REPORT OF THE 2005 BEEF QUOTA REVIEW PANEL

ON

ADMINISTRATIVE ARRANGEMENTS FOR THE US BEEF QUOTA

Report to the Minister for Agriculture,
Fisheries and Forestry

June 2005

Beef Quota Review Panel

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Published by the Quota Review Panel Secretariat
GPO Box 858
Canberra ACT 2601

Copies of this publication are available from:
Meat, Wool & Dairy
Australian Government Department of Agriculture, Fisheries & Forestry
GPO Box 858
Canberra ACT 2601

30 June 2005

The Hon Warren Truss MP
Minister for Agriculture, Fisheries and Forestry
Parliament House
CANBERRA ACT 2600

Dear Minister

I have attached for your consideration the report of the Quota Review Panel on administration of the Tariff Rate Quota (TRQ) for the US beef market for 2006 and beyond. Quota administration for beef exports to the European Union are the subject of a separate report which will be provided to you by 31 July 2005.

In undertaking this review the Panel has had careful regard to recent quota outcomes, the recommendations of previous reports on this matter, including the 2002 Quota Management Panel, and the views of industry. In relation to the latter, the Panel conducted a comprehensive consultation process involving both written submissions and one-on-one meetings with industry participants. Beef processing and exporting companies that provided written and oral submissions represent around 90% of Australia's beef exports to the US and 80% globally.

In developing its report the Panel considered underlying principles of quota administration and then used them to examine the appropriateness, effectiveness and efficiency of the current quota administration, as well as alternative approaches. Close regard was also given to the market outlook for Australia's beef exports to the US.

The Panel notes there are strong differences within the industry on the need for quota allocation arrangements and as such its recommendations will not be supported by all participants. Nevertheless, the Panel considers the approach recommended in this report should improve the effectiveness and efficiency of TRQ utilisation and will receive support from the majority of companies within the Australian beef industry.

Given the role that the Secretary to the Department of Agriculture, Fisheries and Forestry has under the legislative arrangements in relation to quota, the Panel has taken the liberty of providing a copy of this report to her at the same time as you.

Yours sincerely

Jan Taylor
Chairman
Quota Review Panel

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Executive summary

The current administration arrangements for the US beef quota have operated since January 2003 following the Government's consideration of a report from the 2002 independent Quota Management Panel (QMP). In its report the QMP recommended that the new quota administration arrangements be reviewed in 2005.

On 17 February 2005 the Minister for Agriculture, Fisheries, and Forestry, the Hon Warren Truss, announced the establishment of a Quota Review Panel to review the appropriateness, effectiveness, and efficiency of the current US and EU quota arrangements. This report deals with the US arrangements.

Since the completion of the Uruguay Round of multilateral trade negotiations in 1995 Australia has had a tariff rate quota (TRQ) for beef into the US of 378 214 tonnes. Under the provisions of the recent Australia US Free Trade Agreement (AUSFTA) this TRQ will increase by 20 000 tonnes from 2007 and then by 5 000 tonnes biannually to 2023. Out-of-quota shipments are subject to an *ad valorem* tariff of 26.4%. However, this tariff will be phased out by 2023 effectively terminating the TRQ.

Since mid 2002 the TRQ has been subject to allocation arrangements administered by the Australian Government Department of Agriculture, Fisheries and Forestry (DAFF). The key features of the arrangements from January 2003 are:

- exporters receive an allocation of quota at the commencement of each year on the basis of a three year rolling average of shipments to the US and to global markets on an 80:20 US/global ratio
- quota may be traded between exporters with transfers registered
- there are no new entrant provisions although quota can be transferred from quota holders; companies exporting globally generate a future allocation from the 20% global component
- unused quota is compulsorily withdrawn by mid October each year and redistributed
- the minimum quota allocation is 12 tonnes
- there is no administrative penalty for failure to use allocated quota.

Review approach

The Panel undertook its review in three stages. The first was collection of information through a series of briefings, consideration of past inquiries and reports, and submissions and discussions during April-May 2005. The second stage included development of principles and analysis of market projections. The third involved an assessment of the performance of current US beef quota administration arrangements, consideration of options and development of recommendations.

Principles identified by the Panel for determining the optimal use of Australia's US beef quota were used to assess the appropriateness, effectiveness and efficiency of the current arrangements and in making recommendations for improvement.

The Panel conducted a comprehensive public consultation process which included written submissions as well as holding meetings with interested parties around Australia. This enabled the Panel to clarify and seek further information on issues raised in the submissions.

Principles for quota administration

The US TRQ was achieved through government to government market access negotiations and the level cannot be influenced by administrative arrangements. In the Panel's view, the primary objective of TRQ administration is to optimise commercial use of the TRQ by exporting companies (maximising its value to Australia). TRQ administration is not intended as a mechanism for creating property assets for individual companies.

The Panel considers the TRQ should be managed to achieve sound public policy outcomes for the meat and livestock industry and the broader Australian community. Such public policy objectives include promoting economic prosperity by encouraging innovation and facilitating competitiveness in Australian industry, plus consideration of social, environmental, equity and regional development needs.

Against this background, the Panel identified (*Section 3*) a set of principles to guide its deliberations in evaluating the *appropriateness, effectiveness and efficiency* of TRQ administration arrangements as per its Terms of Reference.

1. Minimise government intervention in the marketplace

The US TRQ will be utilised most effectively by Australian exporters where market forces are allowed to operate to the greatest extent possible, with individual firms able to make decisions in response to domestic, US and global market signals.

2. Optimise the TRQ's commercial value to Australia

Optimal economic outcomes associated with the TRQ are more likely to be achieved where company decision making is focused on maximising commercial returns rather than meeting conditions established by quota arrangements.

TRQ administration should not seek full utilisation of TRQ where such outcomes are contrary to market signals and potentially reduce the overall value of Australian beef exports.

3. Minimise barriers to exporting

Administration should minimise barriers to TRQ use by companies willing to compete in the marketplace. The value of the TRQ will be enhanced by a competitive, innovative and profitable Australian beef production, processing and exporting industry. If a system creates undue barriers to companies entering the market or to company expansion, less efficient incumbents may retain quota and possibly utilise it in a sub-optimal manner.

4. Consider commercial arrangements

Changes to existing TRQ administration need to consider production, processing and exporting investments, existing commercial relationships, current or planned capital expenditure, and how affected businesses might make adjustments.

5. Administer consistently, transparently and efficiently

Any administrative system should seek to be user-friendly and transparent to all segments of the industry and other observers. This provides the optimum basis for business planning and commercial decision making. In particular, it should seek to minimise the use of discretionary decisions or changes to quota rules.

Market outlook for beef exports to the US

A central issue is whether the TRQ, with the AUSFTA increases from 2007, is likely to be filled over the next decade and onward. At the start of this review, the Panel sought briefings on the global and US beef market outlooks from the Australian Bureau of Agriculture and Resource Economics (ABARE), and Meat and Livestock Australia (MLA).

ABARE considers the TRQ will not be filled over the medium term with Australian beef exports to the US expected to decline to around 321 000 tonnes by 2009-2010, some 80 000 tonnes or 20% short of the TRQ. MLA considers the TRQ is unlikely to be filled in 2005, 2006 or 2007. However, unlike ABARE, MLA predicts the TRQ will be filled from 2008 to 2010.

While not wishing to make judgements on the accuracy or otherwise of these forecasts the Panel does note the following key points (*Section 4*):

- There is broad agreement between ABARE and MLA on the outlook in the shorter term i.e. between 2005 and 2007 the TRQ will not limit Australian beef exports to the US.
- Beyond 2008 ABARE predicts declining exports to the US, with the TRQ underfilled by 16%, 18% and 20% respectively during 2008, 2009 and 2010, while MLA predicts the TRQ will be filled from 2008.

Taking this into account the Panel has approached the Review on the basis that:

- it is highly unlikely the TRQ level will be reached in 2006 or 2007
- the TRQ is unlikely to constrain Australian beef exports to the US in years 2008 and beyond. ABARE predictions of significant underfill soften MLA projections of possible fill.
- Australian arrangements for managing the TRQ (including increases under AUSFTA) need to take into account uncertainty about the TRQ being reached.

Industry perspectives on US beef TRQ administration

The Panel notes industry positions have changed since 2001-2002 when current quota arrangements were introduced after a period of open trading during most of the 1990s. Australia had reached its TRQ in 2001 and at that time there were expectations that TRQ would continue to be filled. There was agreement among stakeholders on the need to ration use of the TRQ but no industry consensus on how this could be achieved.

