry is Australia's largest processed food industry. It is a hi-tech industry at both farm and manufacturing levels, but suffers from a poor career profile among students."*
>
> The Australian Dairyfarmer[27]

There has been a strong recognition of the importance of education and training in these industries over the last two decades, especially in the food processing sector where technological change has been significant. Post secondary education is now prized or required in many agrifood industries, with the wine and dairy industries offering leading examples.

> *"During the year Goodman Fielder introduced an MBA … tailored specifically for the needs of Goodman Fielder and offered by Macquarie University in NSW."*
>
> Goodman Fielder[28]

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[25] De Laine, Laplagne and Stone, *The Increasing Demand for Skilled Workers in Australia: The Role of Technical Change*, Productivity Commission Staff Research Paper, Canberra, AusInfo, 2000, p13
[26] *ibid*, pXI.
[27] The Australian Dairyfarmer, "Successful camp for budding scientists", November/December 2000, pg 11

A key to building a skilled workforce in any industry is the perception that the industry is a sound proposition for an interesting, profitable career. The agrifood industries have generally lacked this image and are thus often disadvantaged in attracting an appropriate workforce.

Wine

The Australian wine industry has a workforce that tends to be very well technically qualified and compares favourably on skills with most of its competitors. There has been a sustained interest in grape and wine studies at tertiary level, such that there are now a wide range of new courses being offered across the country. Despite the development of education within the industry to the tertiary level, there is scope for further improvement in the skill levels of the itinerant and/or manual workers across the industry as a whole.

Seasonal labour for the grape growing industry is not as severe a problem as it is for other horticultural industries due to the high level of mechanised picking within the industry. However, even mechanised establishments require six to eight workers and there are pruning and pre-pruning staffing requirements. There are proposals being considered within horticultural industries and by the National Harvest Trail Working Group for the development of a method of improving and recognising the skills of seasonal workers.

Many agrifood industries rely on a seasonal workforce during time-critical periods such as harvest. Lack of a seasonal workforce seriously impacts on the ability of the industry to retain profitability; however, innovation through mechanisation reduces this risk significantly.

Dairy

An issue identified as essential for the dairy industry's continued development is strong leadership skills. The up-skilling required by the dairy industry is a major focus for the Dairy Research and Development Corporation (DRDC). In broad terms, the DRDC provides funding for education and training in the area of farm management leadership and scientific development. Its programs facilitate leadership development to help the dairy industry face future challenges.

The DRDC grants Postdoctoral and Visiting Scientist Fellowships to bring additional skills into the dairy industry. Industry recognises that bringing overseas skills to Australia boosts local skills and knowledge in the dairy industry and international expertise is particularly important to Australia's global advancement. The Fellowships allow overseas experts to visit Australia on either a long or short-term basis and take strong training roles in the industry.

The Australian Dairy Industry Council (ADIC) is also active in identifying skills-gaps through its Education Strategy. The Strategy "aims to increase the supply of highly qualified and motivated people considering the dairy industry as a career to ensure the industry is able to respond to the challenges of the future."[29]

[28] Goodman Fielder Concise Report 1999, pg 15

[29] The Australian Dairyfarmer, "Successful camp for budding scientists", November/December 2000, pg 11

Industry bodies are in a good position to identify skills-gaps within an industry and to develop long term policies to overcome shortages in the availability of appropriately qualified people.

Grain

The Grains Research and Development Corporation (GRDC) invests in a program to develop highly trained and committed people for the industry as a whole. Creativity and innovation is being developed through this $3.6 million program among researchers, growers, handlers, marketers, information specialists and agricultural consultants. In 1999-00 more than 100 travel and study scholarships were offered.

Market access

The limited size of the Australian market for food products results in access to international markets being vital for the future growth of the Australian processed food sector. The international market for food products continues to be highly distorted by the high levels of support and protection in many major markets and is characterised by high tariffs, tariff quotas, subsidies (both domestic and export) and technical restrictions such as labelling requirements. Tariff escalation in many countries worsens the situation for value added products. The monopoly import arrangements in some countries also protect domestic industries and have a considerable impact on the price competitiveness of Australian products in export markets.

