APIMAA

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RESEARCH AND DEVELOPMENT – CRUCIAL TO HIGHER VALUE ADDING

Submission to the House of Representatives Standing Committee on Industry, Science and Resources Inquiry into Increasing Value-adding to Australian Raw Materials from:-

The Active Pharmaceutical Ingredients Manufacturers Association of Australia (APIMAA)

BACKGROUND

APIMAA is a relatively new Australian manufacturers' association, having been incorporated in March 1998.

Its members are all, as the name implies, manufacturers in Australia of a prime pharmaceutical ingredient used in medicinal products here and in many overseas countries,

(A full list of members is attached at Appendix A).

APIMAA's members are all involved in processes which add value to Australian raw materials, ranging from alkaloids derived from Tasmanian grown poppies through bio-tech and chemical processes.

Collectively, APIMAA members employ approximately 600 full and part-time workers and produce goods worth around A$125 million of which in excess of 85% are exported and represent about A$500 million flow-on to the Australian economy.

Value adding operations by APIMAA members are very significant contributors to the agricultural and other primary sector economies of several States, most notably Tasmania, Victoria and Queensland.

SYNOPSIS

The following submission concentrates on the crucial role Research and Development expenditure and activities play in sustaining and promoting value-adding to Australian raw materials and the desirability of continued and preferably higher Government financial support for private sector R&D.

APIMAA recognises and acknowledges that other factors play an important role in encouraging value-adding, in Australia, to Australian raw materials. Cost competitiveness and product quality of the nation's agricultural and resource sectors are also important factors but, it is our submission, in the long term R&D is the essential foundation for these and other factors.

All of APIMAA's members recognise the key role which their R&D activities play in sustaining and developing their businesses and especially in improving value-adding to raw materials.

OVERSEAS INCENTIVES

However, it is becoming increasingly difficult for Australian-based companies to justify maintaining, let alone increasing, expenditure on R&D *in Australia* because of the steady reduction in Government financial assistance for private sector R&D and, by contrast, the often generous tax and other concessions offered by some neighbouring countries - such as Malaysia - to firms which undertake significant R&D operations in those countries.

As the Committee has no doubt been advised via other submissions, Malaysia and other Asian countries, despite the economic difficulties they have experienced in the past couple of years, continue to actively encourage Australian and international firms to move R&D operations to their countries.

OUT OF STEP

APIMAA does not want to labour the question, beyond pointing out that the "level playing field" concept underpinning much of the Australian Government's economic and competition policy "reforms" over the last ten years or so, including reducing assistance for R&D in the private sector, seems to have found favour only in Australia.

Recently, we note, the US, Europe, Japan and most of the rest of Asia have all demonstrated a lamentable ignorance of the benefits of unrestrained trade and lower Government financial and other support for private enterprise. Lower product quotas, higher tariffs, special tax concessions to maintain key industries and the like seem to be accepted as desirable everywhere except in Canberra.

Everyone else is out of step, it seems. Presumably, these recalcitrant nations will eventually learn they are only damaging themselves by maintaining protection and industry support.

But, APIMAA suggests, until our international competitors achieve that Economic revelation, the Australian Government should help its industries retain and improve international competitiveness by, among other things, providing greater support for private sector R&D in Australia.

R&D - CUTS

Significant reductions in the level of Government support for private (and public) sector R&D has been a key component of policy "reforms" since the 1980's and has had a predictably adverse effect on the amount of R&D being carried out in Australia.

Government support for private sector R&D dropped by about 48% from approximately $935 million in 1995/96 to approximately $486 million in 1997/98.

In particular, the expenditure via taxation concessions fell from about $820 million in 1995/96 to a little more than $280 million in 1997/98, a cut of 65%. Although the reduction was offset somewhat by the introduction of the R&D *Start* programme, that funding was confined largely to new R&D by small companies.

ADVERSE EFFECT

The immediate effect (widely predicted, incidentally, by private sector spokespeople) was that several major companies quickly took their R&D operations off-shore, others cut back sharply and some abandoned R&D altogether. We understand the Committee has received substantial evidence on this issue so, again, we will not labour the point. Nevertheless, it should be noted that the Government was constrained fairly soon to widen the scope of the *Start* programme.

