Report of the House of Representatives Standing Committee on Industry, Science and Resources

Getting a better return:

Inquiry into increasing the value added to Australia's raw materials

GOVERNMENT RESPONSE

Introduction

The Australian Government welcomes the opportunity to respond to the report of the House of Representatives Standing Committee on Industry, Science and Resources, *Getting a better return.* This report follows the Committee's earlier report on the same issue, *Of material value?*, and outlines the findings of its inquiry into increasing the value added of Australian raw materials.

Australia has a long history as a major producer and exporter of raw materials, reflecting its abundance of naturally occurring mineral producing ores and other important factors of production such as arable land, and it is clear that the potential for adding further value to this solid base offers significant prospects for the nation's on-going development.

Indeed, it is clear from the Committee's work that the nation is already strongly drawing on this base and is adding significant value to a range of raw materials with substantial flow-on benefits for the Australian economy and the community as a whole. The report showed that raw materials accounted for $45.2 billion of industry value added in 1998-99.

Given the significant income and employment opportunities that are available from adding further value to this base before the nation's raw materials are exported, the Government agrees with the Committee that it was important to conduct this review of Australia's value adding capacity in an endeavour to ensure the nation is fully realising these opportunities.

The benefits potentially available from further value adding of the nation's raw materials are too important to ignore and it is clear that Australia has significant potential for further development in this area if it is able to create the environment which attracts the investment necessary to realise this potential.

It is notable in this context that the Committee received significant evidence that Australia is competitive in a number of the factors of production that allow it to undertake successful value adding activity. The Committee found, for example, that raw materials processing industries would be attracted to Australia because of its competitively priced energy, its mature infrastructure, the lower raw materials transport cost and the generally capital intensive nature of these industries. Australia also offers the benefits of a strong democracy with a competitive free-market and the judicial institutions that are necessary to foster investment.

The issue of how Australia can draw on these advantages and further develop raw materials processing is also important. As indicated by the Committee, further processing is in itself not necessarily synonymous with increased value added if the production itself is not efficient. Value adding is most effective when it is directed at industries with comparative advantages; hence the outcome is very dependent on the competitive nature of processing undertaken and on the measures used to encourage additional activity.

The Government agrees with the Committee that the broad solution to this issue lies in directing any action by governments at ensuring there are no policies or institutional measures hindering the development of raw materials processing industries that have a comparative advantage. The Government believes the encouragement of industry growth is best approached through mechanisms which are based around the free and open operation of the market place and on the removal of market impediments.

The Government therefore welcomes the two reports from the Committee on adding value to the nation's raw materials and agrees they provide a useful and comprehensive analysis of the state of value adding in Australia and of the issues impacting on its further development.

Recommendation 1

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

Government position:

Agree that the Commonwealth Government should continue to take a proactive role in facilitating investment in new value-adding industries, but not that it should assume business risk and/or provide profit guarantees for commercial enterprises.

Comment:

The Government recognises that winning investment is essential for continuing strong economic growth in Australia and for the nation's future prosperity, and it strongly encourages prospective investment in all areas of the economy, including in the value-adding industries. To achieve this end, the Government has endeavoured to ensure that the overall environment in Australia is conducive to investment, while establishing Invest Australia as the national investment agency.

The pursuit of the first of these objectives has required a broad and coordinated economy-wide approach to ensuring Australia is an attractive destination for industry investment, including the implementation of measures such as good fiscal and economic management, reform of infrastructure, tax, trade and the labour market, and other initiatives in the areas of education and training and the environment.

The Government also recognises that, in some circumstances, there may be a need to provide limited incentives to secure strategic investments for Australia. Accordingly, it has implemented the Strategic Investment Coordination process under the guidance of the Strategic Investment Coordinator. This process aims to attract to Australia economically viable projects with significant net economic and employment benefits that would have otherwise located offshore. The Government considers proposals on a case-by-case basis, against published criteria, to ensure incentives are carefully targeted.

It does not believe, however, that governments should assume the risk of investing in more speculative projects or that they should provide profit guarantees for such projects. It believes it is more appropriate for this risk to be carried by the companies that stand to profit from these ventures.

Recommendation 2

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

Government position:

Agree that the Government will take all appropriate action to ensure that Australia is an attractive investment destination for light metals producers.