As the margin on most food products is low, the ability of food companies to compete in some markets is an excellent testament to the overall competitiveness of their products. It also reflects the ability of companies to work around trade barriers. However, as the overall effect of the trade barriers is to restrict trading opportunities for Australian companies and to reduce their profit margins, this should not be taken as an indication that trade barriers are a minor issue.

"The export of value-added products are in many cases essential to the viability of particular enterprises involved in value adding. The Australian domestic market is simply not large enough to support large scale value adding enterprises. For these enterprises to be profitable they must be involved in exporting their products as well as selling on the domestic market."

Value Adding in Agricultural Production; Report of the Senate Rural and Regional Affairs and Transport References Committee[30]

In securing greater market access for Australian agricultural products, the Commonwealth Government actively participates in and promotes the global move towards an international agrifood trade system which is free from subsidies and other non-tariff barriers. The Government's approach to trade policy has been to adopt a three prong approach combining multilateral, regional and bilateral approaches to seek improvements in the opportunities for Australian exporters including for exporters of agrifood products. The

[30] *Value Adding in Agricultural Production*; Report of the Senate Rural and Regional Affairs and Transport References Committee, May 1997, pg 149

principle vehicle has been through multilateral negotiations which have been seen as the best way to deliver real reform of the international market for agrifood products.

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. 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. New negotiations on agriculture (including food products) formally commenced in March 2000 as mandated under the Uruguay Round. These negotiations will provide an important opportunity to address the continuing problems faced in world agrifood markets and to secure permanent improvements in prices and access to key markets through the removal of distorting tariff and non-tariff barriers. The prospects for these stand-alone negotiations are not high and without the trade-offs associated with a broad-based round of negotiations it will be difficult to achieve the reform necessary in world agrifood markets. However it is expected that these negotiations would be rolled into any new round agreed at the next WTO Ministerial Conference.

AQIS has negotiated a number of unreciprocated unilateral agreements for the importation of food products. AFFA is currently investigating options to use the APEC Mutual Recognition Agreement (MRA) process to develop bilateral agreements for food products. While such agreements would have no impact on our regulatory framework, and while both countries involved would still be able to perform import assessments to verify health and safety, MRAs have the potential to reduce the regulatory burden on exporters.

Bilateral and multilateral negotiations and arrangements continue to have a crucial role in building exports of processed products, thereby increasing value adding in Australia.

The wine industry – sectoral trade agreements

Sector-specific bilateral agreements have proved to be an effective way forward for the wine industry. For instance, Australia negotiated a wine agreement in 1994 with the European Union, Australia's major wine export customer. This agreement, administered by the AWBC, has helped streamline arrangements for accessing this important market. Australia and the European commission are currently negotiating on a number of matters left outstanding in 1994.

Facilitation of market access is also being pursued through the New World Wine Producers Forum. This group (which includes Australia, Argentina, Canada, Chile, New Zealand, South Africa, Uruguay and the United States of America) was formed in 1998 on the basis of like-minded countries sharing information on and developing where appropriate cooperative approaches on wine trade related matters. The group is currently developing a mutual acceptance agreement on winemaking practices and will be focussing on identifying possible improvements in arrangements for labelling of wine.

Australia also has the opportunity to influence wine regulatory practices through membership of the International Office of Wine and Vine, a peak/global intergovernmental wine organisation which influences many countries, particularly Europe.

A strong, unified sector with a clear long-term strategy may have success in increasing access to export markets through sector-specific bilateral and multilateral negotiations driven by the industry and coordinated by industry bodies.

