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STANDING COMMITTEE ON INDUSTRY, SCIENCE AND RESOURCES

Reference: Increasing value-adding to Australian raw materials

TUESDAY, 21 NOVEMBER 2000

SYDNEY

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STANDING COMMITTEE ON INDUSTRY, SCIENCE AND RESOURCES

Tuesday, 21 November 2000

Members: Mr Prosser *(Chair)*, Mr Hatton, Mr Lloyd, Mr Ian Macfarlane, Mr Allan Morris, Mr Nairn, Ms Roxon, Mr Cameron Thompson, Dr Washer and Mr Zahra

Members in attendance: Mr Hatton, Mr Lloyd, Mr Ian Macfarlane, Mr Allan Morris, Mr Prosser, Ms Roxon, Mr Cameron Thompson, Dr Washer and Mr Zahra

Terms of reference for the inquiry:

To inquire into and report on the prospects of increasing value-adding to Australian raw materials. The Committee will start with an evaluation of the current state of value adding in Australia, and how that compares internationally. This will provide a base from which to evaluate the following topics:

- incentives and impediments to investment;
- intellectual property rights;
- national/international marketing factors which may encourage or hinder Australian value-adding;
- government intervention, both nationally and internationally;
- the location of value-adding industries and projects in regional Australia;
- resource licensing/permit arrangements;
- the impact of vertical integration within particular industries; and
- the Australian skills base and any associated impediments.

WITNESSES

Committee met at 9.15 a.m.
BURDEN, Mr Warren, Commodities Director, Goodman Fielder Ltd

HADLER, Mr Robert, Corporate Affairs Manager, Goodman Fielder Ltd

CHAIR—Welcome. I remind you that proceedings here today are legal proceedings of the parliament and warrant the same respect as proceedings of the House. The deliberate misleading of the committee may be regarded as a contempt of the parliament. The committee prefers that all evidence be given in public but should you at any stage wish to give evidence in private, you may ask to do so and the committee will give consideration to your request. Would you like to make an opening statement?

Mr Hadler—Thank you. I will make a few opening comments. Just to give the committee some background, Goodman Fielder is the oldest and largest food company in Australasia. It was formed through a process of merger and acquisition over a period of about 100 years. We own the biggest food brands in Australasia, which include brands such as Uncle Tobys, Meadow Lea, Buttercup, Sunnicrust and, in New Zealand, Bluebird Foods and Flemings. We employ about 14,000 people in 40 countries around the world. We are the 22nd biggest employer in Australia. We have about 120 manufacturing sites worldwide, the bulk of those being in Australia and New Zealand, but also sites in North and South America and places as far away as Asia and South Africa.

From our perspective, Goodman Fielder is a value adding success story in Australia. The keys to that success have basically been the generation of size and scale in Australasia and our ability to leverage synergies and profits out of that size and scale. We are twice the size of our nearest competitor. Most of our competitors are multinational food companies. The only other big food companies in Australia are mainly in the dairy industry rather than in processed foods, so National Foods, for example, would be in the food sector but in completely different categories.

Also, I think we have been successful because of the fact that through product innovation we have been able to seize on and maximise global food trends in Australia and New Zealand. I think there are three food trends that we have been able to focus on: the first is health and nutrition, the second is a consumer push for convenience and the third is a consumer push for indulgent type products. But with our very strong brands of Uncle Tobys, Meadow Lea and Buttercup, we have been focusing primarily on health and nutrition. Therefore, through product innovation, we have been bringing out new products—value adding wheat, rice and edible oils to produce ingredients or products such as Hi-maize, which is a resistant starch that adds fibre to white bread without changing the colour or texture. Mums love it because it is good for their kids and the kids do not know it is good for them. It is in every McDonald's bun in Australia and it is one of the product innovations that have been very successful.

Gold'n Canola is a canola based margarine spread that has worked very well with the producers of canola in Australia. It has been one of the primary reasons why the canola industry has been able to develop as successfully as it has as an alternative to other grain based crops. We have been very successful in marketing an alternative health based margarine to Australian consumers.

I now turn to the value adding part of what we do. Goodman Fielder works with the Australian rural sector in two areas: one is wheat and grains generally, and the second is edible oil. On the wheat side we purchase about one-third of the Australian wheat crop that is produced for the domestic market. That is about 1 million tonnes per annum. We do about another 250,000 tonnes per annum in New Zealand. We purchase the wheat from the Australian Wheat Board, other major suppliers and individual growers. Following the acquisition of the Bunge Defiance business in 1998 we gained access to an individual grower network, which we did not have previously. That has brought us much closer to the wheat growing industry than we were previously. We use a wide variety of wheat, but mainly Australian hard white. Warren Burden, who is our commodities director, can answer more detailed questions about our relationship with the commodities side of the business.

We have also just acquired the former Water Wheel Rice Mill business, that was previously owned by John Elliott in Victoria. We got into that for two reasons: (1) we see it as a potential export market business; and (2) rice is also becoming the next health grain. We see some potential benefits of getting into the rice industry. I will come back to some of the constraints that we face in that area in a minute.

On the edible oil side, we purchase about 350,000 tonnes of edible oil a year, about 25 per cent of which is imported from and South America. Palm oil and coconut oil is imported from places like Indonesia, Malaysia and the Pacific Islands. We mainly use canola and other soft oils in Australia such as sunflower, olive oil—we import olive oil from Spain. Tallow is the other major edible oil that we use. Once again, we purchase the oilseeds and unrefined oil from a range of major suppliers. We export bulk wheat to New Zealand, Asia and the Pacific Islands, and we export finished edible oils—margarine, cooking oils and dressings—to Asia and the Pacific Islands as well.

Commodity marketing arrangements therefore have a very big impact on our operations. We can see why the federal wheat marketing arrangements, the single desk arrangements and the tender and pool arrangements run by the Wheat Board are in place—aiming to get an export premium for growers. However, they do impose additional costs on domestic food manufacturers and therefore Australian consumers. We believe they act as an anchor to value adding and exports by other producers. For example, under current wheat marketing arrangements, the tender system is very cumbersome for domestic food producers like Goodman Fielder; it places priority on the export market and therefore the domestic market comes a distant second. Post-harvest access to wheat is restricted, and that poses additional constraints on our flexibility as producers and exporters. The Australian Wheat Board has a veto power over bulk exports, and that constrains us in shipping wheat to places like New Zealand and the Pacific Islands. The Australian Wheat Board has sole responsibility for setting standards and typically does so without consultation with domestic users, and we find that very difficult to deal with at times when we are trying to juggle a wide variety of grains. We believe that the current arrangements are at odds with trade harmonisation under CER with New Zealand, where we are obviously trying to develop closer economic relations, and yet we have arrangements in place which prevent that.

Just to make it clear, we do not oppose the single-desk arrangements that are in place at the moment but we do support proposals to partially deregulate wheat marketing before 2004 and we have made submissions to the review committee chaired by Malcolm Irving on that matter.

In particular, we support export licences or permits for bulk wheat to New Zealand and the Pacific islands by domestic producers such as ourselves in addition to the Wheat Board. We suggest that there should be broader representation on the Wheat Export Authority and there should be improved access to the Australian Wheat Board pooled wheat stocks, particularly post harvest. Warren can talk to this in more detail but we think that the operation of pool swaps and pricing for wheat can be improved as well.

Finally, on commodity marketing arrangements, I have flagged that we have just acquired the Water Wheel rice mill in Victoria. Unfortunately we have not been able to run that mill at its maximum capacity because we cannot get access to New South Wales rice. As most of you would be aware, rice marketing in New South Wales comes under a statutory marketing arrangement under New South Wales legislation which puts vesting powers in the Rice Marketing Board which are delegated to Rice Growers Limited. It is effectively a monopoly in New South Wales and we found it very difficult to get access to that rice crop. That is effectively limiting the potential for us to get into the rice growing industry and develop that export market. We would be very keen to value add the domestic rice crop. We are confident that we could pay growers a premium to what they are already getting from the Rice Marketing Board. We are looking forward to deregulation of those domestic arrangements in New South Wales as quickly as possible. We understand that the federal Treasurer has been in negotiations with the New South Wales government on deregulation and putting in place a single-desk Commonwealth arrangement to try and facilitate that.

Of final areas of public policy that impact on value adding in the grains and edible oils industry, the first one is trade policy. Goodman Fielder welcomes what it sees as bipartisan support on trade reform at bilateral, regional and multilateral forums. We operate on the ground in Asia in places like Indonesia, China and Taiwan. We see direct benefits of trade reform through forums such as the Agribusiness Council under the previous government and the Supermarket to Asia arrangements under the current government, so we would continue to support bipartisan government assistance in those areas.

The last area is research and development. As I have flagged to you, product innovation supported by commercialisation of research and development is a key area for value adding of Australian commodities. Goodman Fielder has worked closely with organisations such as the CSIRO and the CRCs to develop a range of products. The two product successes that I have mentioned to you previously are Hi-maize and Gold'n Canola. We can elaborate on those if you like but I have commented on those at the start of my discussion.

We see the discussion to cut R&D tax concessions from 150 per cent to 125 per cent as a reduced incentive for long-term research and development and we would encourage the government to review its position on tax concessions for R&D to try and provide added long-term incentive in that area.