Comment:

The Light Metals Action Agenda (LMAA) Strategic Leaders Group (SLG) report to Government contained a number of recommendations that responded to the need to ensure that Australia is an attractive investment destination for light metals producers and can compete with other destinations. These recommendations cover issues such as the promotion of the benefits of new and continuing investment in the light metals sector in Australia; working with the State, Territory and local governments to ensure Australia offers the advantages, including the provision of appropriate infrastructure, that ensure it can compete as an investment destination; monitoring of the taxation regime to ensure it supports investment in these industries; and the continuation of the commitment in international negotiations to pursue cost effective greenhouse gas abatement policies.

The Government endorsed all these recommendations and has also been seeking to secure improved market access for light metals as part of the Doha Round of multilateral trade negotiations and, as appropriate, in any bilateral negotiations. The LMAA was formally concluded in January 2005.

The LMAA recommended that the Government consider enhancing Invest Australia's role in working with industry to promote the benefits of new and continuing investment in the light metals sectors in Australia. Invest Australia has been active in promoting Australia's capability in the high-value end of the light metals production chain, particularly in the die casting industry.

Co-operative Research Centre CAST Metals Manufacturing (CRC CAST) is also contributing to the creation of a more attractive environment for industry investment in light metals. For example, they are working with industry to develop strategic alliances in the downstream sector and collaborating with the Australian Die Casting Association to formulate strategies to improve industry competitiveness. CRC CAST also facilitated the establishment of an Energy Roundtable through their Die Casting Best Practice project to address the key issue of energy management.

Recommendation 3

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

Government's position:

Not agree to provide an additional industry specific assistance package for this purpose.

Comment:

The Government has provided substantial assistance over recent years to the development of Australia's magnesium sector, including significant targeted support for research and its commercialisation. This assistance has included $20m towards development of the Australian Magnesium Corporation (AMC)/ Commonwealth Scientific and Industrial Research Organisation (CSIRO) magnesium metal production technology and $50m towards commercialisation of this technology.

It believes those involved in the magnesium industry are now well positioned to take advantage of the Government's general support mechanisms for research and development, including the tax concession, the Co-operative Research Centre program and the various grant schemes administered by AusIndustry and other agencies. While it is clear that research and development (R&D) will continue to play an important role in furthering the development of the magnesium industry, the Government believes there is no evidence to suggest that existing mechanisms to support research are inadequate or that a lack of research and development is impeding the development of the industry.

This view was confirmed by the recent Light Metals Action Agenda Strategic Leaders report. In addressing the need for continued innovation, R&D in the magnesium industry, the report's recommendations focused on the use of existing frameworks and programs.

The CSIRO Light Metals Flagship (LMF), launched in 2003, offers industry specific opportunities for innovation. The Flagship provides an opportunity to draw resources from across CSIRO to tackle the R&D opportunities that will secure Australia's competitive advantage for the industry and tap into a knowledgeable and capable source of project delivery in the light metals area. The LMF aims to build a multi-billion dollar light-metals industry in Australia by developing breakthrough technologies for low-cost and green processing of aluminium, magnesium and titanium from ore to finished product.

The Flagship Collaboration Fund – worth $97 million over seven years – was launched in May 2005 by the then Federal Minister for Education, Science and Training, the Hon Dr Brendan Nelson MP, as part of the Government's *Backing Australia's Ability* package. The collaboration fund will foster collaborative research between universities, CSIRO and other publicly funded research agencies.

Recommendation 4

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

Government position:

Agreed

Comment:

The Department of Foreign Affairs and Trade (DFAT) is seeking to secure improved market access for magnesium products as part of the World Trade Organization (WTO) Doha Round of multilateral trade negotiations. The Government notes that negotiations have commenced and that Australian firms have, and will continue to be, consulted by DFAT for details of their market access interests.

Under free trade agreements (FTAs) concluded with the United States, Thailand and Singapore, tariffs on magnesium products were eliminated. Australia is currently negotiating FTAs with China, ASEAN and Malaysia to secure the elimination of tariff barriers. Further, Australia has recently agreed to begin FTA negotiations with Japan and the Gulf Cooperation Council.

As part of the LMAA, the Department of Industry, Tourism and Resources (DITR) disseminated a paper on tariff and non-tariff barriers to form the basis of specific consultation with industry. DITR has been working with DFAT to address these concerns on a case by case basis.