There are now significant industry differences on market outlook and on the need for an administration scheme (*Section 5*). The majority of exporters and processors who made submissions to the Panel argued against current allocation arrangements for a range of reasons. Most advocated a return to a form of first-come first-served (FCFS) non-allocated system. A smaller group of processor-exporters, accounting for a significant proportion of total beef processing output, argued for retention of the current system of quota allocation.

Submissions to the Panel raised the question of the need or otherwise to maintain arrangements for rationing access to the TRQ. The AMIC-stated industry position, confirmed in most submissions and discussions, is "if we are not going to fill the quota then we do not need a quota scheme"[1].

Analysis of quota administration options

The Panel identified and considered five TRQ administration options (*Section 6*):

- <u>Current</u> annual allocation
- <u>Modified</u> annual allocation
- Annual allocation with a <u>low-fill suspension trigger</u>
- <u>No quota allocation</u> ('FCFS' until TRQ filled)
- No allocation with a <u>high-fill trigger</u> to introduce allocation.

Current annual allocation

The Panel understands the 2003 quota allocation scheme was a considered and practical model in the context of market conditions and industry expectations in 2002. These arrangements were designed to achieve effective use of the TRQ. Changing market conditions, distortions and their consequences mean the current scheme is not achieving intended outcomes. After evaluation of its features and workings, the Panel considers the current approach is not appropriate for the next five years and beyond.

Modified annual allocation

The Panel considers modifications to the current system cannot resolve identified problems without creating countervailing difficulties. This option would likely increase government intervention while not advancing the delivery of appropriate, effective and efficient quota administration.

Annual allocation with a low-fill suspension trigger

Under this option annual allocations would be made to companies but the regulatory scheme would include a mechanism to suspend quota controls part way through the year if predetermined criteria are met. Once allocations were suspended, any exporter could apply for TRQ export certificates on a FCFS basis.

The Panel considers controls on the market should be considered only where there is need and benefit; this has not been demonstrated.

No quota allocation (first-come first-served)

Under this option the market would operate freely, with approvals to ship being issued on a FCFS basis until the TRQ is reached. This situation existed between 1995 and 2002.

[1] Australian Meat Industry Council submission to the 2005 QRP

Overall, not allocating TRQ quantities would be the optimal administrative approach where the TRQ is unlikely to limit beef trade to the US.

However, if TRQ fill is approached during the year there may be rushes to use TRQ, with distorting effects on the market and commercial decisions. Government intervention may be sought to smooth access to TRQ before the limit is fully reached.

As there is some uncertainty about future TRQ fill rates (*Section 4*), the Panel considers non-allocation alone would be inappropriate.

No allocation with a high-fill trigger to introduce allocation.

Under this option each TRQ year would commence with no allocation of quota to individual companies. Shipping approvals would be issued on a FCFS basis. The system would include a mechanism for triggering allocation arrangements when it becomes evident the TRQ will be filled in that year. A final portion of the TRQ would be allocated in accordance with predetermined rules.

The Panel considers a no allocation/high-fill trigger model will optimise returns to industry participants when TRQ fill is not expected, but provides acceptable rules to accommodate periods of high fill if they occur. Such a model should be effective.

Recommended TRQ administration

Based on market projections the Panel considers the TRQ is unlikely to be filled in the foreseeable future (2006-2010). With reference to the principles in *Section 3*, and to industry submissions, the Panel recommends that the market for beef exports to the US should be allowed to operate as freely as possible. However, recognising there is a degree of uncertainty about export projections and TRQ filling from 2008, a safeguard is warranted. The Panel considers option 5 (no allocation/high fill trigger) provides for appropriate, effective and efficient TRQ administration.

The Panel recommends, as detailed in *Section 7*, that the following arrangements should apply to the new TRQ administration model.

1. No company allocations at the commencement of a quota year
2. A mechanism to smooth access to the TRQ if the limit is likely to be reached
3. The safeguard triggers if shipments to the US reach 85% of the TRQ based on TRQ certificates issued on or before 1 October in any quota year
4. If 85% of the TRQ is not reached by 1 October then quota will not be allocated
5. Companies will be informed of a Provisional Trigger Allocation (PTA) in January each year
6. The PTA will represent an eligible exporter’s proportion of 15% of the TRQ calculated on shipments to the US only, using a rolling two-year average
7. PTA calculations will be made on the basis of shipper-of-record
8. If the high fill trigger is reached, companies will have ten working days from the trigger date to apply for quota allocations against their PTA
9. Companies will be able to trade their PTA during the application period but the transferee will need to apply for an allocation by the tenth day

10. Applications to convert PTA to quota will require evidence of capacity and markets
11. The minimum allocation for the PTA and quota will be 1 tonne
12. A penalty should apply for non-use of allocated quota
13. The TRQ should be administered by the Australian government
14. These arrangements should take effect from 1 January 2006 and the industry notified as soon as possible.

The Panel is confident these changes to the administration system will be supported by most industry participants. It is a model that allows a dynamic processing sector to operate in an unconstrained market-driven manner to optimise the return from the TRQ. Imperfections inherent in an allocation-based regulatory system will largely disappear, administration of the TRQ will be simpler, and there will be better market outcomes.

Glossary

ABARE	Australian Bureau of Agricultural and Resource Economics
ABS	Australian Bureau of Statistics
ALFA	Australian Lot Feeders' Association
AMIC	Australian Meat Industry Council
AUSFTA	Australia United States Free Trade Agreement
CCA	Cattle Council of Australia
CL	chemically lean
COAG	Council of Australian Governments
DAFF	Australian Government Department of Agriculture, Fisheries and Forestry
FCFS	first-come first-served
MFN	Most Favoured Nation. (The application of the lowest tariff rate given to any other nation. All members of GATT offer most favoured nation status to each other).
GATT	General Agreement on Tariffs and Trade
MLA	Meat and Livestock Australia
NIDP	New Industries Development Program
PTA	Provisional Trigger Allocation (refers to the portion of the 15% of TRQ that will be provisionally allocated to individual companies at the commencement of each year).
Quota	allocations of TRQ to individual companies
QMP	2002 Quota Management Panel
QRP	2005 Quota Review Panel
RMAC	Red Meat Advisory Council
TRQ	Tariff Rate Quota (Australia's tariff free beef access to the US - currently 378 214 tonnes increasing to 448 214 by 2023)
USMIL	United States Meat Import Law
WTO	World Trade Organisation

1. Review process

On 17 February 2005, the Minister for Agriculture, Fisheries and Forestry, the Hon Warren Truss (the Minister), established an independent panel to review arrangements for the administration of beef import quota granted by the United States to Australia (i.e.the Tariff Rate Quota). The Minister stated the main task of the Quota Review Panel would be to review the appropriateness, effectiveness and efficiency of the current arrangements and, if need be, identify changes which should be made[2]. The Terms of Reference (Box 1) also asked the Panel to consult widely with the Australian beef industry including relevant industry organisations and individual processors and exporters.

Box 1: Terms of Reference for 2005 Review of US beef quota arrangements

Background

In October 2002, following the recommendations of an independent Quota Management Panel (QMP), the Minister agreed to a quota administrative regime for the management of Australian beef exports to the United States of America (US). At the time, the Minister also agreed that these quota arrangements would be reviewed in 2005. The Minister has determined that the 2005 review would be undertaken by an independent Quota Review Panel with assistance provided by the Australian Government Department of Agriculture, Fisheries and Forestry.

Terms of Reference

The QRP will examine and report on:

1. The appropriateness, effectiveness and efficiency of the current quota arrangements.
2. As needed, identify areas where improvements to the quota management arrangements could be made in the areas of:
    - options for the allocation of quota entitlement
    - minimum allocations, having regard to commercial practices
    - provision for new entrants to the US beef market
    - quota transfer arrangements
    - measures to deal with unused quota, including incentives and/or penalties if applicable, that will ensure maximum utilisation of Australia's in-quota access to the US
    - cost recovery mechanisms
    - transitional arrangements from the current procedures to those recommended by the QRP, and
    - any other area the QRP considers is relevant.
3. The implications of the provisions of the Australia-US Free Trade agreement on the administration of the beef quota in 2006 and subsequent years.

Considerations

In undertaking the review, the Panel should also have regard to recent quota fill outcomes, the cost of quota administration, and the commercial requirements of individual quota holders.