Just to conclude, the key point I would like to make is that value adding for Goodman Fielder is unlike that for a mining company, a high-tech company or a motor vehicle manufacturer. Food manufacturing is the biggest component of manufacturing in Australia and can continue to play a big role in value adding and in export industries. As the biggest food manufacturer, we think regionally and globally, not just locally, so our relationships with New Zealand and with Asia are very important. Government policies at state, federal and international levels have a big

impact on our competitiveness and therefore our ability to value add. I would like to conclude it there and we would be more than pleased to answer questions.

CHAIR—Thanks for that, Robert. I will open the batting, so to speak. How have you found Austrade?

Mr Hadler—Austrade is very customer focused. They work quite closely with some of our offices in Asia. The biggest benefit of Austrade, though, is not for big companies like Goodman Fielder but for the small to medium sized exporters who do not have the in-house capacity to support the sort of information networks that we can generate through our own businesses. I see Austrade as adding value, but that value is primarily focused on small to medium sized exporters rather than on the big companies like us.

CHAIR—I only asked the question because in another inquiry in which I was involved the smaller companies were saying that, for the fees they have got to pay, it is not worth their while.

Mr Hadler—There is always a balance between payment for services and the benefit that the nation gets from Austrade providing those services. User pays is always good in principle but the beneficiaries usually do not have the capacity to pay.

Ms ROXON—Is there much piggy-backing done in terms of trying to position Australian food manufacturers in overseas markets, so that Goodman Fielder might have the capacity to do certain things but other smaller companies run off that? In a way, I suppose you would hope that Austrade plays a role in that. Do you see that happening in the way Australian manufacturers, either through Austrade or individually, market themselves overseas?

Mr Hadler—Speaking on behalf of Goodman Fielder, we have very close relationships with a lot of our major suppliers and our major customers, not only in Australia but offshore. A lot of our networking is done at a distance from government, so we really work behind trade barriers or under trade barriers through commercial networks. You can do that in a business that has size and scale and which has major customers, like Unilever, Nestle and Cadbury Schweppes, right around the world. It gives you the leverage that you would not get if you were a much smaller company. I think that much smaller companies which do not have that leverage need an organisation like Austrade to actually open the doors and get them through the barriers.

Mr Burden—Although we are a big company in Australia, when you are competing with the likes of Unilever, Nestle and so on, we have to keep in mind that the way in which they operate can have a big impact on their domestic operations. A lot of Australian companies can take advantage of that—if that makes sense—domestically in terms of product innovation. They can be faster.

Mr Hadler—I will give you one example of how we have used our networks proactively offshore. Through our contract to supply Hi-maize for McDonald's buns in Australia, we have worked with McDonald's to approach suppliers to McDonald's in other overseas countries and we have sold them rights to Hi-maize to use in their products and to supply McDonald's elsewhere. So we have been able to generate a third party network, through our commercial contracts in Australia, to generate sales overseas.

Mr ALLAN MORRIS—Mr Hadler, could you give the committee a breakdown of who your shareholders are.

Mr Hadler—Our major shareholders are institutional investors. About 75 per cent would be Australian institutions, which would be superannuation funds and fund managers. The other 25 per cent would be split between US and UK fund managers.

Mr ALLAN MORRIS—I was interested in the fact that you said you import oil but you also export oil.

Mr Hadler—We import unrefined oil and we export refined oil.

Mr ALLAN MORRIS—Is that because of the shortage of Australian oil; in other words, there is more market capacity—

Mr Hadler—It is the different varieties.

CHAIR—We do not have any palm oil, do we?

Mr Burden—No. We import palm oil from Malaysia. Palm oil is great for deep frying. When you buy potato chips you are buying a product that has usually been prepared in palm oil. We also import some minor quantities of sunflower oil from Argentina because the logistics in Australia do not work: most of the sunflower is grown up in Queensland, we have a plant in Melbourne, it is cheaper to bring it across from Argentina. But the quantity is minor. Olive oil is imported at the present time. There is a developing Australian olive oil industry, which is very fragmented and will need to consolidate, both geographically and in terms of function, because at present it is more or less like a cottage industry where everyone wants to do everything—they want to grow the olives, crush them, bottle them and market them.

The big import that we have is palm oil—as you say, we do not produce palm oil. And the big opportunity we have as a food company is, over time, to find a means of replacing that imported product with a domestically produced product. That is a chicken and egg situation. I have mentioned high oleic sunflower oil. We have been attempting to develop that for 10 years and unfortunately, due to the vagaries of the Australian weather, reliability of agriculture production in Australia has a big question mark on it, and it always has. Just look at the situation now: we have had a drought in northern New South Wales and southern Queensland and now we have turned the drought into a flood.

There is a big opportunity for us to replace palm oil. Australia imports about 120,000 tonnes a year of palm oil, of which we would import 70,000 tonnes. We are the largest in the commercial area, selling to other food manufacturers. Palm oil is used in biscuits because it is fit for purpose and it is low value, and Australia sits below the largest palm oil producing area in the world. Malaysia produces 10 million tonnes of palm oil. There is a big opportunity for us to replace that. A lot of issues are involved—there are the health issues, and the big one, of course, is the cost issue, that high oleic sunflower oil is much more expensive. There are certain applications where people are swinging into using that oil. I mentioned before the Kettle chip.

CHAIR—Colombia is trying to introduce palm oil to farmers as a replacement for their drug crops.

Mr Burden—Palm oil would grow in northern Queensland.

Ms ROXON—Do we import the palm oil and refine it just for sale in the domestic market, or do you also export that or just your other products?

Mr Burden—No, not palm oil.

Ms ROXON—It would not be worth doing that, would it?

Mr Burden—No. Palm oil is used instead of tallow. On the commodity side, where we can compete globally is where we have an exportable surplus. It is quite simple and it makes sense, because we then work pricing on export parity rather than import parity. Just staying with fats and oils, Australia has an exportable surplus in canola, in tallow and in cottonseeds. If you are a hamburger producer or you are running the kitchen at the back of the local pub or club, you can use tallow or you can use palm. They are both very good oils, long life, for deep frying purposes. Palm competes in that area as well. Over time, there will be opportunities for people to replace that.

Mr Hadler—Consumer preference plays a key part in what happens in the supply of various products. I mentioned two consumer trends to you before. There is a consumer trend towards health and nutrition and, as a result of that, people are eating less visible fat in their diet or they are eating healthier fats. For example, they are going to canola based and olive oil based margarines, rather than other types of margarines, or Logical, which is a cholesterol reducing margarine. Perversely, one of the other consumer trends is towards convenience, so people are eating out of home more often. As a result of that, they are actually eating more fat in their diet out of home than they would be in home. We supply both sectors of the market, but what we would like to do is to try and raise the consumer profile on health and nutrition in both sectors so that we could supply sunflower oil into the eating out of home sector of the market as well as to retail supermarkets for edible oils for eating at home. Those sorts of things show how consumer trends work and can influence how you value add your products.

Ms ROXON—Is there a big scope with the GMO debate to be looking at developing new types of crops that will meet the specifications that palm oil does for being long life or other particular things but having a lower fat content or be healthier in some other way? Is that an area that Goodman Fielder has a view on or has been involved with?

Mr Burden—You are right, there is a lot of work going on there. Lauric oils are the coconut palm kernel oils which people are working on producing from the canola plant. We are not directly involved because most of that work is being done offshore.

Ms ROXON—Most of the research is done offshore?

Mr Burden—There are a number of multinational companies that are doing it in Australia, but they are directed from offshore. Ron Bowrey, our R&D director, would be the person to talk to as to the level of involvement—I am not sure how much involvement we have.

Mr Hadler—We have made a corporate decision to minimise our exposure to genetically modified organisms in our products. Fortunately, we source nearly all of our raw material from Australia, and that is non-GMO, or we source from suppliers who can give us a guarantee that we are not exposed to GMOs in our products. We are still completing an audit and still waiting for the ANZFA health ministers to finalise the guidelines on labelling and what goes into GMO products. But, essentially, we have minimal exposure. That is a satisfactory position in the short run, but ANZFA is approving the use of GMO crops in Australia and, unless segregation of crops is effective and is brought in, it will be very difficult to avoid using GMOs in the future.

One of the big challenges facing the agriculture industry and the agribusiness companies that are promoting GM products is to actually produce products that provide consumer benefits. Most of the GM products that have been produced to date only provide farmer benefits, in terms of increased targeting of pesticides and therefore reduced environmental damage, but there have not been any benefits so far to consumers. I think that until the agribusiness sector actually provides those products, consumers are going to remain wary of GMOs. It will be a constant battle.

CHAIR—On the quality assurance point, I notice in your report you are asking growers to adopt processes on farm that complement the rest of the supply chain, and saying that the growers who take up the initiative in this area will benefit most. What sort of processes are you referring to? How much help are the growers getting in that area?

Mr Burden—There are a number of quality assurance programs in Australia. One which we are supporting is called Great Grain. We are encouraging farmers to the involved in that program and there is an incentive. There are manuals and an implementation program for individual growers, and currently it costs about $500 for their registration, manuals and so on. When a wheat farmer who is contracted with us wishes to become involved—and we encourage him to become involved in Great Grain—at this stage we are paying his $500 fee for registration and to allow him access to the operating manuals that are provided by the Great Grain program. Eventually, the grower would anticipate that there would be some premium attached to his wheat payment once he has been involved in the Great Grain program. There are some competing programs and at some stage, hopefully, we need to sort out which programs are going to be supported nationally.