Market development activities are a critical component of the CSIRO LMF Program. CRC CAST is also assisting in development of market opportunities through global value chain projects and Innovation Access Workshops.

Recommendation 5

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

Government position:

Agree to include representatives of State Governments in the continuing work on this Action Agenda

Comment:

The SLG completed its work on the Agenda prior to the Committee tabling its report in September 2001 and it was therefore not possible to take the Committee's recommendations into account during that process.

The SLG, however, was comprised of members from a wide cross-section of interested parties, including the industry, research agencies, peak industry bodies, and the Commonwealth Government. While the State Governments were not represented on the SLG, they were fully consulted from the early stages of the LMAA process. The first point of contact was through the Australian and New Zealand Minerals and Energy Council's Working Group on Minerals Processing. The SLG also consulted other specific State and Territory interests, including those responsible for state development, energy and industry development, as the major issues were identified.

The LMAA report recommended the establishment of a steering committee to facilitate the implementation of its recommendations. Accordingly, a steering committee drawing members from industry associations, major companies, Government and the public research sector was established. The Group of officials supporting the work of the LMAA Implementation Steering Committee included representation from each State as well as the Northern Territory and the Australian Government Department of Environment and Heritage (DEH). The LMAA was formally concluded in January 2005.

Recommendation 6

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

Government position:

Agree that government agencies continue to explore and develop avenues for increasing developing country participation in action to limit greenhouse gas emissions.

Comment:

The Government has in place institutional arrangements for the handling of issues relating to international climate change policy and negotiations. DFAT is the lead agency for international climate change policy and negotiations, working closely with DEH, DITR and other government agencies.

The Government has undertaken an assessment of the Kyoto Protocol and found that, in its present form, participation could be contrary to Australia's national interest. As a first step, the Protocol does not provide at this stage a clear path beyond 2012 towards developing country commitments to limit emissions. In the absence of US participation and without developing country commitments, the Kyoto Protocol will make only a very modest contribution — around one percent — to reducing the growth of global emissions.

Although the Government has not ratified the Kyoto Protocol, it is committed to meeting Australia's internationally-agreed target under the Protocol of limiting emissions to 108 per cent of 1990 levels between 2008 and 2012.

The Government recognises that an effective response to the risks of climate change requires there to be action by all major emitters, including developing countries. In the 2006-07 Budget, the Government provided $100 million over five years as a founding member of a new global climate initiative: the Asia-Pacific Partnership on Clean Development and Climate (Partnership). The Partnership focuses on practical action to develop, deploy and transfer low-emissions technologies to address energy, climate change and air pollution issues within a paradigm of economic development. In addition to Australia, the Partnership includes the world's major emitters, from both the developed and developing world, including the US, China, India, Japan and South Korea. Moreover, the Australian Government has announced an allocation of $60 million from the $100 million fund for 42 climate change projects.

The Government provides climate change-related assistance to developing countries through its bilateral climate change partnerships (particularly with China), and through bilateral aid programs and projects funded by the Global Environment Facility (GEF). Many of the projects funded bilaterally and through the GEF are specifically designed to facilitate technology transfer and capacity building and enable developing countries to limit their emissions in the future.

Recommendation 7

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

Government position:

The Government recognises the vital role infrastructure has in connecting businesses and communities in regional Australia. Infrastructure provision and planning is currently being considered through a number of forums including the Regional Development Council (RDC), the Local Government and Planning Ministers Council (LGPMC) and the AusLink initiative.

Comment:

Ministerial councils

In June 2001 the Council of Australian Governments agreed to create a new RDC by amalgamating regional development issues from the Industry, Technology and Regional Development Council (ITRDC) and the informal Regional Development Ministers' meeting. The inaugural meeting of the RDC took place on 30 July 2003. There were a number of infrastructure items on the agenda including expanding the natural gas network, the AusLink strategic land transport planning initiative and regional telecommunications.

The second RDC meeting was held on 21 October 2005. Regional infrastructure issues, including discussion of the sea change/ tree change phenomenon and information and communication technology, are being examined as part of an ongoing discussion on the RDC.

The LGPMC and its local government officials group, the Local Government Joint Officers' Group, are investigating infrustructure issues as part of a wider project examining the financial sustainability of local government, particularly in rural and remote areas. Part of this project will also considier a nationally consistent approach to asset planning and management by local councils.