The Panel should also take into account the outcomes of the previous QMP independent report, the findings of the 2002 Senate Committee inquiry and the views of industry representatives and individual exporters and processors.

[2] The Hon Warren Truss, *Media Release*, 17 February 2005

1.1. Methodology

The Panel undertook its task in three stages. The first was collection of information through a series of briefings, consideration of past inquiries and reports, and submissions and discussions during April-May 2005. The second stage included development of principles and an analysis of market projections. The third involved an assessment of the performance of current US beef quota administration, consideration of options and development of recommendations.

Principles identified by the Panel for determining the optimal use of Australia's US beef quota were used to assess the appropriateness, effectiveness and efficiency of the current arrangements and to make recommendations for improvement (see *Section 3*).

In approaching the Review, the Panel considered previous inquiries into the administration of the US beef quota including submissions from industry and sought briefings from policy areas of the Australian Government Department of Agriculture Fisheries & Forestry (DAFF) as well as the Quota Administration Unit.

The Review Panel conducted a comprehensive public consultation process as follows:

- Submissions on the US Tariff Rate Quota (TRQ) administration were sought in March 2005 via public advertisements in national and rural newspapers, through the DAFF website, and by direct mail to all registered exporters of meat. In addition, the Chair of the Panel wrote to the chairs of relevant beef industry bodies inviting submissions.
- Submissions were received from 28 companies and four industry organisations (Appendix 1).
- The Panel met with interested parties enabling the Panel to clarify and seek further information on issues raised in the submissions. The Panel decided that hearings would be held on an individual and confidential basis to promote the full and frank exchange of views.
- Meetings were held in Canberra (27-28 April), Cooma (4 May), Melbourne (5 May), Sydney (6 May) Brisbane (9-11 May), Beenleigh and Dinmore (11 May), and Fremantle (21 May). Two discussions were held by teleconference.
- The Panel visited three beef processing plants. The selection of plants was made following discussions with the Australian Meat Industry Council (AMIC).

Report structure

Section 2 provides an overview of the history of quota administration arrangements for beef entering the US, a description of the current market, and detail about the impact of the Australia United States Free Trade Agreement (AUSFTA) on the beef TRQ.

Section 3 sets out key principles identified by the Panel for making assessments.

Section 4 examines the market outlook for Australian beef production and exports, setting the context for consideration of the current arrangements and potential options.

Section 5 outlines industry's views on the adequacy of the current TRQ administration and options for change.

Section 6 uses the principles outlined in *Section 3* to analyse the appropriateness, effectiveness and efficiency of current arrangements and four options.

Section 7 details the Panel's recommendations for administering the TRQ from the quota year commencing 1 January 2006.

1.2. Industry views

The Panel notes industry positions have changed since 2001-2002 when current quota arrangements were introduced after a period of open trading during most of the 1990s. Australia had reached its TRQ in 2001 and at that time there were expectations that TRQ would continue to be filled. There was agreement among stakeholders on the need to ration use of the TRQ but there was no industry consensus how this could be achieved.

There are now significant industry differences on market outlook and the need for an administration scheme. A majority of exporters and processors who made submissions to the Panel argued against current allocation arrangements for reasons including that the TRQ was unlikely to be reached. Most advocated a return to a first-come first-served (FCFS) non-allocated system. A small number of large processor-exporters argued for retention of the current system of quota allocation (*Section 5*).

Submissions to the Panel have raised the question of the need or otherwise to maintain arrangements for rationing access to the TRQ. The AMIC-stated industry position, confirmed in most submissions and discussions, is "if we are not going to fill the quota then we do not need a quota scheme"[3].

[3] Australian Meat Industry Council submission to the 2005 QRP

2. Background to US beef quota administration

2.1. History

An administrative system for Australia's beef and veal access to the US was first applied in 1968 following the introduction of the United States Meat Import Law (USMIL) several years earlier.

Since then quota allocation arrangements have operated intermittently, mainly when supply from Australia was significantly in excess of quota access into the US. This was the case under the USMIL until 1994 when US limits were lower, quotas had just been removed in Japan, quotas were still in place in Korea and the EU was a substantial beef exporter.

In 1995, following the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) negotiations, the USMIL was replaced with a Tariff Rate Quota (TRQ) of 378 214 tonnes. This was a 17% increase in Australia's quota access.

At that time Australia's TRQ was well in excess of beef exports to the US and Australia fell short of filling it through the late 1990s. During this time a FCFS approach operated. As a result of several factors including stronger US demand for beef and weak demand in Japan (Australia's other major market) the TRQ was reached in 2001. This led to calls by industry for the Australian Government to implement a TRQ allocation system.

Quota administration controls on Australian beef exports to the US were introduced on 15 May 2002 following a series of reviews.

2.1.1. Red Meat Advisory Council (RMAC) Report 2002

The decision to introduce quota controls followed advice from RMAC to the Minister on administration options. RMAC recommended that quota allocations be made to eligible companies based on their recorded shipments in 2001, giving a 60% weighting to US exports and 40% to global exports. A 'hardship' provision of 14 000 tonnes was recommended to assist any disadvantaged companies.

The Minister adopted the main elements of the RMAC proposal, but specified upper and lower thresholds for gains and losses derived from implementation of the arrangements. This meant no company would receive less than 85%, or more than 140% of its 2001 export volumes[4] to ensure processors heavily committed to US trade were not penalised by their choice of business model and to limit windfall gains to processors with little commitment to the US market.

2.1.2. Senate Rural and Regional Affairs and Transport Legislation Committee Inquiries

Subsequent to the Minister's 2002 announcement, the matter was referred to the Senate Rural and Regional Affairs and Transport Committee. On 26 June 2002, the Senate Committee submitted recommendations including:

[4] The Hon Warren Truss, *Media Release*, 15 May 2002

- conversion of the ‘hardship’ provision to a ‘discretionary’ provision of 30 000 tonnes and
- establishment of further inquiries into the performance and appropriateness of the existing government advisory structures in the Australian meat industry and quota allocation arrangements for beef exported to the US and Europe[5].

The Minister agreed with these recommendations and established an independent Quota Management Panel (QMP) on 11 July 2002 to allocate the discretionary amount and provide advice on longer term quota management issues[6].

The Senate Committee provided a further report in September 2002 which analysed options for, and provided recommendations on, quota allocation arrangements as follows:

- quota allocations based on global shipments (including the US) over the previous year
- allocation in three equal tranches each year
- transitional provisions for those companies highly reliant on the US market with an assessment of the need for the transitional provisions after 18 months[7].

The report was intended as an input to the deliberations of the QMP.

2.1.3. 2002 Quota Management Panel

After its establishment the QMP assessed applications for discretionary tonnage. The QMP then developed recommendations for an appropriate quota administration scheme for 2003 and after. It considered, among other matters, options presented in the September 2002 Senate Committee report and the likelihood the TRQ would be filled in future years.

The QMP concluded allocated arrangements should operate to facilitate optimal use of the TRQ, and then developed an allocation model to reflect this. The Minister accepted the main provisions recommended by the QMP.

The key features of the model accepted by the Minister, and currently in operation, follow:

- exporters receive an allocation of quota at the commencement of each year on the basis of a three year rolling average of shipments to the US and global markets on an 80:20 US/global ratio
- quota may be traded between exporters but must be transferred absolutely (i.e. shipping performance[8] and quota allocation cannot be split)

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[5] Senate Rural and Regional Affairs and Transport Legislation Committee, *Report on the Introduction of Quota Management Controls on Australian Beef Exports to the United States by the Minister for Agriculture, Fisheries and Forestry*, June 2002

[6] The Hon Warren Truss, *Media Release*, 11 July 2002

[7] Senate Rural and Regional Affairs and Transport Legislation Committee, *The Australian Meat Industry Consultative Structure and Quota Allocation. Interim Report: Allocation of the US Beef Quota*, September 2002

[8] **Performance:** Performance rules previously allowed quota allocation and/or credit for shipments ‘performed’ to be transferred between licensed exporters. This could take the form of the sale of the

- there are no new entrant provisions although quota can be transfered from quota holders; companies exporting globally generate a future allocation from the 20% global component
- unused quota is compulsorily withdrawn by the end of October each year and redistributed
- the minimum quota allocation is 12 tonnes
- there is no administrative penalty for failure to use allocated quota.

The Minister also said a formal review of these arrangements would be undertaken during 2005.

The QMP recommended consideration should be given to auctioning an amount of quota each year (5-10%); this was not taken up by the Minister.