Mr ALLAN MORRIS—Can we talk a bit about your relationship with your farmers. We notice there are different relationships in different parts of the country, and perhaps the world, and we hear about the closed loop system where people supply the grain and the farmers provide the end product. You appear to have a number of different relationships. Can you enlarge on those a bit and where that is going in the longer term?

Mr Burden—Our relationship with growers at this stage is limited to growers of wheat, oats, maize and some other minor grains. But the major one, of course, is wheat. We do not operate any closed loop systems. If I can switch briefly to oilseeds, they are purchased by oil seed crushers—people like Cargill—who have the direct relationship with the grower; our relationship is with Cargill.

Going back again to the high oleic sunflower, when we were attempting to have that grown in Australia we did introduce a closed loop system in the early stages of development. We had an

arrangement with a major seed marketer; we had an arrangement, therefore, with the grower, the crusher and ourselves—there were four parties involved. So if you were a grower and you wanted to grow high oleic sunflower seed, we would provide it to you on the condition that you wrote a contract with Cargill—who would crush it—and then we had a conditional contract with Cargill that they would only supply the oil from that seed to ourselves. That operated for about three years. This program on high oleics is about 10 years old. After three years we were approached by other participants in the industry to remove the closed loop to try and allow other people to become involved. We did that and now we have Unilever and another company in Melbourne who are actively involved in producing the same product.

On wheat, the relationship we have there is basically one in which you can provide and source your own. We do sell sowing seed, but there is no compulsion upon you to buy your sowing seed from us—it is an alternative that you have. Your contract with us is to supply a variety of grade to a specification at an agreed price. We also offer growers what we call basis contracts, where you can fix the price component, the currency component and the offshore derivatives component separately. That is an option that we give you.

Mr Hadler—Because we use a wide variety of grains—and some are highly specialised—it makes sense for us to have that direct relationship with growers to lock in supply. Because we are such a big user of grain domestically, unless we lock in supply, we run the risk of not having sufficient supply through the year.

Mr ALLAN MORRIS—Also, if you want to upgrade quality and all the rest of it, you actually need to exercise more influence within the growing process. That is what we have been hearing.

Mr Hadler—I used to work at the National Farmers Federation and actively promoted quality assurance there, and there was a lot of resistance amongst individual growers to adopt QA systems—primarily because of the cost, but also because of what they saw as an intrusion on their independence. However, I think it is inevitable that quality assurance programs will become a critical part of any successful farmer-supplier relationship.

Mr HATTON—A statement first and then some questions. I want to look at your problem with the single desk situation and how that affects you. Like all of our raw products, we can flog them off overseas—we have got existing markets and so on. But the adding of value comes from the kind of work that you are doing. How much are you hampered by the existence of the current arrangements? Do they create a major barrier for you and how specifically do you think that should be changed in order to create better opportunities for you to sell into markets overseas?

Mr Hadler—I will make an opening comment and then Warren can talk about it in more detail. As I said in my opening remarks, we can see the rationale for the single desk and, while there is a net national benefit or community benefit from the operation of the single desk, it makes sense to keep it. There is a big debate about how big that net benefit is, and the Allen Consulting Group has done work that says it is a lot smaller than is widely assumed. So we are not opposed in principle to the single desk, but we think that its operation—particularly with the Wheat Board and the tender system—can be improved substantially to reduce cost and enhance the flexibility for producers such as Goodman Fielder.

Mr HATTON—And, in particular, because of the domestic situation—you are producing for our market as well as producing for overseas.

Mr Burden—It goes back a little to what Allan asked about development of varieties. We are by far the largest miller of soft wheats used in biscuit manufacture and we work very closely with people like Arnotts biscuits and with research groups in determining and developing better varieties for the biscuit industry. As such, the Australian Wheat Board are very small players in that soft wheat area. Australia does not produce an exportable surplus usually of that variety and therefore when the Australian Wheat Board single desk operations start to talk about determining quality standards for varieties and receival standards we think that is an unnecessary interference in the domestic industry.

Their focus is on export and we do get frustrated at times—and I think Robert mentioned before the way they are organised and structured with their international group operating separately from the domestic group—that communications do not always seem to be the best between the two. The real power lies with the international group because obviously 80 per cent of the crops being exported. The domestic industry quite often is overlooked—and we are on the public record in the NCP review in having made that point. There should be a lot more consultation. Specifically, if we just look at soft wheats, we are doing a lot of work and putting a lot of money into research and development of varieties and working with end-users. To have a single desk then decide to introduce specifications for Australian soft wheat without consultation interferes with what we are trying to do.

Mr Hadler—That is in the domestic market. Then with exports we also face some constraints because of their veto power. Warren, you might like to touch on some of the issues we have with containers versus bulk wheat.

Mr Burden—Yes. We operate flour mills in New Zealand. We have a flour mill in Christchurch and currently one at Mount Wanganui. There is one at Auckland which is closing shortly. With the South Island our policy is to supply as much wheat as we can from domestic South Island growers, and we are fairly successful in that. But the North Island is not suited to wheat and we have to import. We cannot take our own grower contracted wheat and load it on a vessel. We are restricted, as the Wheat Export Authority—

CHAIR—Isn't it a bit dumb that we can't do that?

Mr Burden—I think so, yes. There should be—

Ms ROXON—That is the official term.

Mr Burden—The Wheat Export Authority have to refer those applications for bulk exports to the Australian Wheat Board and they have the right of veto. We asked for two things: firstly, that the Wheat Board schedule those markets that are considered strategic. We understand from the Australian wheat growers' point of view that if there is a premium being earned the Wheat Board would not want other people interfering in those strategic markets. Secondly, we have asked about the New Zealand and New Guinea locations or destinations—and both ourselves and George Weston, the Australian based company, have investments in flour mills—because

you could have a situation where it becomes uneconomic for us to mill in New Zealand for a period of time and we are at a disadvantage to flour exporters from Australia.

CHAIR—You could be regarded as a domestic market. New Zealand is still recognised in our Constitution, I might add. It is interesting reading the history: they decided not to come into the Federation because they feared the debts of Victoria.

Warren, on the Wheat Board, I noted that at one stage their strong argument was that they could guarantee farmers payment, and they effectively acted as their banker. I read with great interest last week where the National Australia Bank are now saying to farmers. 'If you use us as your effective banker, our deal is much better and our fees and charges, in comparison with the AWB, are much lower.' That would then tend to take away a lot of the argument that the AWB for their part were running at the time. Can you comment on that?

Mr Burden—I read the article on NAB and I think the following day the AWB reduced the guarantee fee down to the NAB fee.

CHAIR—It is marvellous what competition does, isn't it.

Mr Burden—Yes. One would not be surprised if other banks came out with a few schemes of their own. In terms of funding, our own position on that is that we pay growers up front but obviously the grower has to make a calculation about an up-front cash payment because we make an allowance in our cash payment for that funding fee.

Mr HATTON—It is very hard to identify other industries where research and development would be more important than in yours, in particular because of the rapid turnover in relation to product development right throughout the food industry. You see one new product after another coming out and the market differentiating. There is a great deal of work that goes into that product development. To stay competitive you have to do it. What is the full impact on you of the reduction from 150 per cent to 125 per cent and the related fact that now, with the changes in business tax from 36 per cent going to 33 per cent down to 30 per cent, to really replace that 150 per cent you need to be looking at 200 per cent to 230 per cent? There is an associated argument here. Ericsson have argued recently that the problem is not with the percentage you can get—that is a tax issue and so on. Their problem is that they cannot get the trained people that they need. They have said that the government should actually pour the money into training rather than anything else. Can you comment on that?

Mr Hadler—When we originally did our submissions to the government on the reduction from 150 per cent to 125 per cent, our estimates then were that we spent about $25 million a year on pure research and development and that the reduction in the tax concession cost us about $1 million out of that $25 million of expenditure that we could claim back on tax. Therefore, it did have a fairly significant impact on our R&D budget. That is one of the reasons why we would be urging the government to reconsider its position on the R&D tax concession.

We have noticed that on the separate issue of education and training there are increasing demands on scientific organisations and funding is increasingly difficult for them as well. We are seeing a squeeze on both sides of the fence, basically on the R side and on the D side, so funding is being squeezed on both sides and it is leading to a reduction. I think the ABS figures

clearly show that there is a reduction in research and development expenditure as a result of that.

Ms ROXON—Can I ask a follow-up question on that which also goes back to your comment when you were talking about the GMOs that a lot of the research that you ultimately could use is being done elsewhere. What impact does that have for the decisions you make about how much value adding you do in Australia? What difference does it make if you have the researchers overseas giving you their knowledge and techniques, compared to if you have them here? It seems that you would be able to have a closer working relationship and make sure that they are developing ideas and researching the areas that you want. Can you talk about what impact that has?

Mr Hadler—There are two issues. The first is access to the R&D which affects your ability to target a specific product development. If it is done locally you have greater access to the development, greater input into the development process and therefore you—

Ms ROXON—So you do not just mean who owns the intellectual property; you mean talking with and actually explaining the situation?

Mr Hadler—Being actually involved in a face-to-face discussion in the development process.

Ms ROXON—And that does have value?

Mr Hadler—Yes, certainly. That is why Hi-maize and Gold'n Canola are two perfect examples of domestically developed product innovations from which benefits have been derived out of a research and commercialisation process domestically, rather than from overseas. The second one is price. If you are doing it domestically and in-house, typically it comes at a lower price than if you are buying it internationally and its R&D has been commercialised externally. So it is both access and price that affect you.