AusLink initiative

The Australian Government's AusLink land transport infrastructure plan sets out $15.0 billion in land transport funding from 2004-05 to 2008-09, which includes a substantial upgrade of Australia's east coast road and rail systems. Under AusLink, the Australian Government is working with the states and territories to progress 24 strategic corridor studies, covering the major transport routes forming the National Land Transport Network. These cooperative long-term plans for each transport link will identify transport needs within each corridor and the priorities for meeting those needs. They will provide a basis for decision making on future project planning and construction timeframes.

Under AusLink, the Australian Government's commitment to local road improvements in the financial years 2004-05 to 2008-09 is over $2.0 billion. This comprises $1.48 billion for AusLink Roads to Recovery to Australian councils for local road improvements, the $307.5 million supplementary payment in 2005-06, which is a one-off-grant to councils, and $220.0 million under the AusLink Strategic Regional Program (ALSRP). The ALSRP is designed specifically to assist councils develop regional land transport infrustructure supporting industry, tourism, social connectivity, access to services and economic development.

Recommendation 8

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

Government position:

Recognises that continued investment in rural R&D is important, but notes that any increase in the funding ceiling would need to be considered in the budgetary context.

Comment:

The Australian Government notes that the dollar for dollar arrangement has been a catalyst for industry to invest in R&D. This support has provided a solid foundation for rural industries to maintain or increase their R&D funding as they grow and develop, and has seen the overall expenditure by the rural research and development corporations increase from $63 million in 1985-86 to over $510 million in 2004-05. Some industries contribute above the matching government ceiling. For example the wool industry is contributing at 2 per cent of GVP to industry R&D and the grains industry at 1 per cent.

The Productivity Commission research study "Trends in Australian Agriculture" (July 2005), found that adoption of technological advances and innovation underpinned a doubling of real agricultural output over the four decades to 2003-04, and over the last 30 years, productivity growth has accounted for the entire increase in output by the agriculture sector.

Recommendation 9

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

Government position:

Agree. It has always been planned that each element of the dairy industry package will be the subject of independent review, in line with best practice program management procedures. An independent evaluation of the major components of the Dairy Industry Adjustment Package (DIAP), the Dairy Structural Adjustment Program (DSAP)/Supplementary Dairy Assistance (SDA) measures and the Dairy Exit Program (DEP) was undertaken during 2003. The associated evaluation reports were made available to the public from 23 February 2004.

Comment:

The Australian Government's response to the industry and State governments' proposal to deregulate farm gate market milk prices was to provide a $1.78 billion DIAP and the $159 million SDA measures. The overall objective of the Government response was to enable the dairy industry and communities to better adjust to the impacts of deregulation.

The Australian Government agrees that the elements of DIAP and SDA be the subject of reviews, noting that a review was intended in accordance with Government program management guidelines. The dairy assistance measures represent a major Government initiative and a significant investment in one of Australia's major export industries and as such it is appropriate that their effectiveness be assessed.

The subsequent evaluations undertaken during 2003 of the DSAP/SDA programs and the DEP provide a comprehensive review of the major programs of assistance through the DIAP and are a validation of the Australian Government's program of assistance to dairy farmers facing significant adjustment pressures following deregulation by the states.

In both the DSAP/SDA evaluation and the DEP evaluation, the reviews found the assistance was well targeted, the administration was cost effective and it was delivered efficiently. Most importantly, the programs averted a potential significant loss of dairy farming livelihoods.

Recommendation 10

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

Government position:

Agree that, where appropriate, harmonisation of State legislation is desirable, but will raise the issue with State and Territory governments by letter rather than through Ministerial Council consideration.

Comment:

The Australian Government agrees that where appropriate State and Territory legislation that affects business and industry in general should be harmonised. Although, on occasions, it would be appropriate for such issues to be brought to the attention of the relevant industry Ministerial Council, as the differences in approach on issues such as those mentioned in the report (liquor licensing and environment protection legislation) are ones that go beyond just the wine industry, this approach may not be appropriate on this occasion. Furthermore liquor licensing is the responsibility of State governments. Accordingly, the Government believes it would be more appropriate for this issue to be considered by State governments and it is proposed that the Commonwealth Minister for Agriculture, Fisheries and Forestry write to State counterparts, drawing their attention to this recommendation of the report, and requesting that the relevant State Ministers consider this issue.

