

5. ECONOMIC AND COMPETITION ANALYSIS

5.1 Introduction

As part of the NCP process, the Committee is required to assess the legislation and its administration against Section 5 of the Competition Principles Agreement. Section 5 (9) (c – e) is particularly relevant, stating:

Without limiting the terms of reference, a review should: . . .

- (c) analyse the likely effect of the restriction on competition and on the economy generally;
- (d) assess and balance the costs and benefits of the restriction; and
- (e) consider alternative means for achieving the same result including non-legislative approaches.

The economic justification for government intervention to control exports under the *Export Control Act* rests upon the presumption that the net economic benefits to the Australian economy would be lower without the Act than with the Act.

Under the Act, export of food products from Australia is conditional on 'acceptance of' and 'compliance with' the requirements of importing countries. Therefore it can be argued that the economic value of the Act is the value of the market access and flow-on benefits that it facilitates. Because access would be denied to certain markets in the absence of the Act, export volumes of certified product would be considerably lower than the present level of \$13 billion.

Against this background, the chapter examines:

- the case for regulation of food products,
- costs and benefits of the Act, and
- the effect of the Act on competition.

Costs and benefits are considered in Section 5.3 and in the consultancy report prepared by the Australian Bureau of Agricultural and Resource Economics (ABARE). The Committee decided that the most appropriate method was to conduct a broad-based theoretical analysis of economic and competition issues, supported by:

- commodity-based assessments through an indicative study of the cost of compliance, and
- modelling by ABARE of the likely effects of loss of access to selected markets for two commodities.

This was judged as the most effective way of tackling the task given its sheer size and complexity, reflecting the number of commodities to be covered and the inter-relationships between products and markets. The consistency of the stakeholders' support for the Act in general and the Committee's analysis in particular have confirmed adoption of this approach.

Restrictions on competition, (c) quoted in the opening paragraph above, are considered at 5.4 in terms of the pivotal issues of administrative costs, registration, fees and charges, exemptions and cross subsidisation. The issue of alternative means of achieving the same result, (e) also quoted above, is discussed at 6.3.1.

5.2 The Case for Regulation of Food and Agricultural Product Industries

Food exports make an important contribution to Australia's international trade position. In 1998-99 they totalled \$16 billion and accounted for just under 20 per cent of all goods exports. Disruption of these exports would have a significant impact on the performance of the Australian economy, and particularly on the rural and food sectors, and individual producers. The Australian government has a policy of facilitating access to food export markets.

5.2.1 The Need for Government Intervention

The Act facilitates exports by providing a mechanism for inspecting and certifying food products, and ensuring that they are safe and wholesome. The Industries Assistance Commission (1989) identified four main reasons for government regulation of food processed for export, namely:

- to meet requirements imposed by or negotiated with foreign governments,
- to meet obligations under various international conventions to which Australia is a signatory, such as SPS, WTO and TBT,
- to meet a moral obligation not to export dangerous or unhealthy food, eg the Code of Ethics on International Trade in Food, and
- to enhance an industry's prospects in export markets.

The first three reasons effectively impose a requirement on Australia to put in place legally enforceable mechanisms to control food exports, ensuring compliance with the requirements of foreign countries and with international obligations. Most governments make it a condition of entry into their markets that imported foods meet certain standards. Some require foods to be inspected and certified by a government agency in the exporting country. In these circumstances Australia must comply with the foreign country requirements.

The fourth reason is based on an assessment by industry and government of the potential impact of safety failure incidents caused by individual exporters. Where the risk of market loss to the industry is estimated to be large compared with the cost of regulation, there are sound economic reasons for regulating exports.

5.2.2 Characteristics of Food and Agricultural Products

Food safety is the most important public policy issue facing the food industry and an issue of considerable concern for government. Food safety failures

can have high economic and human cost, with spillover effects that can be felt by all producers. An intrinsic characteristic of food is that many attributes, especially those that can be harmful to human health, such as bacterial or chemical contamination, cannot be detected easily by the consumer before purchase and consumption.

These characteristics of food create a need for government regulation to determine food safety for the consumer. Governments intervene in the food industry by setting and enforcing minimum food health and safety standards.

Food safety concerns apply equally to foods that are produced locally or are imported. Governments monitor and control the quality of imported foodstuffs to ensure that they meet at least the standards required of domestic foods. To this end, importing countries often negotiate to reach agreement on minimum standards to be imposed and policed by the government of the exporting country.

5.2.3 'Generic' and 'Branded' Products

Consumers often perceive agricultural or food products (such as meat or grains) as generic, particularly with their frequent use as inputs for further processing. Without brand names, it is difficult for users to differentiate products produced by individual firms, and buyers tend to rely on country of origin as an indicator of food safety and quality. Hence if a safety incident occurs, the repercussions are likely to spread beyond the offending producer and affect all other suppliers from that country.

Spillover effects can be mitigated by the creation of a strong brand name for a product, to help insulate it from adverse effects caused by safety failures involving competing products. Firms that invest in the establishment of a brand name, through advertising, labelling and packaging, have an incentive to protect the reputation of their brand. Therefore, these companies are likely to set up systems to monitor quality assurance processes, both of their own products and of the inputs they use.

However, the nature of food products is such, that the risk of spillover effects may not be completely removable through use of a brand name. This point was made by the Australian Food and Grocery Council who stated to this Review:

Branded manufactured food products carry with them an overt and high value seal of quality and safety—namely, the brand name. Nevertheless, despite the strength of brands, negative spillovers can occur even for branded products in the event of product failures related to safety—particularly when food poisonings actually occur—and quality. Export markets are critically dependent upon customer confidence in Australia's regulatory system which will be undermined in the event of product integrity being questioned.