Mr ALLAN MORRIS—You might want to take this on notice: with respect to your exports into Asia, obviously you export some processed oils, which you mentioned earlier. You also export some finished products. Can you give us a breakdown of the kind of mix and value mix? I do not want to go into your business operations in detail, but I would like to try to better understand at what level of the chain you are exporting—whether it is intermediate material or finished material in the main?

Mr Hadler—It is mainly finished material. We export about $120 million or $130 million of finished product.

Mr ALLAN MORRIS—Is that chips in packets, for example?

Mr Hadler—It is things like Meadow Lea margarine into Indonesia, Uncle Tobys bars into places like Singapore and Hong Kong, noodle mixes into Japan, out of Australia and New Zealand, and white sauce mixes. That is the type of product that we would be exporting into Asia.

Mr Burden—The major product is tallow based product—tallow is an animal fat—such as cake and pastry margarine which is in the food service category. It is a 20-kilogram box of white fat. That is sent mainly into China.

Mr Hadler—We would be exporting that out of West Footscray.

Mr Burden—Mainly out of Brisbane.

Ms ROXON—May it continue out of West Footscray for a long time.

Mr HATTON—I think Treasury are extremely dumb to go for a value added tax rather than just an end point or retail sales tax. For all of the benefits of taking out the input costs, they have added in administrative costs. The bigger firms can handle it. How significant are the administrative costs for you of putting the tax on and taking it off? How much difficulty has that created for the business?

Mr Hadler—There are two aspects to that question. The first aspect is: how much did implementation cost us? The second one is: what is the cost of the ongoing administration of applying it to our various products? The implementation cost was about $3 million or $4 million up front, in terms of reviewing our exposure, reviewing all our contracts, updating all our systems, putting in new software, and employing consultants and new staff specifically to administer it. The previous wholesale sales tax was much less onerous than the GST in terms of implementation and ongoing administrative costs. In terms of the ongoing administrative costs, about 85 per cent of our products are non-GST affected, so it is relatively concentrated.

Ms ROXON—What percentage did you say?

Mr Hadler—About 85 per cent are non-GST affected. So about 15 per cent of our products are affected by GST and most of those were previously subject to wholesale sales tax as well. So we have not been as adversely affected as some of the other businesses. Our biggest cost was the up-front implementation cost.

Mr HATTON—But it would be of benefit to you if those administrative costs were taken off and if the thing was changed so that it became a retail sales tax and it was at point of sale only and you did not have to do all of that back and forwards process with the 15 per cent?

Mr Hadler—The devil is always in the detail. I would like to hold back on that and see what the specific proposal would mean for us.

Mr HATTON—With respect to tariff and non-tariff barriers in Asia, how significant a problem have they been, and are they, for you in selling into the markets in Asia?

Mr Hadler—Both of them are a problem but non-tariff barriers are the biggest problem. As I said, we export into a range of Asian countries and it is the unseen trade barriers that are the biggest problem rather than tariffs. Warren might have a specific comment to make on that.

Mr Burden—I am involved in purchasing products; I am not a marketer. The problems we see really are in reverse—in the non-harmonisation of tariffs in Australia. To give a simple example, if you import a 20-litre drum of soybean oil from Singapore and bring it into Australia it comes in duty free and competes with a product in Australia that is put in a 20-litre drum. If you want to import tin plate into Australia, you pay an import duty and if you want to import fibreboard you pay an import duty. You can import palm shortening in fibreboard and it comes in duty free. It is not a major issue but it gives us a cost disadvantage, because the domestic producer of tin plate and fibreboard imputes that tariff. To add a bit of additional cost comparison, people like BHP in fact incrementally sell their tin plate into South-East Asia.

On a recent visit to South-East Asia I was talking to a fats and oil producer. He was buying the tin plate and forming the drum at a 40 per cent discount on what we could pay here in Australia, and he was buying the product from Australia. That is not a tariff issue, but if we were to import tin plate we would have to pay a duty, and if you bring the tin plate in full of oil you do not pay a duty. That harmonisation of tariffs, I am sure, has come up before but, from a domestic producer's point of view, we are at a disadvantage. In terms of the exports, I mentioned that our major market for pastry and cake margarine is China. In effect, that is quite a regulated market. The Chinese will put quotas on; they will put total restrictions on so that there are very big barriers to our export business in that area.

Mr Hadler—We are hoping the Chinese entry into the World Trade Organisation will lead to a rationalisation of tariff and non-tariff barriers, but I think it is going to be a long haul.

CHAIR—On that basis, we have to wrap up, unfortunately. It is starting to get quite interesting. I would like to thank both of you very much for your submission.

[10.09 a.m.]

HARALDSON, Mr Tony, Chairman, Australian Coal Association

PORTER, Mr Denis, Joint Executive Director, Australian Coal Association

CHAIR—I welcome you here today. I would remind you that the proceedings here today are legal proceedings of the parliament and warrant the same respect as proceedings in the House. The deliberate misleading of the committee may be regarded as a contempt of the parliament. The committee prefers that all evidence be given in public, but should you at any stage wish to give evidence in private you may ask to do so and the committee will give consideration to your request. I now invite you to make an opening statement.

Mr Haraldson—Thank you, Mr Chairman. I do have a brief opening statement. Thank you for the opportunity to appear before the committee today. The Australian Coal Association represents the black coal producers in New South Wales and Queensland. Our submission to the committee covers the role of coal domestically and world-wide and the implications of the Kyoto protocol for our industry including the potential impact on key regions. We have also taken this opportunity in our submission to summarise the initiatives the coal industry has taken to reduce greenhouse emissions.

The black coal industry has played a critical role in the development of the Australian economy, in particular, in the development of the industries which add value to our mineral and other resources. We have major concerns that some individuals and groups would like to see the coal industry close down. These individuals or groups like to portray the coal industry as the villain in the greenhouse debate. We saw this bias coming through in the report of the Senate environment committee which has just been released. The Democrat recommendations in this report, for example, include one which says that the government should oppose any proposals for the inclusion of clean coal projects in the clean development mechanism. Another Democrat recommendation says that Australian governments should prepare set time frames to replace coal-fired power with a mixture of gas and renewables with the proportion of renewable energies steadily increasing until our economy is predominantly based on renewable sources sometime after 2050.

We see a major continuing long-term role for our industry as part of a balanced energy mix here and overseas and as a key input into steel making. We recognise that the industry faces major challenges, not least in terms of greenhouse, and we are responding to these challenges. We hope that important inquiries, such as this one, will help to better inform governments and the community about the need for a competitive energy sector and the threat to jobs, exports and living standards from the direction that the Democrats would have us follow. Thank you for letting us make that statement and we will be pleased to take any questions from you.

CHAIR—Can you expand a little on the proposed R&D program and particularly the CRC for sustainable development? It is almost going on from the points you raised. I think we need to get the wider community to focus on how important the comparative advantage we have with power generation is and how it is driven mainly from the coal operations that we are talking about this morning.

Mr Porter—Neither Tony nor myself have been directly involved in that CRC proposal. What we might do, if you are agreeable, is to send you a brief summary of that proposal. It is going through the system in Canberra at the moment—I think it has got through the first round and is part of a figure of a remaining 30 or so, so it is still a very competitive situation. But the proposal has been driven by a concern about the role of coal long-term and it is definitely not some sort of PR exercise. It is going to be a genuine attempt to look at coal's role—how we fit in the long-term energy scene; how we would fit with renewables; how the new technologies will impact on the role, and so on. There is a few page summary of the actual proposal itself which we will forward to you and, hopefully, that will give you a better idea of what is being proposed. We see it as a critical one. It is a very strong proposal backed by a number of the major companies including BHP, Rio Tinto, and so on. Most of these do have the CSIRO and the electricity utilities involved, and even a couple of the Japanese organisations are involved in the proposal. The coal industry's own research program, which is funded by all the producers, is there as a major backer as well. So it has very wide support and we see it as very important.

Mr Haraldson—It is not just producers—users, producers and scientific institutions are involved in it. That is something, I hope, that would come out with research and results that can be demonstrated as being independent and peer reviewed.

CHAIR—Do you think the wider Australian industry has focused enough yet on the ramifications of Kyoto to Australia and to themselves?

Mr Haraldson—Nowhere near it. As our submission includes, it is not just the loss of the export benefits that affect Australia from simply coal, it is the flow-on effects of the value adding, which this committee is certainly investigating. One of the key issues in Australia which supports that is the low cost of our electricity, and that is driven by black coal. We are efficient producers of electricity, and we are looking to become more efficient, as evidenced in the CRC and what we are doing in other areas. I do not think people realise just what it does to our standard of living. If we lose the smelting, the treatment and the value adding that currently happens in Australia, it still has to happen. If it goes offshore to a less efficient place where they are going to do that work, maybe because it is cheaper because of carbon taxes or whatever, it will affect the emissions, such as they are currently from Australia, being done on an efficient basis and we will lose the benefits to the Australian economy and to our standard of living. That is very serious, from our perspective.

Ms ROXON—You know that we are at a stage in our inquiry where we are doing some case studies on particular industries, being aluminium, magnesium, dairy, grain and wine. I am interested in how your industry actually interacts with a lot of other downstream processing industries and what role you play, whether it is in terms of the research and development that is done about how you can become even more efficient and what benefits that has further downstream. Given that we are looking at value adding in Australia, and you play an integral part in that, how much interaction is there between different industries and the needs of different industries—how you can help meet them or barriers, et cetera?