The dairy industry – the self-sufficiency argument

International trade in dairy products is significantly distorted by high tariff and non-tariff barriers and by highly subsidised competitors. The majority of OECD countries and many developing countries heavily subsidise their dairy industries and this has had a wider impact on international trade flows and pricing. Domestic prices are supported through a combination of import restrictions, minimum prices support, government purchasing and subsidised disposal of surpluses. Countries implement these policies to meet domestic objectives such as self-sufficiency in food and rural development.

The maintenance of artificially high prices for milk and dairy products encourages increased supply, while reducing demand. As a result, many countries with no competitive advantage in dairy production are now self sufficient in dairy or have developed surpluses which must be disposed of through government subsidised sales. These are major impediments to the Australian dairy industry being able to widen its export base.

Self-sufficiency policies have a major impact. However, unlike producers protected by these policies, Australian agrifood producers are exposed to market signals. Exposure to market signals encourages innovation to develop market-specific high value products designed to fill market niches unrecognised by protected industries.

Australian dairy exporters face several uncertainties during the next few years. With limited access to Europe and North American markets, Australia has relied heavily on sales to Asian markets for export growth over the past decade. The economic downturn in Asia in 1997 raised concerns over whether these regional markets can sustain increased demand for dairy products in the short to medium term. While demand appears to have stabilised in most markets, some markets have yet to recover to pre 1997 levels.

Instability in Asian markets is an issue facing all agrifood producers, especially companies too small to diversify across a number of markets. However, industries working cooperatively can overcome this difficulty – generic marketing based on an Australian image can be used to develop market access for all companies within the sector, allowing choice between a range of countries if a key market for a given company fails.

The grain industry

International trade in grains is affected by the support practices of the major exporters. Given that Australia exports around 80% of its wheat production and a large proportion of other grains market access issues have a significant impact on producers and the economy as a whole.

Australia is an active founding member of the International Grains Council and Food Aid Convention under the International Grains Agreement. It is in Australia's interests to provide timely input to international commodity and trade fora to influence their deliberations and to support policies for a reduction in practices which restrict Australia's access to markets.

The grains industry, through AWB Ltd and other single desk sellers particularly, undertake significant market development activities in overseas countries including investment in milling ventures and technical training missions. These developments assist Australia to maintain market share and provide a 'branded' product rather than simply a commodity. AWB Ltd in particular has made a considerable effort to tailor wheat types which meet customers demand, eg for noodle wheats in the Asian market and flat breads in the middle east.

Conclusion

In order to promote rural growth, employment and diversification opportunities, AFFA supports and encourages increased value adding where this is commercially practical and sustainable and is consistent with consumer demand and market signals.

The factors identified by the House of Representatives Standing Committee on Industry, Science and Resources as having an impact on the ability of Australian firms to value add Australian raw materials are all relevant to AFFA's portfolio industries which consistently cite them as important in competitive production and market development. As shown in this submisson, the wine, dairy and grains sectors are good examples not only of the effect of these factors, but of how changes initiated by governments or the industry can improve competitiveness and hence increase the opportunities for cost competitive value adding.

These industries are a source of inspiration to other, less competitive sectors. They are developing scale and reducing input costs. They are innovative and understand the importance of long term investment in people. They take an active role in increasing access to markets and appreciate the necessity of appropriate regulation, which they are then often able to use to enhance their commercial advantage. Their own words say it best.

As we build this world-class food company, we will suffer short-term setbacks. However, our focus is on creating a more resilient and vibrant business that can rebound from these setbacks and continue to grow.

Goodman Fielder

In an increasingly complex and uncertain world, business success depends upon the effective mobilisation of all available resources and intelligence. The Corporation is dedicated to working with local stakeholders to ensure that the Australian dairy industry retains the core competencies and resources it needs to forge a profitable and successful future.

Australian Dairy Corporation

Foster's is moving ahead, resolute in its identity as a premium global beverage company. That momentum comes from the performance of our businesses, the strength of our portfolio and the incomparable knowledge base provided by our people and their skills.