The AFGC considers, therefore, that the Export Control Act is a fundamental and indispensable framework under which all exporting food businesses should operate.

5.3 The Costs and Benefits of the *Export Control Act*

Calculating the costs and benefits of legislation is an important step in assessing whether the Act is of net public benefit. The Committee considered that, given the highly complex nature of the area, a selective commodity-based approach was the most appropriate form of analysis. This was reinforced by strong industry support for the retention of the Act, as expressed in submissions, and the clear industry benefit of the Act. Industry benefit arises from increased market access and the avoidance of severe consequences that would arise from losing export markets. Such losses could result from systemic food safety failures and/or non compliance with importing country requirements.

Once the relationship of the benefits and costs has been established, it is important to determine whether the form and substance of the regulations imposed to ensure compliance with the Act are the most cost efficient and equitable from the industry and community perspective.

5.3.1 Benefits

Market Access

The benefits of the export controls prescribed under the Act lie in their ability to underpin continued market access for Australian products. An approximate measure of the magnitude of these benefits can be obtained by looking at the value of Australian food exports. Although the benefit of the Act does not necessarily equate with the total value of prescribed food exports, the Act plays a crucial role in protecting and facilitating access of Australian food products to overseas markets. So a clear association can be drawn between government certification and the value of exports. This association was recognised by the Queensland Department of Primary Industries which in its submission to the Review stated:

... the value of Queensland rural exports is approximately \$5459 million. The ability to export the volume and value of Queensland agricultural produce is significantly increased by the Act ensuring international obligations are achieved.

Sudden withdrawal of certification could lead to losses to the Australian economy running into billions of dollars. Indeed, in cases where overseas governments require certification by the Australian government as a condition of allowing food products into their country, the Act effectively makes exports to those countries possible.

International trade in food or agricultural products rarely occurs in the context of a truly free market environment. Australian goods often compete in markets that are protected or controlled through quotas, tariffs or some other trade limiting arrangements. Issues of food safety or standards are often linked to an importing country's broader trading policy, and a food safety failure in these markets could have much more severe ramifications than if the product was not the subject of such protection. Under these circumstances, government certification is crucial not only in providing market access but also in safeguarding that access.

The importance of the Act to the export food sector can be better appreciated by considering the possible impact of a loss of market that could result either from failure to enforce mandatory import requirements or from a food safety failure causing a food-borne illness in an importing country. To illustrate the possible impact of a loss of confidence in Australian product, the Review Committee commissioned a consultancy from ABARE to quantify the effect of loss of a key market for two export industries in terms of lost value of production (see page 64).

Australia's reputation for exporting safe and wholesome products

Besides securing market access and minimising spillover risks, the Act has helped in the development of Australia's excellent reputation for exporting safe and wholesome food and agricultural products. This is especially true for the exporters of bulk products who have been able to use Australia's good reputation in the absence of a brand name. The Act has materially assisted this by providing an export inspection service that generates confidence in the safety and integrity of Australian food.

In its response to the draft report the Australian Food and Grocery Council made the following comment:

It is quite simply untenable that Australia should market food products globally that are unsafe. This is not only contrary to our moral obligations but in the longer term would undermine the reputation of Australian food products, damaging Australia's reputation as a provider of safe products, thus threatening the commercial operations and viability of Australian food industries competing in global markets.

The AQIS 'brand'

Establishing a brand name or building up a reputation for safety in a foreign market can prove expensive for an individual company, often prohibitive for small companies. However, with mandatory government certification, individual exporters do not necessarily have to provide separate signals, through identifiable brand names, about the safety of the food exported. These signals are provided by AQIS through its inspection and certification service. Hence, the Act could be considered as a cost-efficient method of signalling the safety of Australian products and can obviate the need to establish a widely recognised reputation or brand name. In this sense, AQIS approval can be considered a type of brand, a symbol of the safety of the product.

Taking the example of the grain sector, while inspection may represent a small proportion of total costs, the confidence afforded in the safety and quality of Australian grain can have a significant effect on prices received. In their submissions to this review, the Grains Council of Australia (GCA) and the Australian Wheat Board (AWB) made this point quite strongly. The AWB's submission stated that:

The impact of the Act on the competitiveness of Australian agricultural exports should be viewed in light of the central role the Act has played in allowing Australia to develop a grain export industry with an extremely strong international reputation. The high quality of Australian wheat, which in part, is a consequence of the current system of export quality control, has been instrumental

in improving Australia's competitiveness in the distorted international grains market.

Economy wide benefits from higher exports

There are a number of important links between the direct benefits of the Act and broader flow-on effects. These benefits include balance of payment, economic growth, and employment considerations.

By facilitating exports, the Act assists the food sector to make a positive contribution to the balance of payments. This has a broad positive impact on the Australian economy. A higher level of exports raises Australia's consumption and investment possibilities by allowing greater access to other countries' production through imports.

Given the mature state of the domestic Australian food market, expansion of the agricultural and food sectors is increasingly dependent on growth of exports. Facilitating export and protecting market access not only delivers an immediate benefit in terms of export sales, but also contributes to the growth of the sector and so fosters economic activity and growth in employment. Furthermore, the *Export Control Act* reduces the risk of a food safety breakdown and resultant spillover effects. It thus acts to protect regional incomes and employment. These employment effects are all the more valuable as they occur in regional areas where the ability to generate employment is seen as critical by State and Commonwealth governments. Approximately 88 per cent of persons engaged in agricultural production are in non-metropolitan areas.

In 1998, approximately 600,000 Australians were employed in the agricultural and food manufacturing sectors combined. This represents 7 per cent of the employed workforce. The agricultural sector alone is responsible for over 380,000 jobs in regional Australia, accounting for 12 per cent of all regional employment. These figures do not take into account employment effects of ancillary regional industries, such as transport and manufacturing, which support and rely on agriculture for continued survival and growth.