The Minister augmented the QMP's recommendations by making 15 000 tonnes of quota available to those companies that could demonstrate hardship in making the transition to the 2003 quota regime.

2.2. Australian exports to the US

2.2.1. Market relevance

Around one third of the beef produced in Australia is consumed domestically; of the remaining two thirds 42% is exported to Japan and 37% to the US (in 2004)[9]. Although Australia exports beef to around 100 countries (Appendix 2), the top ten markets account for around 95% of value and volume. Between 2000 and 2003 the US was Australia's single largest market for beef by volume (while from 1995 to 1999 and again in 2004 Japan was the largest export market).

In 2004, the average price received for product shipped to the US was A$3.95 per kilogram, significantly lower than the average price of A$5.55 per kilogram for beef to Japan. This price difference is partly due to the predominance of manufacturing beef for the US market relative to higher value products such as chilled cuts for the Japanese market.

2.2.2. Shipping trends and TRQ fill rates

Australian beef exports to the US increased steadily from 1995 to 2001 and levelled out from 2002 (Figure 1).

allocation and 'performance' to a licensed exporter where the purchaser gained both the right to export the sold quota and credit for the shipment (increasing the purchaser's eligibility for quota allocation in the next year). More commonly, under a performance system quota was sold among exporters with the proviso that any performance generated would be returned to the seller. Through this process the seller maintains 'ownership' of quota in perpetuity without necessarily participating in the market for which quota was granted.

[9] Australian Bureau of Statistics (Appendix 2).

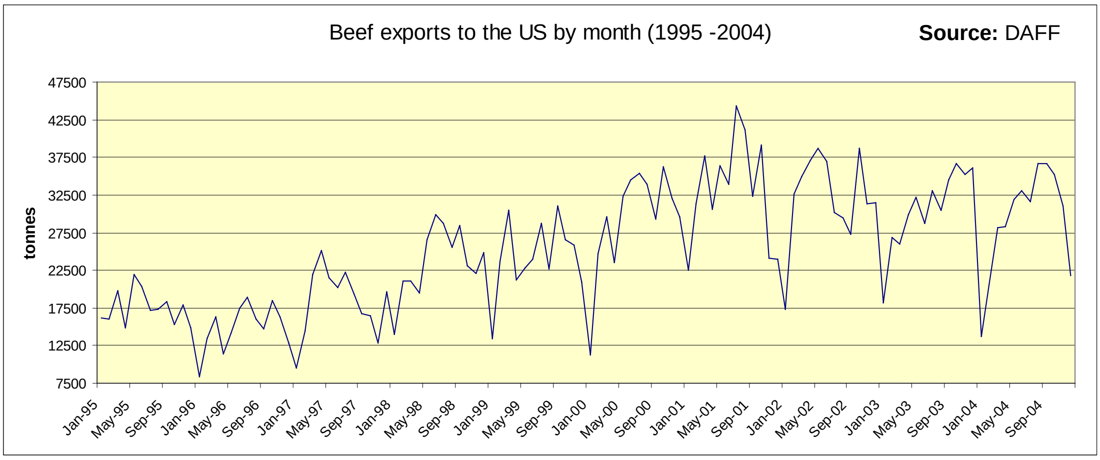

Figure 1: Beef exports to the US by month (1995-2004)

Figure 2 shows average total shipment volumes by month for the years 1995 to 2001. The values have been calculated by expressing the volume exported each month as a percentage of total shipments within that year (this allows for a comparison across years); these proportions have then been averaged and the range of values within each month displayed (i.e. the maximum and minimum).

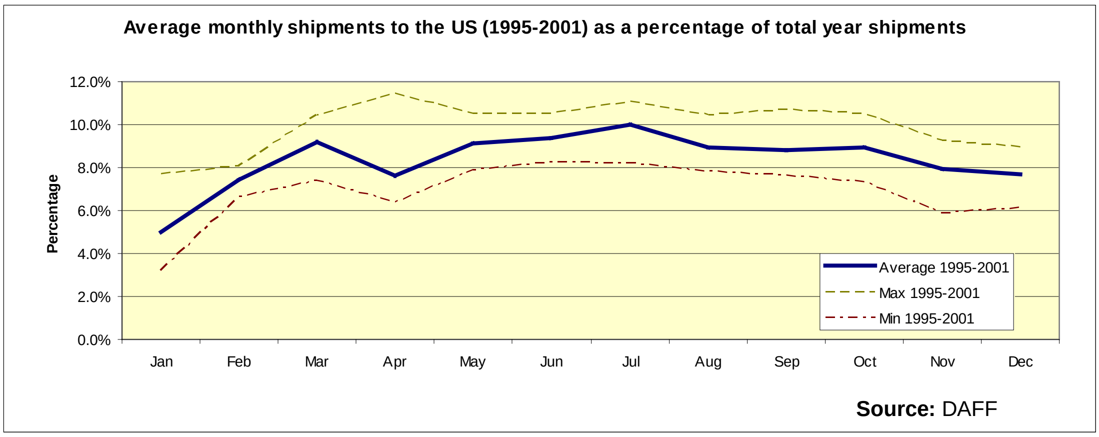

Figure 2: Average monthly exports to the US (1995-2001) as a percentage of total year shipments

Figure 3 presents the same information for the years 2003 and 2004, i.e. those years in which current quota allocation arrangements have operated.

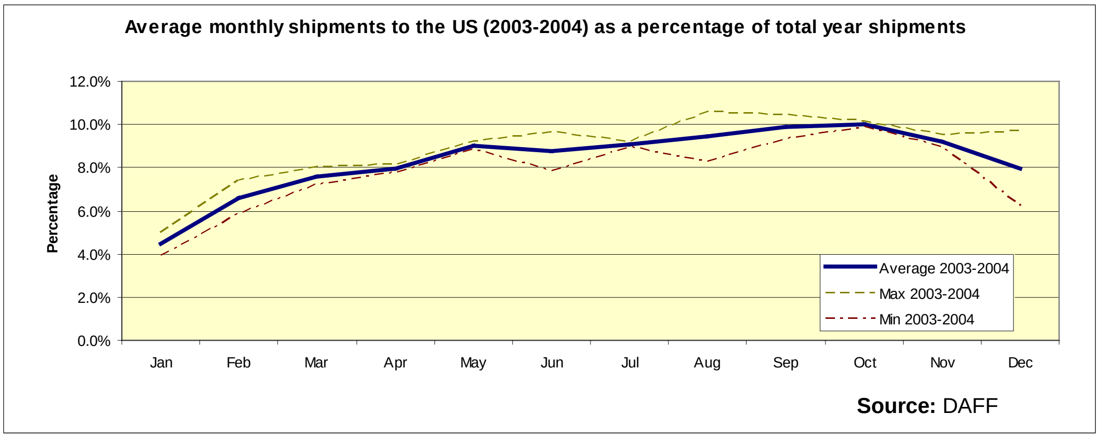

Figure 3: Average monthly exports to the US (2003-2004) as a percentage of total year shipments

From these records it appears the 2002 introduction of the quota administration arrangements has influenced shipping patterns in two ways:

- monthly shipment volumes fluctuate less (i.e. within a narrower range)
- the largest volumes are shipped later in the year especially September and October (whereas during 1995-2001 higher volumes were shipped early to mid year).

A number of factors may explain this shift, including increased quota driven sales, quota driven shipping patterns and take-up of uncommitted quota at year’s end.

2.2.3. Product mix

Australian beef exports to the US equate to around 4% of annual US production, and around 27% of US imports. Table 1 provides a breakdown of Australian beef sales to the US by product category. In 2004, over 90% of exports to the US was lower value beef (manufacturing beef or frozen cuts).

Of the total, 75% was frozen lean manufacturing beef, and within this category around 60% of the product was very lean beef (90 and above chemical lean (CL)) which complements US produced beef. The low fat content of Australian manufacturing meat makes it ideal for mixing with the fattier trimmings derived from US lot fed cattle to make products such as hamburger patties.

Chilled high value cuts make up a relatively small proportion of the trade (6.5% in 2004), however, this has grown significantly from 500 tonnes in 1999 to over 22 500 tonnes in 2004 (and 27 300 tonnes in 2003). The US is Australia’s second largest market for chilled cuts (8% of exports) but this is well behind Japan which takes 79%.