Foster's Brewing Group (owner of Mildara Blass)

Background

The Australian Wine Industry

Wine grapes are grown in all States of Australia, with South Australia the largest producer at around 46% of winegrape production, then Victoria (26%) and NSW (25%). By wine production the percentages are SA (49%), NSW (33.5%) and VIC (17.3% - a considerable amount of wine grapes produced in Sunraysia, Victoria are crushed in NSW). The industry is based on about 5,000 grape growers supplying over 1,200 wineries. In 1999 the top 5 winemakers produced over 55% of total production, the top 10 over 70% and the top 20 produced 84%.

Vineyard capacity has also grown in recent years. In 1999 total vineyard area reached 95,000 hectares of producing vines from a total of 122,915 hectares of vines under cultivation. About 85% of bearing vineyards are planted to winegrapes.

The industry crushed 1,147,000 tonnes of wine grapes in the 2000 vintage, producing over 800 million litres of beverage wine. It sold 653.9 million litres of beverage wine in 1999-2000 worth about $3 billion, with 369.3 million litres sold domestically and 284.6 million litres exported. The industry directly employs 15,700 people, with a further 5,000 in wholesaling and 8,000 in retailing and makes an important contribution to a number of regional economies by providing direct employment, regional leadership and by generating employment in supplier industries. It is also a major contributor to tourism with winery visits one of Australia's most popular weekend activities.

The industry has a 95% share of the domestic Australian wine market by volume. Imports for 1999-2000 were 19.6 million litres worth $113.9 million, a 19.2% decrease in volume but an 11.1% increase in value over 1998-1999.

Exports are growing rapidly. In 1999-2000, exports grew 31.7% in volume and 28.4% in value over 1998-1999 (284.6 million litres worth $1.37 billion. In the year ended 30 September 2000 exports reached 300 million litres worth $1.42 billion. Exports to nearly 80 countries accounted for over 43.5% of total sales of Australian wine in 1999-2000. The top 15 markets account for 96% of trade. In the year to June 2000, our top ten markets by value were UK $590.4m (43.7%), USA $316.9m (23.4%), NZ $65.3m (4.8%), Canada $73.7m (5.5%), Germany $40.9m (3%), Ireland $37.4m (2.8%), Netherlands $36.2m (2.7%), Japan $29.4m (2.2%), Switzerland $28.4m (2.1%) and Sweden $20.3m (1.5%), [No. 11 - Singapore $14.9m (1.3%)]. The total EU market in the year ended 30 September 2000 was worth $789 million from the sale of 186 million litres of wine.

The industry target for exports of $1 billion by the year 2003 was reached in 1998/99. It has also set a further export target of $2.5 billion by 2025. The AWBC has predicted (July 2000) exports of $3 billion by 2010.

The Australian Dairy Industry

The Australian Dairy Industry is highly regionalised as a result of the availability of suitable dairy land and the perishable nature of milk products. Victoria is Australia's largest milk producing state, accounting for 63% of total production in 1998-99. New South Wales and Queensland are the next largest, accounting for 13% and 8% respectively. Tasmania, South Australia and Western Australia account for 6%, 6% and 4% respectively.

Dairy Regions in Australia

Australian milk production increased by over 40 per cent between 1986 and 1996. While there was a significant decline in the number of dairy farms, the total number of dairy cows rose from around 1.78 million to 1.98 million over this period, with an average herd size is 161 cows. National production and productivity has continued to increase, despite fewer farms and in 1999 production reached over 10,000 million litres for the first time.

Key changes in the Australian Dairy Industry over the last 20 years

	1976	**1986**	**1996**	**1999**
Farm Numbers	29,199	18,496	13,888	13,156
Av. Herd Size	-	96	136	161
Milk Yield (litres/cow)	2,533	3,416	4,616	4,867
Value of Exports ($m)	-	427	1692	2173
Milk Output (million litres)	6,248	6,038	8,716	10,178

Milk yields have also increased significantly, reflecting improvements in farm productivity through the uptake of new technologies and better farm management practices. The adoption of animal health programs, supplementary feeding, herd breeding programs, improved irrigation techniques, soil testing and pasture management have all contributed to higher production per cow.