Quantification of the above flow-on effects is difficult and is beyond the scope of the review, but these are quite significant especially in view of their regional implications.

An example of the flow on effects of the Act is provided by the ABARE consultancy. An important finding of the study is that the negative impact of the loss of a vital market can be greater than the value of exports to that market. This reflects the disruption of production and the fall in price that follow the loss of a market. In the case of beef exports to the US, loss of that market causes the gross domestic value of beef production to fall by \$1.1 billion, although the value of exports is approximately \$735 million. The adverse effects are also felt in related industries such the sheep industry which is estimated to suffer a decrease in gross value of production of some \$50 million as a result of lower lamb prices.

Loss of Market Study of Potential Consequences

The analysis performed by ABARE was intended to assess the loss in gross revenue to the beef and dairy industries that may occur from a disruption to a major export market for each commodity caused by a major product failure, using the hypothesis that changes to the current *Export Control Act* may lead to such a scenario. The revenue losses are estimated only for the marketing year in which the disruption occurs.

The analysis was conducted with the aid of the OECD's AGLINK model. The AGLINK model is a dynamic economic model of the world's major temperate zone agricultural commodity markets which, for obvious reasons, includes agricultural commodities of most importance to the member countries of the OECD. AGLINK encompasses demand, supply, trade and price determination on an annual basis for as many as 27 commodities for each of 22 countries or regions.

For the beef industry the reference point chosen was calendar year 1999 while for dairy the reference year was 1998-9. In the baseline it is estimated that Australia's beef exports to the US will reach 405 kt dressed weight and account for nearly 32 per cent of total export shipments. For dairy, it is projected that Japan will account for nearly 46 per cent of total cheese exports and around 7 per cent of Australia's skim milk powder exports.

As a consequence of the closure of the US beef market, it is estimated that the gross value of production in the beef industry could fall by around **\$1.1 billion**. The main reason for this fall is the lower price that beef producers receive for grass fed cattle, the type of beef exported to the US.

The loss of the US market and subsequent fall in the beef price also leads to the diversion of some beef to both the domestic market and to the other export destinations. Domestic consumption increases by around 100 kt in response to the lower beef price. Lower beef prices also result in a rise in beef shipments to other markets so that total exports are estimated to fall by around 240 kt even though the loss in beef exports to the US market exceeds 400 kt.

This impact on the beef industry also influences other industries, with increased competition from lower beef prices reducing the demand for lamb, therefore, the saleyard price of lamb falls. As a result the gross value of sheep industry output falls by \$50 million with lower lamb prices more than outweighing the effect of larger production (the sheep flock is estimated to expand by more than 500 000 head as producers move resources into what are now relatively more profitable enterprises).

As a consequence of the closures of the Japanese dairy markets, it is estimated that the gross value of production in the dairy industry could fall by around **\$400 million**. The most significant factor determining this is the lower price. This impact would be particularly significant in the cheese and skim milk powder markets where relatively high returns are currently being received.

With lower prices, domestic consumption rises and some product lost to the Japanese market is diverted to other export markets. As a result, cheese exports in total are projected to fall by around 50 kt, despite the loss of the 77 kt Japanese market. Even though cheese is diverted to other markets, returns to the dairy industry from cheese production are estimated to fall significantly.

A detailed analysis and tabulated results can be found in Attachment 5 'Market Loss Analysis'.

ABARE 1999

5.3.2 Costs

AQIS's export inspection program operates on a cost recovered basis. All inspection, documentation and registration costs are recovered from industry. However, there is a component of the program that comes under the definition of community service obligation or for which cost attribution is not appropriate and is funded by the Commonwealth. This includes overseas representation on behalf of Australian exporters regarding market access issues, policy and legislative development, and compliance activity relating to investigation and subsequent action taken to deal with breaches of the *Export Control Act*. In 1998-99 the cost to government of these activities was around \$5.6 million.

Export regulation can impose a significant cost burden on participating industries. These costs are generally confined to the food industry; they affect the profitability of firms engaged in exports and act as a barrier to entry for prospective new exporters. The costs of regulation can be broken down into two categories:

Direct Costs: These are costs directly charged by AQIS to industry for the provision of inspection services. In the case of the Act, these costs include inspection and audit fees, export registration charges and export permit charges. As AQIS is on full cost recovery, the fees and charges levied are based on the cost to AQIS of providing an export inspection service. It is therefore important that AQIS provides this service at as low a cost as possible, without, however, compromising the integrity of the inspection arrangements.

The table below shows the value of certified exports and the fees and charges collected by AQIS in 1998-99 for the most important prescribed commodity groups. These vary across sectors, both in absolute terms and as a percentage of the value of exports. None of the export programs cost industry more than 2 per cent of the value of export, with the majority of programs costing less than 0.5 per cent. At \$53 million, meat charges are by far the largest single revenue item, accounting for 73 per cent of all fees and charges collected under the Export Control Act, and 1.6 per cent of the value of certified meat exports.