The Committee's report also discusses wine industry interest in having greater flexibility as to the placement of the volume statement on a wine container. The legislation that governs volume statements are the State and Territories trade measurement acts and regulations. This requirement is uniform throughout Australia for all pre-packaged foods and beverages (again not limited to wine) and flows from Australia's adherence to the recommendation of the International Organisation of Legal Metrology on labelling requirements for pre-packaged products. The Australian Government is working with the International Organisation of Legal Metrology to review the recommendation on the placement of the volume statement.

The Australian Government is negotiating an international agreement in the World Wine Trade Group that would provide for four items of common mandatory information, including the volume statement, to be placed on the front or back of a bottle provided they are in a single field of vision. This flexibility would only apply to standard size bottles and meets industry's desire for increased flexibility. The Agreement would allow wine producers to create a common principal label for all markets - a move which our wine exporters estimate will provide direct cost savings of at least $25 million per year and significant distribution and marketing advantages in some of our key wine export markets. The Government is working through the Ministerial Council on Consumer Affairs to seek agreement to make the necessary changes to domestic trade measurement regulations to amend the requirement that the volume statement be displayed on the principal display panel and enable Australia to become a party to this agreement.

Recommendation 11

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

Government position:

Not agree

Comment:

The Government considered the taxation of wine when preparing the New Tax System and established the Wine Equalisation Tax (WET) to offset the removal of the Wholesale Sales Tax and the introduction of the Goods and Services Tax.

The Government commitment regarding the price impacts of the New Tax System on wine were set out in the August 1998 *A New Tax System* statement where it was stated that

> "The Wine Equalisation Tax will be levied at such a rate that the price of a four-litre cask of wine need only increase by the estimated general price increase associated with indirect tax reform; ie 1.9 per cent. The concessional taxation treatment of the alcohol content of cask wine will therefore be preserved." (Page 87)

The Government has met these commitments in full.

When introducing the WET the Government took the opportunity to establish the WET cellar door rebate scheme for the first time, to support regional economies. The scheme combined with State cellar door rebate schemes to allow WET-free sales at the cellar door or by mail order, to a wholesale value of $300,000 per annum and in 2003-04 paid out around $16 million.

From 1 October 2004, the WET cellar door rebate was replaced by a WET rebate of up to $290,000 for the first $1 million of sales (wholesale value) for each wine producer (or group of producers). At the time of implementation, the package was estimated to provide $338 million in tax relief over the four years to 2007-08. State cellar door rebate schemes were either discontinued or reduced following the implementation of this measure.

In the 2006-07 Budget, it was announced that the Government will enhance the WET producer rebate scheme. From 1 July 2006, each wine producer (or group of producers) will be able to claim an increased maximum rebate of $500,000 each financial year. The enhanced assistance will effectively exempt up to around $1.7 million of domestic wholesale wine sales from WET each year per wine producer (or group of producers), compared to $1 million a year under the current scheme. This enhanced assistance is worth $126 million over the next four years to 2009-10.

The Government does not consider that any further review of taxation arrangements is required.

Recommendation 12

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

Government position:

In view of recent wide-ranging reviews of Australia's tariff arrangements in 2000; and the review of tariff arrangements for passenger motor vehicles (PMV) and textiles, clothing and footwear (TCF) sectors released in 2002 and 2003 respectively, it would be inappropriate to implement this recommendation.

Comment:

As part of its strong commitment to unilateral trade liberalisation, there have been three recent public inquiries, into Australia's existing tariff regime. The Productivity Commission conducted a review of Australia's general tariff arrangements in 2000. On 19 December 2000, the Government announced its decision to retain the general tariff rate at 5 per cent. The Government accepted the Commission's view that there are small benefits from removal of the general tariff, but considered there would be benefit in holding the current arrangements for the present and moving to withdraw them at a time consistent with trade and fiscal objectives.

The post 2005 tariff arrangements for the PMV and TCF industries were reviewed by the Productivity Commission in 2002 and 2003 respectively. Subsequently, the Government adopted the following arrangement for the PMV and TCF sectors:

- Tariffs for the PMV sector fell from 15 to 10 per cent on 1 January 2005 and will fall to 5 per cent on 1 January 2010;
- Tariffs for the TCF sector fell from 15 to 10 per cent (7.5 per cent for some items) on 1 January 2005 and will fall to 5 per cent for all items by 1 January 2015.