20% of milk production is used for domestic liquid milk consumption. The rest is used in the manufacture of dairy products, most of which are sold in the export market. There are 18 major milk manufacturing/processing firms in Australia, most of which are producer owned co-operatives. Australia's five largest co-operatives control around 70%

of Australia's milk production. On the domestic market, the major players are Murray Goulburn, Bonlac, the Dairyfarmers Group (all co-operatives), National Foods Ltd and Parmalat. While many firms participate in export markets, the main exporters are Murray Goulburn and Bonlac.

The milk manufacturing and processing sector has also undergone significant rationalisation over the past decade or so. Manufacturers have sought to secure sufficient equity capital to improve the efficiency of their operations through the establishment and operation of large scale, cost-efficient dairy factories with good distribution networks and successful marketing strategies.

The process of rationalisation has been facilitated by improvements in transport, storage and handling processes, which have reduced the need for the production and processing of milk close to markets. As a consequence, manufacturers have been better able to take advantage of opportunities in domestic and international markets.

Australia's dairy exports, by value, have almost doubled over the past seven years to about $2.2 billion in 1999. Australia currently exports nearly half of its annual milk production, equivalent to around 65% of total manufactured dairy products. Principle export products in both value and volume terms are skim milk powder and cheese, with butter and wholemilk powder also major contributors to industry export returns. In recent years, increasing volumes of short shelf-life products have been exported to the growing retail markets of Asia.

Asian markets account for around 80 per cent of Australia's exports. Japan is the largest single country market for Australian dairy products, taking around 46 per cent of total Australian cheese exports and 13 per cent of skim milk powder exports in 1997-98. Other important destinations for Australian dairy products include the Philippines, Malaysia, Singapore and Thailand.

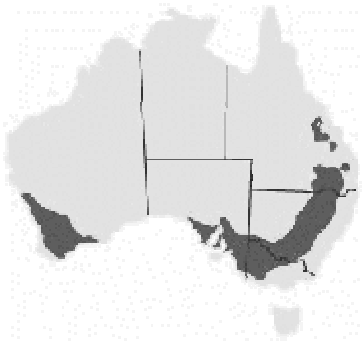
While Australia exports half its total production, it is still a relatively small exporter on international markets, accounting for around 13 percent of world exports in 1998. The EU is the largest exporter at 37 percent and New Zealand is the second largest world supplier accounting for 31 percent of world sales. Other countries such as Argentina and Uruguay, as well as Canada and non-EU countries of Western Europe account for the bulk of remaining export sales.

The Australian Grain Industry

Grain production occurs in most States of Australia but the majority of production occurs in a belt running through the mainland States from central Queensland, through New South Wales, Victoria and South Australia and then through south west Western Australia. The average Australian grain production over for the period 1995-2000 was 37.2 million tonnes. Western Australia is the largest producer with an average over the same period of 13.19 million tonnes with New South Wales the next largest with an average annual production of 10.72 million tonnes.

The average annual production area sown to grains is 19.72 million hectares of which the majority (18.26 million tonnes) is sown to winter crops with a comparatively small area (1.48) used for summer crops.

Wheat is by far the biggest grain crop produced in Australia both in terms of grain produced and value. Average annual production and gross value for wheat over the last 5 years being 21159 kt and $ 4236 million respectively. The next largest crop being barley with an average 5792 kt being produced with an average gross value of $1066 million.



A map showing typical wheat production areas in Australia. (Source AWB)

The majority of wheat produced in Australia is exported with approximately 75% of the annual production being exported in the raw form. This amounts to approximately 15800kt per year. The large amount of wheat being exported allows wheat to takes its place as the largest crop export making up approximately 65% of the total volume of crops exports.