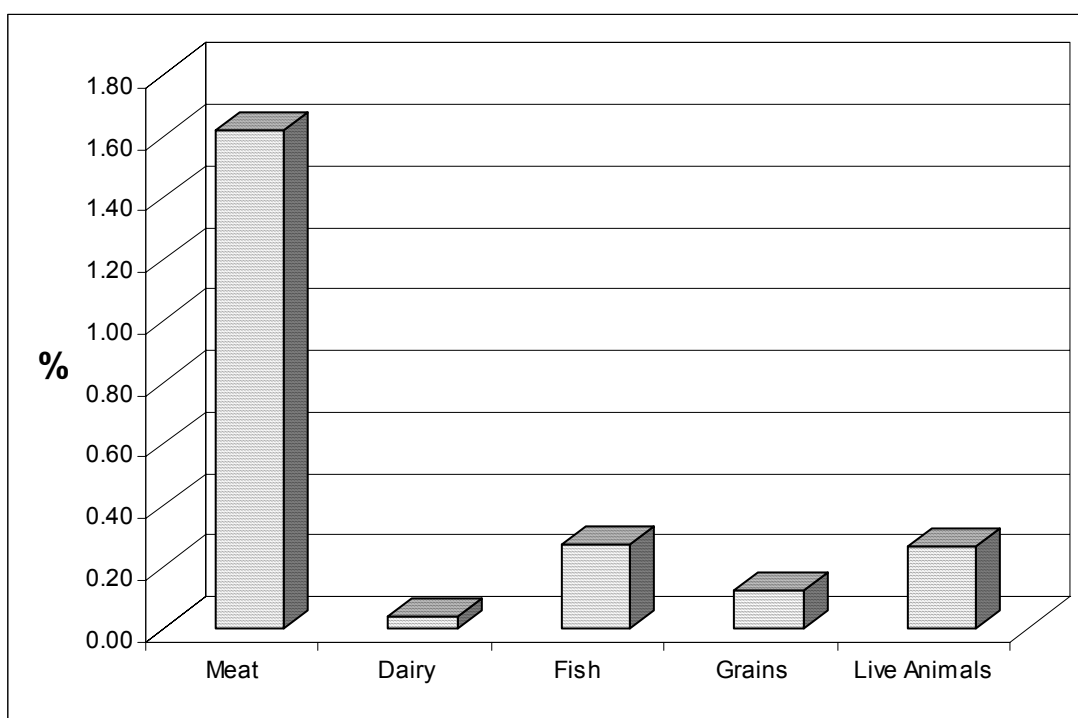
Hence, at an aggregate level AQIS fees and charges impose a small burden on industry relative to the total value of certified exports. This conclusion needs to be qualified in two ways. Firstly, the impact of the charges on individual firms can be more severe than implied by aggregate ratios, and secondly the value of exports is a gross revenue figure; it incorporates a number of costs to exporters, commercial and regulatory, all of which detract from competitiveness.

Table 5.1
Certified exports and AQIS fees and charges: 1998-99

Commodity	Exports \$000	AQIS fees and charges \$000
Meat	3,277,000	52,972
Dairy	2,044,000	809
Fish	1,231,000	3,336
Grains	4,959,000	5,998
Live Animals	556,000	1,482

Source: AQIS

Figure 5.1
Export Assurance Costs (AQIS) 1998-99 as % of Exports



It should be noted that differences in charges between commodity programs do not necessarily reflect relative program efficiency. Rather, they reflect the technical and administrative requirements for obtaining export clearance for specific products, based on a combination of the characteristics of the product in terms of safety risks and of foreign country requirements. For example, meat is a highly perishable product and is more susceptible to microbiological contamination than other food products (eg, cereals, vegetables, and fruit). In addition, some animal diseases can be transmitted to humans, and importing countries require the presence of veterinary officers to carry out post and ante mortem inspections. As a result, the inspection arrangements for meat products are more stringent and more costly than those for other foods.

Within this broad framework, there is scope for improvement and reform to achieve better cost outcomes for industry. In the dairy program, there has been a rationalisation of the inspection function between AQIS and State Dairy Authorities. Whilst there has been some transfer of costs from the Commonwealth to State authorities and industry associated with this rationalisation, genuine cost reductions have also been achieved by eliminating duplication of effort. The graphs below show the total cost reduction achieved over the last seven years as a result of the reforms in the dairy inspection program. This has been achieved against a background of rapidly rising export volumes.

Figure 5.2
Dairy: Export Assurance Costs

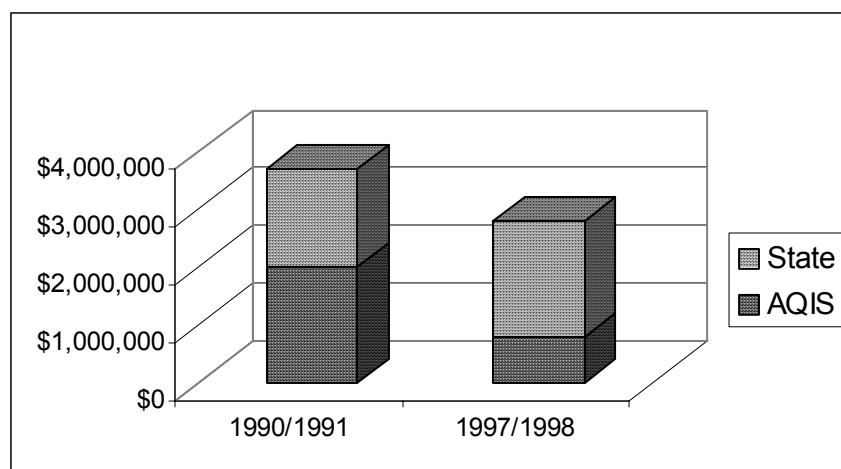
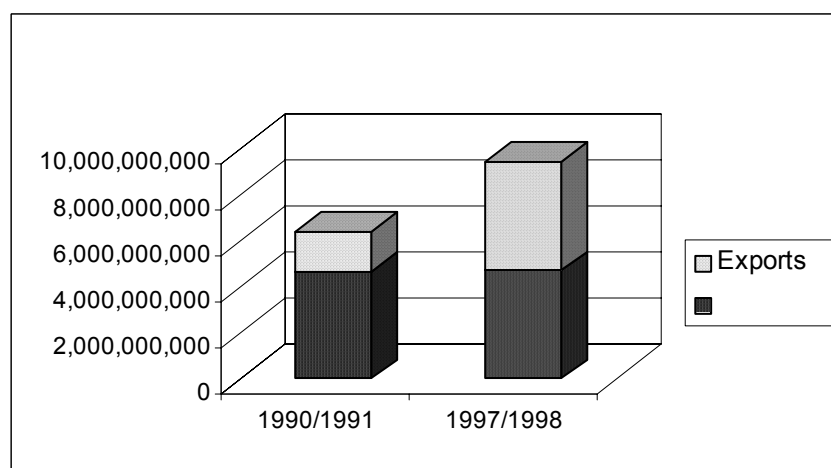