Mr Haraldson—It is growing. To be perfectly frank, for the last five or six years the Australian coal industry has had its head down and its tail up trying to survive. We have been in an oversupplied market. It has been six years since we had a price increase for Australian coals to export and four years of continuous price reductions. We have been working through a

process of survival, basically. In recent times, we have realised that surviving is just not enough. We need to be proactive in selling our own story and putting ourselves into perspective, which we see as most important. You may have heard of the life cycle analysis process which we are starting to develop more. It was commenced by BHP, but it has now been joined by others from both the producing and the using side. We are looking to make sure that people do know how important coal is in their lives, whether it be from a steel making perspective or power generation, and what this leads to in downstream activities.

But it is not some sort of biased approach being promoted by our industry. If it is comparing gas to coal, for instance, it is utilising figures provided by the Gas Association. If it is talking about solar energy, and photovoltaic cells and the like, it is information that is accepted by the manufacturers of photovoltaic cells. The whole objective of this is to make sure that people understand where coal fits in. We do not expect at the end of the day to be able to say, 'Coal is terrific, it is better than gas and whatever else.' But we believe, and we can already say, 'Coal is nowhere near as bad as you think it is from an emissions perspective, on a cradle to grave comparison basis of the renewables and the gas or whatever. So we're not nearly as bad as what we are painted to be and as you think we are. And those other ones are not quite as good as you think they are or expect them to be.'

I have a couple of simple examples. I did a presentation in Canberra on this life cycle analysis, and I was speaking to a Democrats senator. She was very much in favour of promoting biomass renewable. We are also happy to talk about biomass cofiring with coal, because it is a much more efficient way of doing it—we can demonstrate what can come out of it. She was more keen to see straightforward biomass. I gave her a couple of simple statistics. In New South Wales we supply coal to Macquarie Generation, which is the Upper Hunter power generator, and to Delta Electricity, which is in the Newcastle area. Between them, they are burning around 15 million tonnes of coal per year.

If you are talking about two per cent renewables, you say, 'That is 300,000 tonnes of coal being replaced by biomass.' But it is not as simple as that because there is a multiplier effect. To get the same energy out of biomass as you do out of that coal you have to multiply it by three. So we say, 'We will replace two per cent of coal with renewables and, being biomass, we are going to use 900,000 tonnes of biomass.' You would be cutting down every tree in the state. We do not have 900,000 tonnes of waste that I am aware of that can be readily pumped into power stations. It is a matter of understanding these things and putting them into perspective. The gentleman behind us who walked in with us is a very recent appointment, named Mark O'Neill, who is heading up a new program that we are developing called the Australian Coal Association's Sustainable Development Program. Mark is the director of that, based in Canberra. In the future you will hear the coal industry stating its case a lot more, I believe on an unbiased and hopefully acceptable basis to all concerned.

Mr ALLAN MORRIS—We are talking to CSIRO tomorrow but I want to seek your understanding of the ultraclean coal project with White Engineering. Can you talk about that from an industry point of view. We are talking to CSIRO about it from a scientist's point of view but I am curious as to how industry sees that kind of development.

Mr Porter—It is a project that the broad coal industry has not had a lot of involvement in. White Mining and the CSIRO have been involved in it for many years, I think, and it is good to

see a research facility going ahead now in Cessnock. My understanding of it is that, if it proves successful and viable, ultraclean coal could be a competitor to heavy fuel oils in industrial applications. It could also have some applications in power stations. It gives coal, possibly, a broader application in the future but I think a lot more work and money need to be put in yet before it is commercially viable.

Mr ALLAN MORRIS—I suppose this greenhouse thing is a vexed question for all of us and I am not sure if I know anybody who actually knows exactly what is the best way to deal with it. On the one hand, it is certainly putting pressure on us to look at other angles, like making our coal more valuable. I gather that it will probably be worth twice as much and therefore, in terms of exports, it will generate activity and export at a higher value into a more premium market, if it eventually works. That would seem to be a way of countering greenhouse and responding to the greenhouse challenge, if you like.

Mr Haraldson—Gives more bangs for your buck, I think.

Mr ALLAN MORRIS—It does that and therefore we get more energy for the same weight and therefore it helps Japan with their grid hunt but it also may well mean that we can do more with it ourselves.

Mr Porter—There are big greenhouse savings, as I understand it, if a power station were to use the technology. Yes, it has potential.

Mr ALLAN MORRIS—That is the thrust of your CRC as well—moving towards more sustainability a la other applications, not simply coal. In a sense, the focus seems to be shifting towards that and the industry is doing that but it is not saying much about it.

Mr Haraldson—We are starting to.

Mr ALLAN MORRIS—Yes.

Mr Haraldson—Until now we have been in survival mode. I am hoping you will start to see us being more outgoing and more proactive in telling our story but telling it in a way that is not just another lobby and not just another con job. We are looking to be able to produce unbiased, independent peer reviewed material that, I think, will put coal into much better perspective.

Ms ROXON—I must say my question was not really directed as much at what the industry was doing in terms of promoting its story, which obviously you need to do. I think your answer is that you are not doing it yet but you would like to do more of it. I am more interested in what work might be done with particular industries that have high power needs or use coal in a particular way that may be able to use it in a better way which some research and development that you do jointly might assist. I guess I was interested to know if any of those sorts of discussions were happening or planned. I know the fundamental argument for you at the moment is convincing people about the value of coal generally.

Mr Porter—If you look at the markets for coal domestically, power generation is by far the biggest. Then there is steel making. Very few other industries, apart from cement, take coal

directly. The coal industry's major customers are the power stations, BHP—the steel producer—and the cement companies. Less than one per cent would go to other applications.

Ms ROXON—So that question is better directed to our next witnesses who are the electricity supply people?

CHAIR—Yes.

Mr HATTON—I want to follow up with the coal industry what you are doing in relation to that. In Britain newer power stations are being developed—I think the *Science Show* carried a story about them last year. They have discovered that if they burn coal at a much higher temperature—I think 700°C to 1,000°C—there is a much better burn and enormous efficiency gains in terms of the electricity produced. They are looking at developing that. It is possible to use those findings here to retrofit our power stations, and therefore use the coal more effectively—which, for you, in terms of running your case, would be very effective. Have you had any discussions with coal powered stations about the work that is being done in Britain or about ways in which they could get a better burn?

Mr Haraldson—No, not personally. I am not aware of any industry discussions. But it is an ongoing process. One of the problems in Australia at the moment are the concerns of those power generators—you say that they will appear before the committee next—who are looking at their future too. They are not just coal-fired power generators—Macquarie Generation has been burning biomass for some time and we have seen the Queensland experience with gas in recent times. I will not say that they are having an identity crisis because that is overstating it. But they must determine themselves where they want to go in the future and perhaps their research from a coal perspective might be governed by a balanced energy mix into the future.

We hope that the CRC will participate in the sorts of activities that you are talking about. It sounds trite—you may have heard it already—but the Australian power stations in New South Wales particularly are very efficient, as are the Japanese. It has been stated several times in different ways over the years, but, if we were able to bring the Chinese power stations to the same level of efficiency as we or the Japanese enjoy, the Toronto targets of 1990—or whenever it was—of minus 20 per cent greenhouse gas emissions would be met just by improving the efficiency in China to our levels of efficiency. It is in those sorts of things—particularly from the perspective of this committee—that we see the importance of reinforcing the fact that we should be doing things efficiently—where we are able—and not let carbon leakage occur. It is better for the world and for the environment, and we should be promoting that position.

Mr Porter—On that point, Pacific Power International, with funding from the federal Department of Industry, Science and Resources, has been doing some work in China on a fairly small power station. They have shown that, with certain technical upgrades and quality coals, you can lift the efficiency of that sort of power station—and there are many of them over there—dramatically and reduce greenhouse gas emissions. I can supply you with a one-page summary of that work. It is very interesting and has some broad implications.

Mr ALLAN MORRIS—I suppose some of us are concerned—I certainly am—that the community perception is that the coal industry is fighting the greenhouse issue and violently opposes it. You often hear some quite strong comments and attitudes. I recognise that there are

difficulties with the way the greenhouse debate is evolving in Australia, but the coal industry is not seen to be behind the pressure for more efficient use. Michael mentioned that CSIRO have another project running that is capable of increasing power station efficiencies: the ultra clean coal. The industry in the broad does not seem to saying 'We are doing all these things because we accept there is a problem.' We also think the formula might be wrong. It seems to me—it may be the media; I suppose that we all have the same problem—that the coal industry is not perceived to be pushing for the more efficient use, including new forms of use, of coal in our power stations. I think your credibility is suffering: you are attacking only one side of the argument rather than working on both sides, which is what I think you probably need to do.

Mr Haraldson—I accept the fact that we have not been doing what we should have been doing. That is because we have been trying to survive during the last five or six-year period. We have determined that we are going to make our presence felt more, and you will hear more, I am sure, in the future. I can honestly say that the industry is not fighting against the greenhouse battle. We have long decided that we would not fight the science. We are trying to put it into perspective, from the political perspective more so these days. You will not see any responsible coal producers in Australia saying that greenhouse is not true. I could perhaps use more vernacular language in saying that. But that is not the case; it is not the way in which the Australian coal industry is heading. We are saying, 'Okay, regardless of whether it's right, wrong or indifferent, we can't take the risk and we're proposing to improve our performance and to increase our activities in that regard.'