In the 2005-06 Budget, the Government acted to reduce costs for all business by removing the three per cent tariff on business inputs where there is no substitutable good produced in Australia. The removal of this tariff will reduce costs for affected businesses by $1.3 billion over five years from 2004-05 and increase the international competitiveness of Australian businesses, including the wine industry.

Through its policy of competitive liberalisation, the Australian Government continues to pursue multilateral trade liberalisation through the WTO Doha Round to secure increased market access in the areas of agriculture, non-agricultural products, and services. In addition, the Government has concluded bilateral trade agreements with Singapore, Thailand and the United States of America. As a result, the majority of existing tariff lines in these sectors have been eliminated, and the remainder will be phased out under agreed schedules. Australia is currently negotiating agreements with China, ASEAN and Malaysia to secure reciprocated duty free access to these important markets for Australia's exporters and importers. Also, Australia has recently agreed to begin FTA negotiations with Japan and the Gulf Cooperation Council.

Recommendation 13

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

Government position:

Not agree to the setting of targets for business expenditure on research and development (BERD).

Comment:

The Government acknowledges that Australia's ability to create and commercialise knowledge is one key driver of our economic development into the future. It notes, however, that there are many factors outside its control that impact on the level of BERD (for example industry structure and market conditions) and does not believe that it is appropriate to set targets for this expenditure.

The Government provides significant support for science and innovation, and in 2006-07 funding will exceed $5.9 billion. Through its *Backing Australia's Ability* and *Backing Australia's Ability – Building our Future through Science and Innovation* packages, the Government is providing an unprecedented $8.3 billion, 10 year commitment to science and innovation. The Government's innovation policy involves investments in key areas, including strengthening Australia's research base, improving the rate of commercialisation, and developing and retaining skills. The Government has also commissioned a Productivity Commission study into science and innovation in light of its substantial investments in this area. The results will inform the design of future assistance programmes.

Substantial policies are also in place to support businesses undertaking research and development. Most notably, the Government provides a 125 percent tax concession for investment in R&D. Moreover, the concessional arrangements were expanded as part of *Backing Australia's Ability* to provide a 'premium' 175 percent concession for additional business investment in labour-related components of R&D.

As part of the 2006-07 Budget, the Government also announced more support for innovation programmes. This includes establishing a new investment vehicle – the early stage venture capital limited partnership – to increase the provision of start-up capital for small, innovative firms. Additionally, $200 million will be provided to establish up to 10 new funds in a new round of the Innovation Investment Programme.

Recommendation 14

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

- **options for developing a business zonal taxation system:**
  - **which would encourage investment in value-adding and research and development activities in rural and remote areas; and communities; and**
  - **which would promote economic growth in rural and remote communities; and**
- **options for enhancing the zonal taxation rebate for individual taxpayers.**

Government position:

Not agree

Comment:

The Government does not consider that a public inquiry into the existing zonal taxation system is warranted.

While understanding the objectives associated with proposals for business zonal taxation systems, the Government is not convinced that the benefits will outweigh the costs. Business zonal taxation systems would be complex to administer and in the longer-term may dislocate economic development. The large budgetary cost of zonal business tax incentives would further undermine fiscal objectives. The Government believes that in addition to broad-based tax reform, the better way to assist businesses in rural and remote areas is through macroeconomic policies that promote both low inflation and high overall economic growth. Specific reforms aimed at increasing flexibility of the labour market, and well targeted initiatives, such as those aimed at improving regional infrastructure, are also appropriate.

Further, the Government has extended Fringe Benefits Tax concessions for employers in remote and rural areas as part of tax reform.

In relation to the remote zone rebate, it is provided for residents of remote areas to compensate for harsh climatic conditions, isolation and the costs of living in remote areas. The Government does not consider that the current zone rebate arrangements warrant review at this time. It is the preferred policy of the Government to cut taxes generally, for all Australians, such as personal income tax, rather than providing geographically targeted tax cuts through increases to the remote zone rebate. Further, any significant increase in the cost of the zone rebate would require some new revenue measures or measures to reduce expenditure in other areas.