Figure 5.3
Dairy: Production (litres)



Source: ADPF (both)

Indirect Costs: These are costs incurred by firms in order to comply with provisions of the Act. They arise from a change in regular business practice needed to comply with a particular legislation. In the case of the *Export Control Act*, these include administrative expenses to deal with the legislation

and operational expenses incurred to meet standards (construction and/or production processes) required by AQIS or an importing country.

Indirect costs are difficult to quantify but can be just as significant as, if not more significant than, direct costs. An indication of the magnitude of indirect costs of food regulation can be obtained by using the results of a study commissioned by the Department of Workplace Relations and Small Business in 1998 (*Overcooked: A study of food compliance costs for small business*). The study based on a survey of small to medium size firms, estimated the indirect costs of food regulation (administrative and capital expenses) for food export businesses to be around 60 per cent of the total food regulatory burden. Given that fees and charges are \$73 million, the total indirect costs of export regulation are estimated to be approximately \$110 million. This estimate must be viewed with great caution as the study looked at all costs of food regulation and not just export costs, and the results are qualified by a relatively small sample size. Nevertheless, it should serve to put in context the indirect costs of regulation compared to the benefits.

It is important that cost imposts, both direct and indirect, are kept to a minimum and that the Act is sufficiently flexible to allow compliance with overseas requirements at the lowest possible cost to industry. The move from end point inspection to a quality assurance system is part of a strategy to provide companies with greater choice and cost effective alternatives for complying with the requirements of the Act. It is also accompanied by moves to adopt third party auditing of such systems, with AQIS retaining an overall supervisory role.

5.3.3 Conclusion

In 1998-99 the ECA facilitated \$13 billion worth of exports. Although food exports would still occur in the absence of the Act, withdrawal of export controls would, most likely, lead to market losses in the order of billions of dollars. As the ABARE study indicated, the losses (when flow-on effects are considered)—in terms of price and production effects—can be even higher than the value of the market lost. Any downturn of such a magnitude will have obvious effects on employment, and these are likely to be felt particularly keenly in regional Australia.

Fees and charges collected under the ECA in 1998-99 amounted to \$73 million, representing 0.56% of the value of certified exports. Indirect costs could not be calculated with any precision. However, a rough *guesstimate* is that these could be in the order of \$110 million.

On this basis the Committee concluded that the Act confers a significant positive net benefit to industry.

5.4 Competition Issues

The competition principles under the Competition Principles Agreement (CPA) seek to promote efficiency and economic growth through maintenance of an environment conducive to competition. Under the agreement, a restriction on competition can only be justified if it creates a net public benefit. Section 1(3) of the CPA sets out circumstances in which an assessment is required in order to ensure that regulation does indeed confer a net public benefit.

The Review has identified two varieties of competition: competition among firms in Australia seeking export markets; and competition of Australian produce, as a whole, in export markets. Examples of the different effects are: the potential damage caused by fee structures that are generally too high (competition of Australian industry as a whole); and the existence of up-front costs which discourage new entrants or smaller companies (mainly competition within industry). Some stakeholders have tried to link one with the other—that is, domestic restrictions making for more effective competition overseas—but the causal link does not necessarily follow, and this aspect should be examined on a case-by-case basis.

Whilst the Act does not set out to restrict competition directly by limiting the number of firms that can export prescribed goods, it may do so as a result of:

- administrative costs incurred to comply with export regulation,
- the need to obtain export registration in order to export prescribed goods, and
- the imposition of fees and charges.

In highly competitive markets, the additional costs (those imposed by legislation) will exclude marginal suppliers. The more competitive the markets the less the opportunity to pass on extra costs. Regulatory costs that impact more heavily on smaller or new operators can limit their capacity to enter the export sector and so provide some form of protection to established operators.

Provisions involving the requirement for the registration of export premises reflect both of the following:

- a desire by Australian authorities to safeguard the integrity of the food export sector from unscrupulous or incompetent exporters, and
- mandatory requirements by some importing countries, for a register of exporters who are permitted to export to their markets.

By helping maintain the reputation that Australian food products enjoy overseas, the Act allows Australian companies to trade on that reputation and so helps enhance market access opportunities for Australian producers in foreign markets. This can be of particular benefit to smaller exporters who, as a result, may not have to invest heavily in building a product specific reputation.

The Act can also generate some distortions through cross subsidisation and the operation of 'exemption' arrangements. This section looks at aspects of the Act that can affect the level and the nature of competition through their impact on industry costs.

5.4.1 Higher Administrative Costs to Comply with Export Regulation

In complying with the provisions of the Export Control Act, exporters incur administrative costs relating to the inspection and clearance of export consignments. For example, under Section 6 of the Act, notification of intention to export must be given to the Secretary of AFFA or their delegate, and arrangements for the inspection of consignments must be made by anyone who is intending to export prescribed goods. The process involved in obtaining export clearance takes up company resources and so imposes a number of administrative costs on businesses.