Table 1: Australian beef exports by product category to the US 2002-2004 (January-December)

	2002		2003		2004	
Summary	**Kilograms**	**% of total**	**Kilograms**	**% of total**	**Kilograms**	**% of total**
Manufacturing beef	284,880,343	73.8	273,459,142	74.3	263,715,583	75.4
Beef cuts						
Chilled	*20,038,685*	5.2	*27,357,671*	7.4	*22,576,757*	6.5
Frozen	*80,942,720*	21.0	*67,193,326*	18.3	*63,458,062*	18.1
Total beef	***385,861,748***		***368,010,139***		***349,750,402***	
Manufacturing						
Manufacturing beef	**Kilograms**	**% of total manufacturing**	**Kilograms**	**% of total manufacturing**	**Kilograms**	**% of total manufacturing**
95CL+	47,176,813	16.6	54,656,211	20.0	54,071,439	20.5
90CL	108,464,637	38.1	102,588,252	37.5	102,592,179	38.9
85CL	58,087,156	20.4	52,065,436	19.0	45,042,026	17.1
80CL	38,752,090	13.6	33,902,332	12.4	32,561,173	12.3
75CL	19,080,667	6.7	13,890,631	5.1	15,969,593	6.1
70CL	3,871,747	1.4	4,477,148	1.6	3,418,764	1.3
65CL	9,187,897	3.2	10,177,412	3.7	7,692,010	2.9
60CL	17,908	0.0	792,789	0.3	859,049	0.3
50CL	186,613	0.1	884,765	0.3	1,509,350	0.6
Other CL	54,815	0.0	24,166	0.0	-	0.0
Total	***284,880,343***	***100.0%***	***273,459,142***	***100.0%***	***263,715,583***	
Beef cuts						
Chilled	**Kilograms**	**% of total chilled**	**Kilograms**	**% of total chilled**	**Kilograms**	**% of total chilled**
Chuck and Blade	1,154,806	5.8	2,360,437	8.6	378,027	2
Inside/Outside/Eye Round	5,092,031	25.4	6,671,901	24.4	6,024,069	27
Thin flank meat	1,749,074	8.7	2,991,230	10.9	2,098,851	9
Knuckle	1,551,667	7.7	2,156,473	7.9	1,000,613	4
Loin cuts	2,134,433	10.7	4,178,900	15.3	3,687,643	16
Tenderloin	4,732,403	23.6	4,917,018	18.0	4,910,587	22
Other	3,624,271	18.1	4,081,712	14.9	4,476,967	20
Total	***20,038,685***		***27,357,671***		***22,576,757***	
Frozen	**Kilograms**	**% of total frozen**	**Kilograms**	**% of total frozen**	**Kilograms**	**% of total frozen**
Chuck and Blade	7,503,116	9.3	5,645,511	8.4	2,577,261	4
Inside/Outside/Eye Round	42,072,856	52.0	34,177,386	50.9	34,207,441	54
Thin flank meat	13,613,782	16.8	12,105,242	18.0	11,494,890	18
Knuckle	7,031,136	8.7	5,877,538	8.7	5,756,015	9
Loin cuts	5,330,417	6.6	5,118,311	7.6	4,958,819	8
Tenderloin	373,023	0.5	158,804	0.2	129,978	0
Other	5,018,390	6.2	4,110,534	6.1	4,333,658	7
Total	***80,942,720***		***67,193,326***		***63,458,062***	

Source: Data based on AQIS Request for Permit (RFP) Health Certificates.

Note: This data is based on recorded shipments at the time they left Australia and therefore may not correspond to the year in which they entered the US. It is not representative of quota fill levels.

2.3. Impact of the AUSFTA

2.3.1. Additional access

Under the AUSFTA which commenced on 1 January 2005 Australia will have access to an additional 70 000 tonnes of beef on a tariff-free basis phased in over 18 years (Table 2). The full amount represents an increase of 18.5% over the current WTO TRQ of 378 214 tonnes.

It is expected increased access will begin in 2007 at 20 000 tonnes (bringing the total TRQ amount to 398 214 tonnes). There will be no addition in year two because US beef exports must rise above 2003 levels for it to be triggered prior to 2007.

Table 2: Schedule for additional TRQ amounts under the AUSFTA

Year of AUSFTA operation	Cumulative additional amount (tonnes)
1	0
2	15 000
3	20 000
5	25 000
7	30 000
9	35 000
11	40 000
13	45 000
15	50 000
16	55 000
17	60 000
18	70 000

2.3.2. Tariff reduction

The AUSFTA eliminated the in-quota tariff for TRQ beef (which was 4.4 cents per kg), effective on commencement. It also provides for the phasing out of the over-quota duty from year nine onwards. Between years nine and thirteen the tariff rate will reduce by one third. Between years fourteen and eighteen the remaining duty will reduce to zero. At year eighteen (2022), there should be no quota restrictions or tariffs on Australian beef trading into the USA.

2.3.3. Safeguard arrangements

Under the AUSFTA two types of tariff will be applied to Australian beef exports to the US. Between Years 1-18 a duty can be triggered if beef imports from Australia exceed Australia's TRQ level by 10%. If triggered the duty rate will be 75% of the difference between the Most Favoured Nation (MFN) duty (26.4%) and the preferential TRQ over-quota duty for that year. After this the duty will be 65% of the MFN. The USA has the discretion not to apply the safeguard duty.

3. Principles for beef quota administration

The US TRQ was achieved through government to government market access negotiations, and the level cannot be influenced by administrative arrangements. In the Panel's view, the primary administrative objective is to optimise the TRQ's commercial use by exporting companies (which will maximise its value to Australia). Quota administration is not intended as a mechanism for creating property assets for individual companies.

3.1. Public policy and regulatory contexts

The Panel considers the TRQ should be administered to achieve sound public policy outcomes for the meat and livestock industry and the broader Australian community.

Such public policy objectives include promoting economic prosperity by increasing the competitiveness of Australian industry and consideration of social, environmental, equity and regional development needs.

Over the last decade, the Coalition of Australian Governments (COAG) has developed a set of principles to underpin effective regulations and review of those regulations[10], including:

- *Minimising the impact of regulation*: the overall goal of regulation should be effective enforcement of stated objectives.
- *Minimising the impact on competition*: regulations should have minimal impact on competition, except where the 'public interest' is served, or where the only means of achieving regulation is through restricting competition.
- *Predictability of outcomes:* regulation should have clearly defined outcomes.
- *Regulations should not restrict international trade:* regulations should not be applied in a way that creates unnecessary obstacles to international trade.
- *Flexibility of standards and regulations:* regulations should be capable of being adapted to changing circumstances.
- *The exercise of bureaucratic discretion:* good regulation should attempt to standardise the exercise of bureaucratic discretion, but this should not preclude an appropriate degree of flexibility to permit regulators to deal quickly with exceptional or changing circumstances or to recognise individual needs.

These principles have been articulated by COAG into a series of tests for assessing the impact of making or reviewing a regulation (see Box 2).

[10] Council of Australian Governments, *Principles and Guidelines for National Standard Setting and Regulatory Action by Ministerial Councils and Standard Setting Bodies*. As at June 2004.

Box 2: Key regulatory impact assessment tests

In proposing a regulatory measure decision makers should consider the following questions.:

- Is regulation needed?
- Is regulation likely to improve market outcomes?
- What are the likely benefits of regulation and who will reap them?
- What are the costs of regulation and who will bear them?
- Does the community support the proposed regulation?
- What is the likely impact of the proposed regulatory measure on competition, including the introduction of new processes and techniques?

These considerations were incorporated into National Competition Policy (NCP) principles and reviews, as recently summarised by the Productivity Commission.

> *The NCP represents the joint desire of Australian governments to deliver the benefits of competition through a national approach to competition reform. It aims not only to facilitate effective competition to promote economic efficiency and the social benefits which flow from that, but also to accommodate situations where competition conflicts with social objectives*[11]*.*

NCP aims to remove regulatory arrangements that restrict competition among enterprises in order to facilitate a range of socio-economic benefits for the Australian community. It allows for restrictions on competition if such regulation can be shown to be in the 'public interest'. Factors that can be considered in determining levels of public benefit include:

- legislation and policies relating to ecologically sustainable development
- social welfare and equity considerations, including community service obligations
- economic and regional development, including employment and investment growth
- the interests of consumers generally or a class of consumers
- the competitiveness of Australian businesses, and the efficient allocation of resources.

3.2. Principles

Against the above background, the Panel has identified a set of principles to guide its deliberations in evaluating the *appropriateness, effectiveness and efficiency* of the current quota administration arrangements and options as per its Terms of Reference.