I remind the committee that the New South Wales coal industry, particularly in the last five years, have produced an annual profit summary, or lack of profit summary. We just have not had the ability to spend huge amounts on research. We have been struggling, as I say, to survive but also to put out the little that we could in respect of research. We are doing that through ACARP—the Australian Coal Association Research Program—by way of a 5c a tonne levy. We have recently increased it by way of a new levy to take part in the sustainable development program. We are attempting to lift our game and trying to move towards some of the areas that we all agree are desirable for the future.

Mr HATTON—In your briefing there was a study done which refers to energy use forming a small fraction of greenhouse gas emissions compared with fugitive emissions from mining. Can you explain the 'fugitive emissions from mining'? With respect to the comparison with energy use, does that mean in terms of extracting the coal rather than its use in power stations?

Mr Porter—If you look at the pattern of energy use in mines, you have got electricity for machinery, petroleum products and so on. The greenhouse emissions from those sources are quite small compared with the greenhouse emissions from the methane that comes from underground coal seams or, in some cases, from the spontaneous combustion of coal. A lot of companies are focusing on energy efficiency, but at an industry level we are saying that the big priority for us as an industry is to try to reduce the so-called waste mine gases—the methane that is ventilated or released from the coal seams, and also better controlled spontaneous combustion. That is where you get the really big gains. Several companies have made submissions for funding for the GGAP program that is out there at the moment for bids. We have done research into this area. Again, it is going to be one of the areas of focus of this new CRC. So it is really saying that, yes, you can make some gains in energy efficiency on mine sites, and that is very positive, but the really big gains are in the other areas.

Mr Haraldson—As I understand it, every underground mine is ventilated. They have quite significant fan systems that blow the gases. That is for safety reasons. If the gas underground exploded, we would be killing people. That is vented into the atmosphere. You may be aware that BHP, at its Appin and Tower collieries on the South Coast, have been harnessing that gas rather than venting it into the atmosphere. They are putting it through 90-odd caterpillar generators, developing and producing electricity, using it for their own purposes and selling it into the grid. I am aware that the Moura mine in Queensland is doing exactly the same thing. They are taking the methane out of the coal seam and selling it into the power grid.

Mr Porter—They sell it into a pipeline rather than actually generating—

Mr Haraldson—Into the gas grid. There are demonstrable benefits that can come from further harnessing of these fugitive emissions, as they are called.

Mr Porter—The problem is that a lot of those emissions are of a fairly low concentration, so are not necessarily as economic as in the BHP type of situation.

Mr HATTON—I go to the last comment—this is really extraordinary stuff:

Governments need to return to the main task of establishing sound market frameworks with a minimum of government regulation and intervention.

It is an extraordinary free market thing. It is one of those things that mindlessly get put into submissions. Governments are actually here, still, to do things. And entirely unregulated markets, as we saw at the end of last century, end up in a devastated environment, economic, political, social and the rest of it. I take it as read that this is just one of the reflex statements, or do you really mean this, that there should not be any real regulation or intervention at all in the setting of standards?

Mr Porter—You have said something that is actually not reflective. We said, 'with a minimum of government regulation and intervention,' and a minimum does not mean zero. You have the ESAA here next. They will tell you about some of the problems in the regulation of the electricity industry at the moment. There is scope for improvement there. We recognise a role for government, we recognise a role for regulation in all sorts of areas, be it health and safety or whatever, but I think you are saying minimum equals zero, and we did not say that.

Mr HATTON—Therefore, do you mean by this that there needs to be a better interplay between governmental agencies, the government process, and the industry associations, to get a better regulatory framework that more directly matches the needs and concerns of a particular industry?

Mr Porter—It is hard to generalise. My view is that in some of these areas the problem is the federal structure of government, the state and federal governments. A lot of improvement can be made there, and a lot more interaction with industry, but I think you would have to look at each industry and each set of conditions to be a bit more specific. Certainly, with energy markets and the attempts to free them up and make them more efficient, the fact that you have so many governments involved and two levels of government has made it much more complex, much more difficult.

Mr HATTON—Does it really impact on you adversely in terms of your attempts to improve value adding in coal?

Mr Haraldson—If government regulation led to early action in respect of greenhouse related activity, I think it could be very harmful. Our submission is saying, 'Don't jump the gun please, let's see what's happening in the world, otherwise we're just going to export our industry.' To that extent, less regulation is better. Ninety per cent of our regulatory activities are state based anyway. They are more to do with the regulations associated with health and safety and the like. The regulatory environment from a federal perspective is relatively little. From our perspective, in the context of the discussion on greenhouse, early action is something we would strongly advise against. If that means less regulation, I heartily endorse it.

Mr HATTON—How do we stand now with selling coal into Japan? They have crushed us very effectively year after year by playing off different companies against each other. However, I understand that in the last couple of years people have got their act together here and taken more of a single desk approach. What is the score now?

Mr Haraldson—That's true. I got back on Sunday from Japan. And we had the Australia-Japan coal conference, which I chaired from the Australian side, about a month ago in Queensland. I believe there is acceptance of price increases in the coming round of negotiations. I do not want to sound like a free marketeer, that is not my intention, but whatever you have seen happen in recent years from the market perspective, whether it be Japanese, Korean or European buyers, it has simply been a reflection of an oversupplied market. If the market was not oversupplied they could not have got away with what they got away with because we would not have accepted the price reductions that we were forced to.

CHAIR—Motorists would have loved that with oil.

Mr Haraldson—I'm sure.

CHAIR—So would government, by the way.

Mr Haraldson—An oversupplied petroleum market would be very nice. But an oversupplied coal market has been the fundamental cause of our problem. It was heading to a marginal oversupply until the Asian crisis hit us. There was such a reduction in activity in our buyers when that occurred that suddenly the demand dropped but the production which was established and which was committed kept going and we ran into a significant oversupply situation. You will start to see that turning round. It happened this year in the Korean negotiations where the Australian suppliers did stand together and resisted being forced to accept an increase which one supplier had inadvisably already accepted. We ended up in a position better than the one that that supplier achieved. All power to our elbow, and I hope there is more of it.

Mr Porter—Also, the Japanese typically still pay the best prices.

Mr ALLAN MORRIS—How do you factor in then the takeover of the mining companies by others so that you actually end up with fewer companies competing?

Mr Haraldson—I think that can only help from the perspective that they would have a more rational approach. They are stronger organisations; there is no doubt about that.

Mr ALLAN MORRIS—Except if some are substantial shareholders of the buyers.

Mr Haraldson—I do not believe that is the case. The big four or five at the moment in Australia are heading that way. They are Anglo-American, Billiton, Rio Tinto and BHP. Apart from BHP and its own steel business in Australia, I do not believe any of those are shareholders in buyers of our coal. I see that consolidation as adding strength to the industry from the perspective that they are big enough and strong enough to say that they are not prepared to accept that outcome, and perhaps have enough tonnage and muscle to make the buyers sit up and take notice. From the other perspective, the buyers should be relatively comfortable. They are never comfortable in seeing a shrinking or less fragmentation of the market which is to their advantage. They should also be comfortable that you have suppliers out there who are healthy and strong and who are not going to go to the wall in a short downturn.

CHAIR—Are there any further questions? There being no further questions, I would like to thank you very much for your presentation. I would inform you that this morning we resolved to accept for publication your submission. Thank you very much.

[10.46 a.m.]

ORCHISON, Mr Keith William, Managing Director, Electricity Supply Association of Australia Limited

CHAIR—Welcome. I remind you that proceedings here today are legal proceedings of the parliament and warrant the same respect as proceedings of the House. The deliberate misleading of the committee may be regarded as a contempt of the parliament. The committee prefers all evidence to be given in public, but should you at any stage wish to give evidence in private you may ask to do so and the committee will give consideration to your request. I now invite you to make an opening statement.

Mr Orchison—Thank you, Chairman. I would like to take the opportunity to do that. The association made a submission to the inquiry in August of last year and then I gave evidence before you on 18 October. Today we are pleased to have the opportunity to present to the committee two publications that we have issued since then. One is our annual statistical report, *Electricity Australia* for the year 2000 and the other is our annual publication on *Electricity prices in Australia for 2000/2001*.

I would like with your permission to draw the attention of the committee to data that appears on pages 57 and 58 of *Electricity Australia* and to a table that appears in the other publication, *Electricity prices*. The reason I particularly want to draw the committee's attention to this information is that on pages 57 and 58 of *Electricity Australia* the data shows that out of a basket of some 30 developed nations Australia's residential and industrial electricity prices at January 2000 were bettered only by South Africa. For large industrial users Australia provided electricity at a typical rate of $54 a megawatt hour compared with $81 for Germany, $89 for France, $99 for Spain, $119 for Britain, $136 for Italy and $208 for Japan.

The countries named, of course, are all large manufacturing states and Australia's electricity prices obviously provide a strong input cost advantage to domestic manufacturers. The data on page 10 of *Electricity prices in Australia* contains prices for power adjusted for inflation covering the period 1991-92 to 1999-2000 and also contains projections on the association for the current financial year. I am sure the committee can see very easily that for commercial and industrial tariffs the introduction of electricity competition has driven down prices since 1996-97 and has held them in round numbers to $80 per megawatt hour over the past four years. The GST, of course, will increase all prices from July this year. You will also note from that particular chart of electricity prices in Australia that a decade of improvement in labour and capital productivity has seen commercial and industrial prices on a virtually continuous downward path.