Arranging for inspections and the flow of documentation can be problematic for exporting companies in regional or remote areas which are not serviced by a local AQIS office. Discussions with a number of exporters in non-metropolitan areas have confirmed that lack of quick access to AQIS offices is causing logistical problems in arranging for inspections and transmitting documents. This can often result in additional costs or delays in shipping the product.

The expansion of EXDOC to cover all export programs is seen as an important measure that will reduce the administrative burden on all exporters and especially those in non-metropolitan areas. EXDOC, by being linked to the Customs export clearance system, further benefits exporters as they only have to input export data once to satisfy the requirements of AQIS and Customs. Proposed further developments with E-Commerce are expected to lead to further reduction in the administrative burden of regulation.

Export regulation clearly imposes administrative compliance costs on industry. However, the Committee did not find that these costs are excessive. Nor did it find that the costs act as a barrier to entry or that they restrict competition to any significant extent. These costs are of incremental significance and are treated by companies as part of the normal cost of conducting business.

5.4.2 The Registration of Premises as a Barrier to New Entrants

Regulations made under the Act require the registration of premises involved in the production of prescribed goods for export. Export registration has a twofold objective:

- to ensure that premises are up to standard to meet export specifications, and
- to give effect to the fit and proper person provisions of the Act.

Generally, exports of prescribed goods are only permitted from export registered premises. Export registration is conditional upon fulfilment of certain construction and production standards specified in the Act, and these are often different from the Australian domestic standards. This restricts

competition in the export sector by limiting access to overseas markets to establishments that are assessed as complying to the required standards.

Expenses associated with the construction and upkeep of export premises raise costs of production and inhibit the entry of smaller players—particularly establishments that supply the domestic market and are considering expanding operations to export. The Committee found that detailed information to quantify the additional costs of such requirements was not available. However, evidence collected from industry suggests that the fixed cost component forms a substantial part of the total package. This means that the imposts are relatively heavier on smaller companies or companies exporting only a proportion of their production. This adds to the disincentive for smaller establishments to enter the export sector. Some of the extra costs identified include: construction of approved premises, maintenance of premises, adoption of quality assurance systems, inventory controls, product traceability and segregation.

Where the standards specified in the Act stem from conditions imposed on Australia by an importing country and are different from domestic standards, such restrictions are justified in terms of access to these markets. In such cases the restrictions imposed by the Act cannot be said to be anti-competitive in nature.

However, some stakeholders (particularly in meat) contend that the standards demanded by the Act are, in many cases, unnecessarily different from Australian domestic standards thus excluding domestic market producers from obtaining registration. The application of standards that are different or more onerous than needed to access a foreign market have a twofold negative impact on the Australian economy:

- They result in Australian exports being less competitive than they need be in markets that do not require such standards.
- They unnecessarily restrict the degree of competition by preventing—through higher production costs, potential exporters from entering the export sector.

For example, the standards required by the Export Meat Orders (EMOs) are largely those needed for access to the United States market. Where the US standard is over and above what is required by other countries, to have that standard as a benchmark for granting export registration makes Australian meat products less price competitive in these other markets.

Allowing exports from domestic (non export registered) abattoirs under the exemptions provisions of the Act, represents an endeavour by the Government to deal with the issue of export standards that are too stringent for certain exports. Exemptions are discussed later in this chapter, at 5.4.4.

The fit and proper person provisions were introduced in the aftermath of the meat substitution scandal of the early 1980s. Although this measure can be seen as restrictive of competition in terms of keeping certain persons out of the industry, it reflects a concern to protect the reputation of the Australian export sector from rogue or criminal elements in the industry. Countries like the United States place considerable importance on 'fit and proper' checks on business integrity in their reviews of the export meat program.

The Committee found that export registration can be restrictive of competition where the export standard required to obtain registration is more stringent than is necessary to obtain access to a particular market. The uniform standards imposed by the EMOs are an example of a potential restriction on competition imposed by the Act.

5.4.3 Fees and Charges add to Production Costs

Except for a small component that relates to policy, legislative development and compliance and which is funded directly by the Commonwealth, AQIS's export inspection program operates on full cost recovery. Under Section 25 of the Act, power is given to set regulations for imposing fees for inspection by authorised officers.

Since the early 1990s, there has been a gradual adoption of full cost recovery. Alongside this, AQIS has taken significant steps to raise the efficiency of its operations and so to cushion the impact of the higher cost recovery levels. AQIS field staff numbers in export inspection fell from 2,054 in 1990 to 821 in 1998. These staff reductions were reflected in lower fees and charges. In the period between 1993-94 and 1996-97 fees for most export inspection programs have been reduced. These efficiencies have often been accompanied by measures to encourage the adoption of quality assurance systems, based on HACCP principles.

Yet, for those companies that are trading in highly competitive international markets with narrow profit margins, any addition to production costs can impair their ability to compete with foreign producers. Australian exporters can be further disadvantaged when competing against overseas producers who, while facing similar requirements in terms of government certification, do not always bear the full cost of inspection as this is often subsidised by government.

There is a wide range of views among stakeholders regarding the level of fees and charges and their impact on individual industries and companies. These views range from a perception of fees as fair and reasonable, to seeing them as a significant burden impeding the development of viable export businesses (see Chapter 4). However a number of dairy and meat exporters interviewed during the course of the Review, indicated that the ability of AQIS to deliver an effective and timely inspection service to industry, including good technical support when needed, is the prime concern, ahead of fees and charges.

The level of competition is affected by the structure of fees as much as by the quantum of fees. The table below shows the fee structure for the main AQIS export programs.