[11] Productivity Commission, *Impact of Competition Policy Reforms on Rural and Regional Australia*, 1999

Principle 1: Minimise government intervention

The Panel considers the US TRQ will be utilised most effectively by Australian exporters where market forces are allowed to operate to the greatest extent possible, with individual firms being able to make decisions in response to domestic, US and global market signals. However, market forces relating to Australian exports to the US can be affected by the TRQ when it is reached or if fill is anticipated (Box 3).

Box 3: Potential for impacts on commercial trade

Quota and tariff regulations plus associated administrative arrangements introduce potential for distortions to market signals and efficient operation – as recognised in Australian and international negotiations on trade restrictions. The TRQ provides an opportunity for Australian exporters to ship beef to the US at a reduced tariff rate with an upper limit on this. For exports above the TRQ the MFN *ad valorem* duty, presently 26.4%, is imposed.

Figure 4 shows how these US rules may impact on Australian companies' capacity to participate in the market for lean manufacturing beef under conditions of minimal Australian government intervention (i.e. FCFS system).

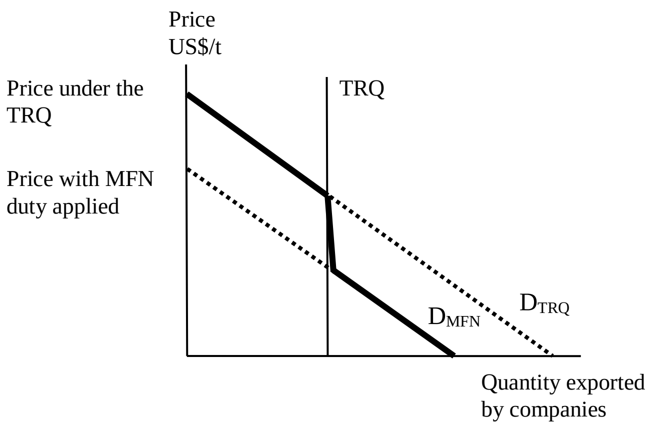

Figure 4: Economic impact of the US TRQ on company decision making where a FCFS operates

Below the TRQ, Australian companies participating in beef trade to the US will operate along a demand schedule represented by the line D_{TRQ}. Individual companies will be able to make commercial decisions in response to market signals.

Once the TRQ is exceeded the price an exporter receives for product will drop (as the MFN duty becomes payable). As exports approach the TRQ, under a FCFS scheme, companies may engage in discounting to gain access to the remaining in-quota tariff rate and avoid paying the MFN (the cost of which may preclude further exports). Where this is the case, quota allocation may increase the certainty with which companies can operate, and the likelihood the value of the TRQ will be optimised.

Where projections of quota fill are uncertain from year to year, government intervention will need to consider likely net gains from introducing regulation. If an allocation scheme is applied each year but TRQ fill occurs only rarely, intervention is likely to be of negative commercial and national benefit due to costs added, distortions driven by sales at lower prices to maintain allocations, and limitations on other companies selling to the US within the TRQ.

Principle 2: Optimise the TRQ's commercial value to Australia

The TRQ's value is derived from the difference between in-quota and out-of-quota tariff rates and price premiums gained in high demand years that are restricted by the TRQ. An analysis of the impact that quota underfill, quota fill and overfill has on generating this premium is presented in Appendix 3.

Optimal economic outcomes associated with the TRQ are more likely to be achieved where company decision making is focused on maximising commercial returns rather than meeting conditions established by quota arrangements.

Quota administration schemes can distort company behaviour by influencing decisions:

- to enter or exit markets, or to invest or not invest in productive capacity or supply systems
- to decide on export action to maintain or enhance quota allocations in future years or
- to choose a business model.

Quota administration should not seek to promote full utilisation of TRQ where such outcomes are contrary to market signals and potentially reduce the overall value of Australian exports. Similarly, quota arrangements may unintentionally encourage beef exports at discounted prices to increase sales into a quota market to protect future allocations, but at the expense of sales into other important markets where higher returns are available.

Submissions to previous reviews have argued TRQ arrangements should be structured to 'encourage diversification' of Australian beef exports to many markets. This Panel, reflecting the view of the 2002 QMP, considers diversification is a matter best left to market forces and commercial assessments of the beef supply chain.

The provision of incentives for companies to export to more than one market may penalise the use of particular business models. In addition, the Panel notes Australia already exports beef to over 100 markets and there is little evidence to indicate the growth in Australian beef exports (eg.to a country such as Korea) has been influenced by quota arrangements applying to the US market ahead of other commercial factors.

Principle 3: Minimise barriers to exporting

Quota administration should minimise barriers to TRQ use by companies willing to compete in the marketplace. The value of the TRQ will be enhanced by a competitive, innovative and profitable Australian beef production, processing and exporting industry.

Factors likely to influence the capacity of companies to access TRQ include:

- new entrant and expansion provisions
- quota tradability and
- eligibility criteria for participation.

If a quota management system creates undue barriers to new companies entering the market or to company expansion, then less efficient incumbents may retain quota and possibly utilise it in a sub-optimal manner. New businesses often bring innovative technologies and other practices to an industry. Ensuring the ability of new companies to enter the market can provide further incentives for existing companies to increase efficiency.

Tradability of allocated quota is, in theory, a key to facilitating optimal use of quota (i.e. by enabling it to go to the most efficient users). However, the trading environment may restrict the ability of companies to obtain quota. Where quota is allocated annually an incentive exists for some companies to hold onto quota until the latter part of the year, particularly if companies are routinely allocated surplus quota and others are in deficit. In this period quota will have the greatest value if there is a perception that the TRQ will be exceeded; this can generate costs for those actively exporting and deliver windfall gains for quota sellers.

TRQ access should be made available to the widest range of companies able to make use of it. This will maximise the capacity to develop business models that utilise the beef supply chain and deliver product that meets a diverse range of market needs. This should optimise returns to cattle producers and supply chain participants.

Principle 4: Consider commercial arrangements

Changes to existing TRQ administration need to consider current production, processing and exporting investments, existing commercial relationships, current or planned capital expenditure, and how affected businesses might make adjustments. Some existing commercial arrangements may have been influenced by the rules of the quota system itself and may not reflect the most efficient and commercial outcomes. These may reduce industry and national returns from the TRQ.

Principle 5: Administer consistently, transparently and efficiently

The Panel considers any administrative system should seek to be user-friendly and transparent to all segments of the industry and other observers. This provides the optimum basis for business planing and commercial decision making. In particular, it should seek to minimise the use of discretionary decisions or changes to quota rules or allocation. Frequent use of discretion can signal that the regulatory system needs revisiting.

More complex quota administration usually means higher costs for government (and industry through cost recovery) plus higher monitoring and compliance costs for individual companies. The objectives noted here are important but they alone should not determine the form of quota administration, especially where an approach offers greater economic benefits with only marginal cost increases.

4. Market outlook for beef exports to the US

A central issue is whether the TRQ, with the AUSFTA increases from 2007, is likely to be filled over the next decade and onward. At the commencement of this review, the Panel sought briefings on the global and US beef market outlooks from the Australian Bureau of Agriculture and Resource Economics (ABARE), and Meat and Livestock Australia (MLA). The Panel requested forecasts for Australian beef production, consumption and exports and the underlying assumptions. Subsequently, the Panel sought updates from MLA and ABARE; this was to include any impacts the continuing drought may have on future production and exports to the US.

4.1. ABARE forecasts

ABARE's most recent medium term forecasts were published in March 2005[12]. ABARE considers the TRQ will not be filled over the medium term up to 2010. These projections are set out below in Table 3 and Figure 5 together with those of MLA.

ABARE identified a number of drivers sustaining a high US demand for manufacturing beef in the shorter term – including the current bans on Canadian beef, foot and mouth disease concerns in South America and reduced US cow slaughter rates. In the medium term exports to the US are expected to decline to around 321 000 tonnes by 2009-10, some 80 000 tonnes (20%) short of the TRQ. Growing South American competition (particularly from Uruguay in the short term)[13], resumption of US trade with Canada and increased US production are expected to lower US prices, making this a less attractive market for Australian beef thereby reducing export volumes to the US over the medium term.

In addition, ABARE has advised continuing poor seasonal conditions (drought) in parts of Australia have raised turn-off and slaughter rates. ABARE has subsequently adjusted its 2004-05 and 2005-06 forecasts for exports to the US upwards to 365 000 tonnes and 371 000 tonnes respectively[14].