My association is at present working cooperatively with the Productivity Commission on a benchmarking study of Australian electricity prices. The commission, I am pleased to say, is paying considerable attention to producing genuine comparisons, taking into account the many complex factors that influence electricity costs and hence, of course, prices. We are hopeful that this study will provide fresh independent evidence of the strong contribution that electricity supply makes to Australia's competitiveness.

I would not like to leave the committee with the impression that the association thinks everything is wonderful in the best of all possible worlds. My members, the business community and some regulators are all in agreement that the pace of energy market reform is flagging. My association is concerned that the regulatory systems applying to electricity supply are becoming ever more intrusive and are restricting the willingness and the ability of regulated companies to pursue innovation. This is a concern that is shared by the gas supply industry. The continuing uncertainty over greenhouse policy, especially at an international level, obviously is also of concern. And, not least, the changes to depreciation arrangements under the new business tax regime are a well-publicised cause of concern. ESAA is at present engaged in a very detailed discussion with the Australian Taxation Office on new, effective life definitions for electricity supply assets, an issue of very considerable importance to us.

I would also like to make the point to the committee that my association believes that 2001 is an appropriate point for the efficiency of the competitive market generally to be reviewed. It has raised this issue with the federal government, via the industry minister, in recent weeks. We believe that such a review, which was envisaged by the Council of Australian Governments when it agreed to competition policy in the mid-1990s, could be very useful in highlighting areas for improvement in the market structure and operations. In particular, we believe that an inquiry can help to illuminate the regulatory problems and to suggest ways to improve regulatory management.

Finally, in the context of adding value to Australian industry, ESAA would like to draw to the committee's attention the promotion of the need for Australia to embark on an energy end use efficiency campaign over the next decade. We believe that such a campaign, which would aim to lift our energy efficiency gains in Australia to the level which the OECD has achieved, would, in the case of electricity, reduce the growth of electricity demand by some 30,000 gigawatt hours by 2010 and reduce CO_2 emissions by between 20 million and 30 million tonnes a year. And such a campaign would obviously improve the competitiveness of Australian business. We are working at present with Senator Minchin's department and others to flesh out a proposal for an approach to a national end use efficiency campaign. That covers the ground as far as any opening comments I wish to make and I am very happy to field whatever questions the committee has.

CHAIR—Thank you.

Mr HATTON—I have a question on this table you have just given us.

Mr Orchison—That is the one on electricity prices.

Mr HATTON—Sometimes I think I might be a bit arithmetically challenged, but I just do not understand the 1991-92 commercial pricing, where New South Wales is 18.79, Victoria, 15.29, and Queensland, 12.52. All of them are high, in double digits, and yet the total is 9.98. How do you have every state and territory having double digits and then the average being 9.98?

Mr Orchison—The point there is that, in 1991-92, commercial and industrial prices—

Mr HATTON—Were conflated?

Mr Orchison—No, were separate. If you run your eye down that particular column, the industrial prices there are very much lower than the commercial ones. Because today commercial and industrial prices are the same, thanks to the competitive market, that figure at the end under Australia deals with both commercial and industrial and is weighted in terms of the use of electricity, and the preponderance—some 46 per cent—of the use of electricity is industrial. I do understand why you might be confused—

Mr HATTON—They are conflated figures.

Mr Orchison—but it is a figure that relates at the end to the weighted average price of electricity. Just for the information of the committee, the demand for electricity in Australia is of the order of 46 per cent industrial, 28 per cent residential, and the balance is commercial. If you pull the smelters out of the industrial electricity demand, manufacturing, residential, commercial is roughly one-third, one-third, one-third. The answer to Mr Hatton's question is that what is not necessarily obvious there is the weighting.

Mr HATTON—Thanks.

CHAIR—On that basis, and just looking at the Western Australian one, they have never separated them, I gather, for that reason. They must have always plonked them into the commercial.

Mr Orchison—I think the short answer is yes. You would be aware, of course, that, in the case of Western Australia, the price there relates to the use of North West Shelf natural gas. The domestic export arrangements were such that in those days the power company, Western Power Corporation now, was paying a rather higher price for natural gas than elsewhere in Australia.

Mr HATTON—Mr Orchison, you may have been here when I asked a question of the coal industry about the research that has been done in Britain. In the last year there was a report on the *Science Show* that there had been some new designs done for power stations. Basically, they found that if you fired coal between 700 degrees and 1000 degrees centigrade you got a much more efficient burn of the coal and greater electricity production out of that. So, they are looking at that in terms of building new power stations, but there is also, at a relatively high cost, the question of the capacity for retrofitting existing power stations in order to get that cleaner, more efficient burn. Do you know if there is an awareness of that in Australia in the power generating industry, or whether we have already done similar work on our own in terms of improving efficiencies at the power stations?

Mr Orchison—There is certainly an awareness in the industry of the developments around the world. Indeed, some of the work on greater efficiency in the use of coal has been done here in Australia, particularly in Victoria with the work that has been done on brown coal, but also in the Hunter Valley with regard to black coal. Some of the new power stations that are coming on in Queensland—and those are black coal power stations—are of a higher efficiency level than the existing ones in Australia. But you put your finger on the issue a moment ago, Mr Hatton, in that it is a matter, of course, of capital cost. Most of the new high efficiency power stations are significantly more expensive to build than the more conventional ones.

There are a couple of points that need to be made. One is that we are working with the federal government at the moment on a system of generation efficiency standards for Australia to push down emissions from the existing power stations. The calculation that we have at the moment is that to achieve 4 million tonnes of CO_2 abatement by 2010 from those standards is going to involve the industry in a capital cost of some $240 million, which is a pretty expensive per tonne of carbon outlay. But we are very aware of efficiency opportunities. Retrofitting at the moment, in most circumstances in Australia, would not be a commercially viable option. Prices, of course, fall. Wholesale prices for electricity in Australia are at the lowest they have been in a very, very long time.

CHAIR—I note the international electricity prices. Given that the United States economy is the largest in the world, why have they left off that comparison?

Mr Orchison—The prices in that bar chart were provided by a European agency which chose to leave off the United States.

CHAIR—I can understand why the Europeans would do that.

Mr Orchison—The Europeans are a bit like that. We use the chart as it was provided. I can say to the committee that the average price of industrial electricity for the United States of America is of the order of $60 per megawatt hour. They are above us and above Canada. Industrial electricity in the United States has been coming down for the past six years so they have moved on that scale quite considerably.

Mr ALLAN MORRIS—And what about residential use?

Mr Orchison—They are coming down generally. They are engaged in an exercise to introduce contestability for customers in 22 of the states in the United States. That involves paying huge amounts of money to the utilities for so-called stranded investment. This has resulted, as far as residential customers are concerned, in much less of a benefit than industrial and commercial customers have received. The committee may be aware of the fact that the prices skyrocketed in the northern summer in California because of a whole range of problems. In San Diego residential customers went from paying $US45 a month to $US105 a month. As all this happened in the middle of an election period it was the cause of a certain amount of political fuss. California has very serious problems in terms of capacity. They are some 7,000 megawatts below domestic state demand and will have considerable difficulties for a number of years. It is a very good metaphor for what can happen if industry regulators and government take their eye off the ball in terms of long-term planning for electricity supply.

Ms ROXON—I have a question that goes a little more directly to our inquiry about value adding. One of the questions we put to the coal association before you that might have been better directed to you is: what sort of role, as an industry, do you play with other industries that obviously need a supply of electricity? What developmental role do you play with them? There will be higher demand if they decide to place their factories here rather than overseas. How proactive are you as an industry? I imagine that the different organisations you represent may all be quite different on this. It would be helpful if you could give us some flavour of how much interaction there is with different industries in terms of trying to attract or keep business here or design cost structures or services or whatever in a way that is attractive to industrial interests.

Mr Orchison—Sure. The answer comes in a series of points. First of all, there is at state government level quite a large interaction between electricity supply businesses and state development departments. In some states where the utilities are owned by the state that relationship is quite close.

Ms ROXON—We do not know what that is like in Victoria.

Mr Orchison—But even in the state of Victoria there are a number of liaisons between government and the industry in terms of looking at future demand. We also on the eastern seaboard have the National Electricity Market Management Company, which is charged with making the wholesale energy market work. It is constantly looking at demand for electricity. Part of that is talking to prospective large customers and so on. The Latrobe Valley is a good example. A number of the companies there are engaged with the local regional development committee. From memory, I believe it is chaired by Professor Dunstan. They are seeking to attract new development to the valley.

Ms ROXON—Can I just interrupt you on that. It is the second part of the same question really. It is my understanding that because of state regulation—I know it operates differently in different states—there is not much flexibility to offer particular regional price advantages. Obviously it would seem sensible that if you set up in the Latrobe Valley you should get your power cheaper than you would be able to get it somewhere else. I understand that is not right. Can you tell me if my understanding is correct? If you had a freer market, why would you not have cheaper pricing in certain areas than in others?

Mr Orchison—The situation as far as large electricity customers are concerned is that they are free to negotiate with retail suppliers across Australia whereas under the old system they were tied to whatever government owned utility supplied the power in the area they were interested in. It is perfectly possible for a company planning to build a factory in the Latrobe Valley to be negotiating deals with up to 20 retail suppliers who may themselves be located anywhere in Australia. The competition for large-load customers is very fierce indeed. The situation for example in the Latrobe Valley where a factory or a group of factories may wish to set up what is known in our jargon as an energy park is quite good. The opportunity then exists to cut a deal with one of the generators to be able to receive a whole range of support not only in terms of actual power but also compressed air and engineering support of various sorts.