Table 5.2
AQIS fees and charges by type (\$ 000) – 1998-99

	Meat	Grains	Horticulture	Fish*	Live Animals	Dairy
Fee for Service	45,809	6,608	2,465	483	733	7
Registration	4,587		17	1,838		420
Documentation	2,572	73	2,006	420	707	380
Other	4	-683	24	594	42	2
Total	52,972	5,998	4,512	3,335	1,482	809

*Fish Other includes \$540 000 export levy. Horticulture includes dried fruit.
 Source: AQIS

Some programs, like the grains and live animal programs, incorporate most of their charges into a fee for service type charge and as a result have low or no registration charges. By contrast, other programs, especially those on quality assurance arrangements, such as fish and dairy, rely quite heavily on registration charges to recoup their costs.

Some stakeholders have stated that registration fees can be an impediment to a more competitive domestic environment, as small and medium size enterprises often find it difficult to pay up front fees for AQIS registration. Generally, flat charges such as registration charges disadvantage smaller producers as they tend not to be directly linked to export or production levels. The Western Australian Government submission contends that for small and medium exporters the initial pre-export AQIS costs are disproportionate to the expected initial returns and thus make it very difficult to develop successful export markets. Consequently, several smaller Western Australian manufacturers have made the decision not to pursue export opportunities. The submission argues for the development of an approval process that transfers the costs from the initial registration stage to the subsequent export stage, while remaining revenue neutral.

The use of both registration charges and fee for service is justified on economic efficiency grounds. In broad terms AQIS has explained that its charging policy is to recover the cost of field operations (inspection) through a fee for service and overhead or infrastructure costs through registration or documentation charges. Within this broad framework, programs develop their own fee structure in consultation with industry. AQIS also seeks to minimise the impact of registration charges on new or smaller exporters, by spreading payment for registration on a quarterly basis and, in some cases, linking registration charges to the size of an operation.

The Committee did not receive strong evidence that the fee structure is inefficient, inequitable or unduly restrictive of competition.

5.4.4 Exemptions

A particular criticism of the Export Control Act from sections of the meat industry is that the EMOs have adopted the stringent US standards as the benchmark for granting export registration to meat processing establishments. This standard is often in excess of the requirement demanded by other countries and can result in the exclusion of some companies from the export sector and also make products less competitive in those markets where less exacting standards apply. This raises competition policy issues, as the EMOs act to exclude establishments that produce safe product for the domestic market from expanding into exports and accessing new markets beyond the US, EU and Japanese markets.

To address this problem, the government has introduced a system whereby AQIS can grant an exemption from normal export requirements where it can confirm that the government of the importing country will accept a product without the generally accepted health certificate.

The exemptions system has a number of implications for the level and nature of competition. On the one hand it encourages more competition by allowing non-export registered establishments which operate in accordance with Australian standards to access export markets without having to fully conform to the requirements set by AQIS in the EMOs. As the costs of supplying these markets are reduced, more product can be exported and new opportunities opened up for a number of Australian companies that were previously prevented from exporting.

On the other hand, the granting of exemptions that allow non-export registered establishments to export without going through the normal clearance process can cause distortions as it enables exempted companies to export prescribed goods without being subject to the rigour of the Act and without incurring the associated costs. Where exemptions are widely used, they can put at a competitive disadvantage registered exporters who face full regulation.

Export registered establishments often invest quite heavily in equipment and in certain processes in order to gain export registration and access to certain markets. An easing of export requirements, whilst conducive to overall lower costs for industry, could leave some of the incumbent exporters with an infrastructure and a cost structure that makes them less competitive in the new environment.

The use of exemptions, while addressing the problem of overly stringent export standards, introduces its own distortions and if used extensively can compromise the integrity of the registration system. The Committee considers that a more efficient and equitable registration system, with no need for exemptions, would emerge through a closer alignment of export and Australian standards, and where possible, a better identification in these standards of importing country requirements. The proposed three tiered model aims to achieve such an outcome.

5.4.5 Prescription and Co-regulation

One of the strengths of the *Export Control Act* is its flexibility in dealing with diverse commodities. However, at the commodity level, the Orders can be highly prescriptive, resulting in too much emphasis being placed on procedures and processes rather than on the achievement of outcomes. Legislation that is overly prescriptive imposes indirect costs on producers by determining a set method for operations which may not be conducive to best practice, and which can be stifling to innovation and change. In addition, the traditional inspection programs tend to produce a focus on attaining minimum standards, so promoting an industry culture focused on merely satisfying the regulator.

In recent years, AQIS has implemented a more outcome based co-regulatory approach to export inspection. This is based on auditable quality assurance arrangements in place of detailed oversight by official inspectors, such as those in the Fish and Dairy Export Programs. A key element in the transition to a more co-regulatory, less prescriptive environment, is the adoption of quality assurance systems that are still capable of meeting the standards required by overseas markets. These systems are based on HACCP and other risk minimisation principles.

Adoption by AQIS and industry of quality assurance systems as an alternative to end point inspection will limit the government's role to that of auditing (or commissioning a third party to audit) these systems to ensure compliance. As such they offer scope for a reduction in AQIS inspection costs, but this does not necessarily mean that there are direct net savings for a company from a shift to a quality assurance environment. Company interviews during the course of the review indicated that food producers in general do not expect to achieve net cost savings through adoption of quality assurance versus end point inspection. If anything, costs tend to rise in the short term during the development, implementation and trialling of quality assurance. Nevertheless, many food exporters support quality assurance because of its effectiveness in securing food safety. A quality assurance system generally confers greater responsibility on industry for meeting food safety objectives. It also promotes a culture of continuous improvement.