ABARE considers that, in the medium term, the Australian beef industry is likely to experience a general decline in beef prices, greater competition in the US market, and declining Australian exports to the US.

4.2. MLA forecasts

MLA considers the TRQ is unlikely to be filled in 2005, 2006 or 2007. However, unlike ABARE, MLA predict the TRQ will be filled from 2008 to 2010. The major assumptions follow:

- a gradual US re-entry to Japan and Korea over the next few years
- re-opening of the US border to imports of Canadian cattle and cow beef from the commencement of 2006
- Argentine re-entry to the US from 2007

[12] ABARE, *Commodity Forecasts and Issues*, vol 12, no. 1, March 2005
[13] In 2004 the US imported 148 000 tonnes of beef from Uruguay, over three times the level of 2003 and of which 87% was subject to the MFN tariff rate of 26.4%.ABARE, as in footnote 12, p69.
[14] ABARE, *Commodity Forecasts and Issues*, vol 12, no. 2, June 2005

- a gradual decline in the A$ value against the US$ and only modest recovery in South American currencies and
- a return to average rainfall across most of Australia from spring 2005.

MLA forecasts cattle prices will remain attractive in the medium term with Australian cattle numbers, production and beef exports increasing during this decade.

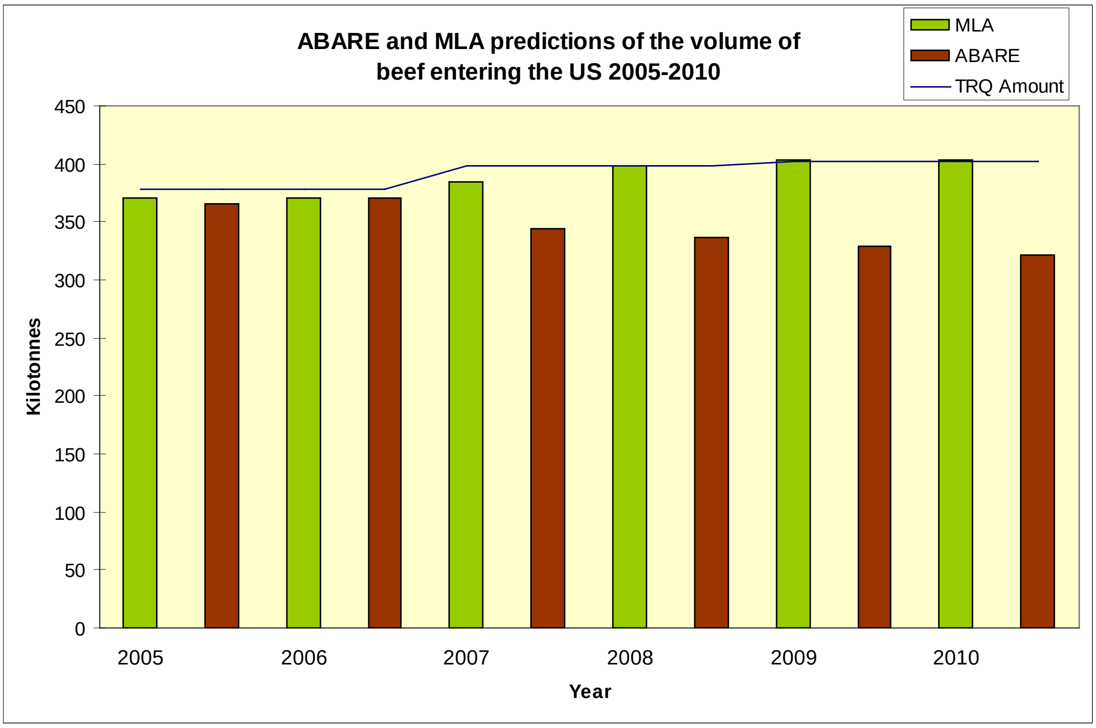

Figure 5: ABARE and MLA medium term forecasts

(*ABARE figures have been revised – see 4.1 above)

Table 3: ABARE and MLA medium term

('000 tonnes)	2005	2006	2007	2008	2009	2010
ABARE	357*	350*	344	336	329	321
MLA	370	370	385	398	403	403
TRQ amount	378.2	378.2	398.2	398.2	402.2	402.2

Source: MLA, ABARE[15]

(*These ABARE figures have been revised – see 4.1 above)

[15] ABARE's forecasts are on a financial year basis, e.g. the 2006 ABARE figure is its forecast for 2005-06.

Both MLA and ABARE recognise the critical issues impacting on Australia’s beef exports will be trade related, particularly the speed of the US return to Japan and Korea, the re-opening of the Canadian US border to cows and cow beef, and access for South American suppliers (particularly Argentina and potentially Brazil) to the US.

4.3. Analysis

While not wishing to made judgements on the accuracy or otherwise of these forecasts the Panel notes the following key points:

- there is broad agreement between ABARE and MLA on the outlook in the shorter term i.e. between 2005 and 2007 the TRQ will not limit Australian beef exports to the US
- beyond 2008 ABARE predicts declining exports to the US, with the TRQ underfilled by 16%, 18% and 20% respectively during 2008, 2009 and 2010, while MLA predicts the TRQ will be filled from 2008.

Taking this into account the Panel has approached the Review on the basis that:

- it is highly probable the TRQ level will not be reached in 2006 or 2007
- the TRQ is unlikely to constrain Australian beef exports to the US in years 2008 and beyond. ABARE predictions of significant underfill soften MLA projections of possible fill
- Australian arrangements for managing the increasing TRQ (under the AUSFTA) need to take into account uncertainty about the TRQ being reached.

5. Industry perspectives on US beef TRQ management.

This Review included a comprehensive public consultation process during April and May 2005 (refer *Section 1*). The Panel received 32 submissions from industry organisations and companies commenting on elements of the current administration system as well as its overall appropriateness. Many submissions sought changes, and a number proposed alternatives while some argued for the continuation of current arrangements. Industry inputs fell into two broad areas: obtaining access to quota, and the quantum of allocations.

The current arrangements commenced on 1 January 2003 after Australian Government consideration of the October 2002 QMP report (*Section 2*). The key features of the current system are set out in Table 4.

Table 4: Key features of the current quota allocation system

Feature	Current settings
TRQ	378 214 tonnes in 2005
Annual increase (under AUSFTA)	20 000 tonnes in 2007 then 5 000 tonnes every two years (*Section 2*)
Administrator	Quota Administration Unit, DAFF
Method of quota allocation	80% of quota allocation is based on a company's beef exports to the US. The remaining 20% is based on global shipments (including US shipments)
Period of allocation	Annual, on 1 January each year
Allocation base records	Annual allocation is based on a three-year rolling average of actual export shipments during the shipping year
Quota year	1 January – 31 December
Shipping year	1 November – 31 October
Minimum quota allocation	12 tonnes
Eligibility	Licensed meat exporters can apply for quota allocation
Administration fee	Allocations cannot be used until the prescribed administration fee has been paid; 0.5 cents per kg. No fee paid for use of redistributed quota. The administration fee is based on cost recovery principles.
Transfer of quota	Quota holders may transfer allocation to another eligible exporter and must be registered with DAFF; they do not earn future allocations.
New entrant provisions	No specific new entrant provisions apply. New entrants meeting eligibility criteria can obtain quota through transfer (if available) or build an allocation by exporting to non-US markets (i.e. using the global component).
Quota product ID	A quota certificate must accompany a consignment in order for it to enter the US tariff free.
Uncommitted quota	By 14 October quota holders must advise how they intend to use remaining quota allocation. After 29 October, unused quota is compulsorily withdrawn and made available to other eligible quota holders on application on a FCFS basis.

5.1. Obtaining access to quota

Accessing quota under current arrangements is of considerable concern to a range of companies including a number with quota allocations that are looking to expand or change operations, as well as potential new entrants.

Under the existing system, quota can be accessed by eligible exporters, either

- by application based on export record prior to the commencement of the quota year
- through purchase or transfer from existing quota holders or
- by re-distribution of unused quota to existing holders toward the end of a quota year.

5.1.1. Applications for quota

Licensed meat exporters are invited to apply for a quota allocation if DAFF has calculated they are eligible for a share of the TRQ amounting to at least 12 tonnes. Those currently not in the beef export industry are excluded from application.