Energy parks are a very interesting prospect for Australia in terms of driving regional development. They really are in their infancy in this country at the moment. There are areas overseas in North America and in the United Kingdom where this concept is being pushed a bit harder. There is a very simple point that needs to be made to the committee about electricity suppliers, whether they are owned by state governments or privately owned. We have a very real vested interest in seeing that the economy grows. The more the economy grows the better our businesses will be able to operate. Under competition policy even the state owned enterprises are now corporatised and are required to operate in a profitable manner. The idea that competition, which very often is confused with privatisation and the two things are not the same, should somehow lead to less interest in industrial and commercial development is not really true.

Ms ROXON—I was looking for some examples where you are proactively working in that way where the competition is leading to your organisation taking an increased interest and how that actually works. The other thing is I assume from what you are saying that you are of the view that the competition has affected pricing. You say there is fierce competition for a big project. I assume you mean that the price is therefore dramatically affected.

Mr Orchison—There is no question. It is on the public record that prices for large industrial customers in Australia have fallen dramatically as a result of competition.

Ms ROXON—It is not anecdotally what they tell you though.

Mr Orchison—We do not have to rely on anecdote to any large extent: we can rely on the regular reporting of NEMMCO for prices; we can rely on market research that is being carried out and published by the Productivity Commission, the Office of the Regulator General and others. There is simply no justification for arguing that competition has led to higher electricity prices. Of course, as demand grows and the availability of generation becomes restricted in terms of that demand, prices inevitably go up. When they go up to a point that attracts new entrants, then you get a further balancing of prices. I have yet to encounter anyone who seriously argues that competition policy is not working. There are plenty of people, including ourselves, who would argue that it is not working as well as it ought to and there are great improvements that can still be made.

Mr ALLAN MORRIS—Mr Orchison, having just spent a night without electricity in central Sydney, I am tempted to ask you the question—recalling what happened in Brisbane and New Zealand not so many years ago, where it appeared that savings were being made by reducing maintenance on infrastructure, power station distribution systems and so on, and looking at the price reductions in power over that 10-year span that you have given us—how do we know whether risk management, the current approach to the maintenance of equipment, has produced supply insecurity or uncertainty? How do we measure it?

Mr Orchison—First of all, Mr Morris, I am sorry that you had an uncomfortable night. My understanding is that the company concerned has been working through the night to reconfigure that substation.

Mr ALLAN MORRIS—What caused its failure?

Mr Orchison—I am not close enough this morning to what has been going on to answer that, but I understand that it was a transformer problem. In fact, I am relying on the news reports on the ABC. But the answer your question is this: part of the establishment of competition policy has been the establishment of oversighting regulators. In the case of New South Wales, the Independent Pricing and Regulatory Tribunal; in the case of Victoria, the Office of the Regulator General. The distribution businesses are required to report in very considerable detail to those regulatory bodies, and they exist in one form or another throughout the marketplace.

The records of what is happening in terms of supply reliability and security are publicly available. The regulators have, by and large, been reporting improvements in that supply reliability. There have been areas where problems have been detected, and the regulators have been very quick to require of the companies concerned that they improve the situation. Of

course, the regulators have the stick with which to impose this because, at the end of the day, it is the regulators' call as to the tariffs that companies may charge. Nevertheless, failures do happen—they happen everywhere. Sometimes it is the result of weather problems; sometimes it is the result of a failure of maintenance. Our track record on all the benchmarking work that has been done involving Australian and international activity in the last decade has always been pretty good. It does not make it any easier or more pleasant for you and the 20,000 other people who were affected overnight.

Mr ALLAN MORRIS—Twenty thousand other properties were concerned, therefore a lot more people were affected. To have that kind of thing happen in a major capital city the size of Sydney is sobering. The point I am trying to make is that, years ago, supply was seen to be an essential thing, not an optional issue and not a question of risk management. The questions now are whether or not in recent years we have been getting thinner and thinner, and whether or not the regulators are adequately equipped to evaluate the problem because they are trying to keep prices down. It seems to me that both sides of the equation have the same approach, which is risk management. In other words, it is not the 'affordable safety' Mr Smith used to talk about, but a similar thing. We are going to have failures, and it looks like we are accepting that we will have a certain number of failures—full stop.

Mr Orchison—I can say quite definitely that there is not a level of failure that is acceptable to my members. We strive very hard to avoid failure. If you were to doubt it, there is one very obvious reason we do not want a power supply to fail: because those are sales that we can never make again. Besides that, the industry is advancing into an era of full contestability. Having customers who are unhappy would not work to the benefit of any of the distribution retail businesses in a year's time when that mass contestability arrives. So far as the regulators and their resources are concerned, they can speak for themselves, but they are certainly charged with responsibility to ensure that standards are maintained as well as prices kept as low as possible. Frankly, my members in Victoria and elsewhere believe that the regulators are looking too closely at the short term, in pushing prices down, than the long term. We believe that a better return on investment would enable my members to invest more in improving the system.

The other thing that you need to bear in mind is that this is a system that has been built and designed over the last 30 or 40 years for a different world than the one we live in. Demands are being made on electricity supply, particularly into central business areas, by population moving back into them—which of course is a highly desirable thing—by increases in the number of high-rise buildings and, most recently, by the emergence of the so-called Internet hotels, which are, in effect, server factories, where you can find a demand for load in a single building of anything from 20 to 100 megawatts. The average 40-storey commercial building has a load demand of somewhere between 10 and 15 megawatts. Some of my members, and utilities in places like London, Chicago and elsewhere overseas, are wrestling at the moment with quite how you manage that level of demand suddenly being thrust on you in the middle of the CBD, which is notoriously difficult for additional infrastructure.

CHAIR—And expensive.

Mr Orchison—Very expensive.

Mr ALLAN MORRIS—The commercial price has dropped quite noticeably. I now wonder how many companies are being forced to have back-up generators just in case, particularly because the commercial risk for them would now become quite high as they would have difficulty getting—

CHAIR—Every major supermarket has a back-up generator.

Mr ALLAN MORRIS—If you have computers operating there is a need to have back-up power. I just wonder whether the savings at one end of the system, in the tariff, are actually being offset by costs at the other end. Certainly yesterday's incident will send a shiver through a lot of business people because it happened to them. And we know from talking to people involved with magnesium and aluminium smelters that to lose their power for any more than a few hours would be absolutely disastrous and very expensive.

Mr Orchison—There are several things folded into your question and your comment. One of them is that, these days, most large enterprises, hotels and so on, do have back-up generators. It is not just in Australia, it is true—

Mr ALLAN MORRIS—That is these days—it was not always the way.

Mr Orchison—It has been a development of the past decade. It is true in France, where the state owns the utility. It is true in other European countries, in North America and it is true here. The second issue is that, as you rightly say, in this digital age the small fluctuations in electricity supply—the little spikes and surges that the electricity industry worldwide has always seen as part of the system; these things happen—can create quite serious problems for factories that are operating heavily in a digital configuration. The electricity industry and its suppliers around the world are developing systems to provide short-term power storage to enable those glitches effectively to pass unnoticed by the system.

Fly wheel storage, for example, is starting to be used in the United States. When I was in the US earlier this year I was shown a plastics factory that had incurred, over a period of a year, some $US250,000 in lost productivity costs. It had invested $250,000 in a fly wheel storage system that eliminates that problem, and the payback is of course 12 months. The electricity industry is not standing still and our customers are certainly not standing still.

One interesting thing about the attitudes of customers at the moment is that, on the basis of research that we have done in the recent past—we have just conducted a survey of 820 business customers in the industry: 410 of them contestable and 410 of them waiting to become contestable—while price is a very significant driving factor in the choice of retailer, what matters thereafter is the standard of service. The interesting thing that we found in the survey conducted in Victoria and New South Wales was that satisfaction with the service provided by the suppliers was running at around the 80 per cent mark. It will not stop a large customer from negotiating on a new price with anyone when his contract becomes due, but, once that negotiation is over, the focus is very much on reliability and service.

Mr HATTON—In terms of value locally, power companies have made several moves to get into the cabling market—particularly with optical fibre and so on. What has happened recently

in that regard? Have there been any major commitments—particularly in regional areas where we are now getting lots of duplication?

Mr Orchison—These days this stuff is all commercial in confidence. I can genuinely say that, other than at a superficial level, I do not have knowledge of what is being negotiated between companies—and neither should I. However, you may take it as a given that that is an area where a number of electricity businesses, particularly those that have transmission networks, are very active. The experience in the UK has been that some companies have done very well out of this: they have tended to gain their biggest benefits on the share market in the short to medium term. That is a shareholder perspective of returns. You can assume that, in this country, it is an area into which my members and others will be keen to develop.

It is partly the answer to Ms Roxon's question earlier. Whatever negotiations may be going on between my members and would-be large developers, absolutely the last person they are going to tell is me. They are out there competing with each other very vigorously in all of those areas.

CHAIR—As there are no further questions, thank you very much for your submission today.

Resolved (on motion by **Mr Hatton**):

That the publications *Electricity Australia 2000* and *Electricity prices in Australia for 2000/2001*, presented by Mr Orchison, be accepted as exhibits.

Committee adjourned at 11.25 a.m.