However, the Government failed to correct the worst element of its "reformed" R&D programme - the cut in the tax concession for eligible private sector R&D expenditure from 150% to 125%.

R&D "TOO LOW"

Only about 2% of Australian firms now invest in R&D and their number has declined since the introduction of the 125% tax concession. This level is inadequate to sustain long-term economic development.

APIMAA members are proud of the fact that they, individually and collectively, maintain a high proportion of R&D expenditure relative to total outlays.

However, Australia falls well below the OECD average for private sector R&D expenditure and our relative position is not improving.

The Committee is no doubt aware via other submissions that there is ample evidence to show that the 150% tax concession, when introduced in 1985/86, sharply boosted R&D effort by Australian-based firms. Even the Industry Commission agreed in a 1995 report that the 150% tax concessions "resulted in net gains for the Australian economy".

In contrast, the fall in existing R&D effort after the cut in the tax concession from 150% to 125% is also well-documented and need not be detailed here. However, it was not only the existing R&D effort which was diminished as a result of the tax concession reduction. There was a marked inability and/or unwillingness by Australian-based firms to undertake fresh R&D and that situation continues today.

Undoubtedly, changes in eligibility criteria also adversely affected the level of R&D expenditure by Australian firms, although APIMAA, along with most industry organisations, welcomed the Government's decision to abolish "syndication" which allowed unscrupulous operators to "rort" the concessional system.

BACKWARD "REFORM"

Syndication apart, the effects of the other changes to R&D support, especially the tax concession reduction, were adverse both for the nation's long-term and short-term interests and for the private sector generally.

Although Australian public sector R&D measures up slightly ahead of the OECD average over recent years - 1993/94/95 - private sector expenditure on R&D is well below OECD average levels. In fact, latest available figures show our private sector R&D outlays are only about 60% of the OECD average, expressed as a percentage of GDP.

CORRELATION

It is generally accepted that there is a clear correlation in advanced industrial countries between high long-term growth and expenditure on R&D, which is also recognised as a key factor in promoting new investment.

Certainly, APIMAA understands that the Government is vitally concerned with Budget reduction as part of a responsible fiscal policy, but we also submit most strongly that R&D policy should be concerned mainly with the long term. Thus, APIMAA believes, the changes to R&D policy introduced by the Government ignored the capacity of established firms to innovate and excluded valuable projects from assistance.

GRANTS vs TAX CONCESSIONS

The Government's use of grants rather than higher tax concessions for R&D projects is not an adequate alternative.

Grants are perhaps better for small firms, but the reduced tax concession has made R&D operations in Australia much less attractive for bigger organisations, especially when other countries offer very attractive incentives for firms to conduct R&D activities within their borders.

APIMAA agrees that it is difficult - and may even be impossible - to forecast the cost of tax-based R&D concessions and to control outlays with the degree of precision necessary to win the favor of the Treasury and the Department of Finance. But, it can be done with a reasonable degree of certainty and the evident benefits, we submit, outweigh the small risk that some tax concessions will be improperly gained and/or wasted, providing appropriate safeguards are established.

CONCLUSION

As the Committee may have gathered, APIMAA believes the reduction in the tax concession for R&D from 150% to 125% 'was a mistake which has already had serious adverse effects on the R&D activities of Australian and Australian based private sector companies.

It has adversely affected R&D in the primary sector as well as the secondary industry sector and, therefore, on value-adding to Australian raw materials.

APIMAA's members themselves have found it harder, since the reduction in the tax concession, either to persuade boards to agree to continue funding current R&D activities or to finance new R&D projects. In fact, in APIMAA's opinion, a tax concession of as high as 200% could arguably be justified, in view of R&D's undoubted short and longer term economic benefits.

However, we urge the Committee to strongly advise the Government that restoration of at least a 150% tax concession for eligible R&D activity should be implemented as a matter of urgency.

Reginald J Smith PhD FRACI
President

APPENDIX A – APIMAA MEMBER COMPANIES

Alkaloids of Australia Pty Ltd

Betatene Ltd

Biotech Australia Pty Ltd

Glaxo Wellcome Australia Ltd

Hardman Australia Pty Ltd

Phytex Australia Pty Ltd

Progen Industries Ltd

Tasmanian Alkaloids Pty Ltd