In some cases, (eg bulk grains) current end point inspection costs are so low (13.5 cents per tonne) that sections of the industry have stated that from a cost point of view alone there is no incentive to move to a quality assurance type system. However, in considering the cost of inspection, it is important to note that often aggregate figures can disguise significant cost variations within a program. For example, in the Grains Export Program there is a considerable disparity in the costs of providing inspection services for bulk and non-bulk grains. The total cost of the grains program in 1998-99 was around \$6 million and was split approximately 50/50 between bulk and non-bulk grains. This was despite the fact that bulk grain exports accounted for some 92 per cent of all grains exports (24 million tonnes compared to 2 million tonnes of non-bulk grain). It follows that the per tonne charge for the non-bulk grain is considerably higher than \$0.13/tonne, and that the drive for quality assurance is likely to be stronger in the non-bulk grain section of the industry than it is for bulk grain.

From a National Competition policy perspective, export assurance arrangements should allow for maximum flexibility for firms to achieve the desired outcomes at minimum costs. Quality assurance arrangements generally deliver the best outcomes for both industry and government in terms of cost effectiveness and minimum prescription. AQIS has an obligation to encourage uptake of such systems in accordance with government policy. Clearly a move to such arrangements should be undertaken if it can provide the required level of standards at an overall lower cost to industry and where these arrangements are acceptable to importing countries. At the same time, there is a need, at least in the short term, to consider the costs of developing and implementing quality assurance and the capacity of smaller firms to introduce and maintain such systems. This is particularly relevant where AQIS can provide an inspection service that is efficient, effective and low cost.

5.4.6 Cross subsidisation

A number of stakeholders have identified some anomalies in the charging of some export inspection programs reflected in cross subsidisation of establishments within programs. This issue was raised by the Australian Chamber of Commerce, who stated in their submission that:

One notable inconsistency is the cross-subsidisation of establishments. A case in point involves the travelling time of inspectors visiting regional/rural establishments, where the travel costs are not being fully borne by the establishment where the inspection is taking place but transferred, at least in part, to urban-based establishments.

If the actual cost of inspection is charged to all producers (taking into account time taken and travel expenses), then it is possible the establishments in more remote areas would not be viable. Cross subsidisation of this kind raises the level of competition by providing a financial concession to remote localities which may assist them to remain viable and continue to operate, but at a cost to other participants. Whilst cross subsidisation does introduce a distortion, this should be viewed against the broader government objectives in relation to regional development and employment.

In the grain industry there has been a case made for the disaggregation of inspection charges on a State basis to reflect different loading and handling efficiencies at different port terminals. This issue was addressed by the QEAC review of the AQIS Grain Export Program which concluded that:

While there could be a small subsidisation of less efficient ports by aggregating the bulk grain inspection levy across States, inspection costs represent such a small fraction of total costs that there are undoubtedly other factors driving efficiency in these ports. Differential charging would be a cumbersome scheme to administer, with high overheads for industry to pay and few benefits to offer.

The Committee did not find evidence of widespread or significant cross subsidisation within AQIS programs. Nevertheless, as a matter of principle, the Committee considers that the practice of subsidising certain establishments through the charging regime leads to inefficiencies and should be discouraged. Government objectives in terms of regional development

policies are better pursued through more direct and less distortionary assistance measures, such as grants or tax concessions.

5.4.7 Conclusion

The Act imposes costs on industry that restrict competition, particularly for markets that are highly competitive and where the capacity to recoup extra costs through higher prices is limited. To a large extent this is inevitable, given the need to comply with importing country requirements and to secure and safeguard access to overseas markets. As indicated in Section 5.3 the benefits of the Act outweigh the costs, as represented by fees and charges and indirect industry compliance costs. On this basis, export regulation and the resulting restriction on competition are justified.

However, the Committee does not consider that the current arrangements provide the most effective or efficient way of providing export assurance. Despite a shift toward a more co-regulatory export clearance model based on HACCP and quality assurance principles, some commodity specific Orders remain highly prescriptive and rely heavily on end point inspection. For some commodities, the transition to a quality assurance environment is a slow and difficult process that needs the agreement of importing countries. In this regard, efforts should continue to be made to encourage foreign markets to accept co-regulation within Australia as delivering outcomes that are of the standard required by them.

Finally, a key concern, especially in the meat industry, is that the requirements for registration are too stringent and for many markets unnecessarily different from the Australian standard. This leads to the exclusion of firms that supply the domestic markets from expanding overseas and so restricts competition. The decision to allow meat exports from domestically regulated meat works under the exemptions system is aimed at addressing this problem, but in so doing creates a different set of distortions.

5.5 General Conclusion

This Chapter established a case that the *Export Control Act* confers a net benefit to the community and so should be retained.

The Act clearly imposes costs on industry which act to restrict competition, but on the whole, the provisions of the Act were not found to be unduly anti-competitive. In fact many of these provisions represent a necessary pre-condition for access of Australian food products to export markets.

It is important to preserve consistency of approach and adherence to competition principles.

Within this broad assessment, the Committee found that the most serious anti-competitive element of the Act is where it imposes standards for export registration that are too stringent or unnecessarily different from the Australian standard. The Committee also considers that there is still considerable scope for further progress in relation to adopting a co-regulatory export clearance

model, accompanied by greater contestability of the inspection and audit functions.

Because of the distribution of industries and the employment associated with them, a vibrant export industry will have a significant positive effect on regional Australia.

5.6 Committee's Assessment of Key Points

- *The Act imposes costs, but the benefits are assessed as considerably outweighing the costs and there is a prima facie case for maintaining the Act on the grounds of net public benefit.*
- *There is a clear case for regulation of food products where the impact of a food safety incident will have an economic impact on the entire industry, not just the offending party.*
- *There is scope for greater efficiency by moving further along the regulatory continuum toward co-regulation.*
- *The cost of the Meat program to industry is significantly more than other export programs.*