Most companies identified the US as an important component of the market for any beef processor and/or exporter because it provides a significant outlet for lower value product including trimmings. Not all companies can readily access this market because the current system raises barriers by requiring substantial and substained non-US exports to obtain sufficient quota e.g. to support a new plant, conversion to export, or an expansion of capacity or plant usage. The reasons for this include:

- global exports are only weighted at 20% of the aggregate export record, and global exports include US exports. US sales currently comprise about 40% of total beef exports which equates to 8% of the global component of the allocation formula making the effective US component about 88% and the non-US component about 12% of the total quantity to be allocated in 2004[16].
- the historical export base is calculated over three years and
- the formula does not count any out-of-quota shipments to the US, even if TRQ is not filled.

On the basis of the above weightings, to reach a 6 000 tonne US allocation to support a new export plant, an intending entrant will first need to export an average of about 50 000 tonnes for each year over three years to non-US markets[17].

This factor was also considered by some to be a significant barrier to obtaining quota to support expansion, whether by adding work shifts and/or increased investments. Some companies noted that those with large allocations could manage restructures and expansions by transferring quota among their plants and managing output to the domestic, US, Japan, and other export markets.

The lack of access for new entrants was seen by some as discriminating against cattle producers in particular regions. It was suggested that without appropriate access for

[16] Hunt Partners submission to the 2005 QRP on behalf of Market Specific Group
[17] This assumes the new entrant does not make any US shipments until year four.

new entrants, some producers are denied access to higher value markets because their local processors do not hold, and cannot realistically obtain, blocs of quota.

5.1.2. Transfers of quota

There was almost unanimous agreement on the importance of quota tradability. Under the current system, quota transfers can be made at any time after allocations are given. Transfer volumes are sizeable: in 2004, 143 000 tonnes were transferred including approximately 49 000 tonnes of inter company trades (with the remaining transfers occuring within companies)[18].

Consultations and DAFF data confirm that many transfers between companies are conducted on a 'lends' basis i.e. under commercial arrangements for transfers-back at the commencement of the next year. Other trades take the form of outright purchases and sales.

Several of the largest companies believe the existing transfer arrangements should be maintained, with the details remaining a matter for commercial negotiation. However, some companies dealing predominantly with the US market expressed serious concerns that quota is not readily available and if it is, the cost can be prohibitive. Estimates from industry participants suggest that 'true' availability of quota to buy outright is 5 000-10 000 tonnes a year. A number of large quota holders did indicate that as a rule they do not trade quota. They say if they have unused quota it is returned in October to DAFF.

Companies processing and exporting beef mainly for the US market (such as the manufacturing beef 'hot boners' that entered the industry in the 1990s) are particularly concerned about costs of buying quota to service contracts and obtaining quota to support expansion.

> For example, HB company exported 100% of its 5 000 tonnes processing output to the US from 2000 to 2002. In 2003, its allocation of quota was 80% of its US exports, i.e. 4 000 tonnes, plus 20% of its global exports (which were all to the US) leading to an allocation of 4 400 tonnes. Under the current formula, HB 'loses' quota allocation equivalent to 12% of its annual US exports.
>
> Every year HB company needs to buy quota to cover 12% of its exports i.e. 600 tonnes to maintain its business model as a specialised hot boner.
>
> If HB determines it can add a work shift and competitively increase sales to the US to 8 000 tonnes a year it will need to purchase (not borrow) an average of 2 720 tonnes of quota a year for three years then purchase 960 tonnes every year after that to maintain sales at that level.

There is the potential to use quota allocations anti-competitively. Even in years when TRQ has not been filled, quota holders and competitors can hold onto quota for many months to drive up quota prices, particularly as the industry knows some companies will have a quota shortfall each year and must buy quota to meet annual commitments. Prices for quota can fluctuate considerably within and across years with discussions indicating 'quota prices on the market' range from a few cents per

[18] DAFF

kilogram for lending to as high as one dollar per kilogram for purchase. The average price for Australian beef exported to the US in 2004 was A$3.95 per kilogram.

5.1.3. Access to unused quota

Access to quota is possible towards the end of a quota year (usually October/ November) when unused quota allocations are withdrawn by DAFF for redistribution.

However, access to uncommitted amounts is considered by many companies to be inadequate. Recall is late in the shipping year and often with insufficient opportunity to take up available quota. The Panel was advised that some companies with a high level of commitment to the US market and a regular quota shortfall have made use of the re-distributed amounts but this is not a reliable option for most businesses, particularly in years of high demand where recalled amounts are minimal. Also, new entrants do not have access to these amounts because they have not held quota through allocation or transfer during the year.

Some companies suggest a system of penalties and/or incentives could be incorporated in order to release more unused quota earlier in the quota year.

5.1.4. Eligibility

Quota allocations are currently issued to licensed meat exporters rather than processors. The majority of companies and some industry organisations consider this criterion to be appropriate on the basis that markets are developed by exporters and quota should be allocated to those businesses that service the market. Although exporters may not be processors, all processors have the option of becoming licensed for export. Most processors are exporters and therefore can obtain a quota allocation.

However, some processing companies that market product through non-packer exporters believe it is the processor who makes specialised investment in plant and equipment and any quota allocations should accrue to them. A few also argue that the allocation system would be simplified and the processor's costs reduced if allocations were made only to processors. This would reduce the need for the processor to track ('loaned') quota and ensure it is returned.

AMIC, in its submission, requested this issue be considered on the basis that "quota is generated by the processing establishment producing and exporting beef"[19]. AMIC noted problems in previous attempts to calculate allocations on processor-of-record due to the lack of a suitable database.

5.1.5. Access options

Overall, many companies consider access to quota is a significant barrier to expansion and to new entrants, and/or an undue cost to their operations. They argue that removing obstacles to accessing quota will promote fair competition and would encourage innovation and efficiency across the industry. These companies remarked on the history of underfill of the TRQ, against which the present arrangements seem unfair with one company suggesting it is an unlawful restriction of trade.

[19] Australian Meat Industry Council submission to the 2005 QRP

Almost all companies advocating changes to access provisions agreed this can be best achieved if quota is unallocated. This will provide all companies with equal access and enable them to manage individual business risks based on efficiency and competitiveness if planning to open new plants or expand. If an allocation system were to continue, then access issues can be resolved by substantial changes such as reserving quota for new entrants or varying the formula to increase the weighting for global exports from 20% to 100% as well as reducing the historical base for exports from three years to one.

However, a number of large companies oppose changes to access arrangements. They argue allocations to existing companies with considerable investments will be eroded by specific new entrant/expansion provisions; access exists through global trading and any company can export out-of-quota product to the US. They claim new entrant eligibility criteria will be hard to define and will just encourage expansion by existing companies. As one company stated, there are "no efficiency or equity arguments for diverting quota away from existing processors and allocating it to new entrants or 'special pleaders'"; such provisions are not "an inducement for new and innovative investment in beef processing but rather an encouragement to (existing) exporters to test the qualifying criteria"[20].

5.2. Quantum of quota

5.2.1. Allocation formula

Industry submissions indicate the formula is a contentious element of the current quota management system. The amount of quota allocated to each company is calculated as follows:

$$\frac{\text{3yr av. company quota exports to the US}}{\text{3yr av. quota exports to the US by all quota holders}} \times 80\%\ \text{TRQ} + \frac{\text{3 yr av. global company exports}}{\text{3 yr av. total global exports by all exporters}} \times 20\%\ \text{TRQ}$$

This formula allocates 80% of the TRQ on the average of all exporters' recorded shipments to the US beef market during the previous three shipping years, and 20% of the TRQ on the average of all exporters' recorded exports to <u>all</u> destinations during the previous three shipping years). As the global proportion includes US shipments, the effective weighting of actual exports to the US in proportioning of the TRQ is about 88%.

Several large companies believe the formula (and the current system overall) is a balanced compromise serving different business models and should be retained. On the other hand, a large number of companies consider the formula to be flawed. Of these, one group believes the current system would be improved by basing the calculations on 100% global trade to encourage opening of other markets. Some members of the Australian Lot Feeders' Association (ALFA)[21] suggest a modest increase in the global performance element of the formula (to 70:30) to encourage market diversification. Another group argues it should be based on US trade only rather than providing windfall gains to those less dependent on the US market. These

[20] Nippon Meat Packers Australia Pty Ltd submission to the 2005 QRP
[21] Australian Lot Feeders' Association submission to the 2005 QRP

companies believe it is unfair they are continually in deficit and compelled to buy quota from companies receiving annual allocations higher than their US trade history.

The inclusion of domestic performance in the allocation formula was proposed by a few companies as a way to achieve allocations for companies that have not been export focused but are keen to gain a foothold. These companies believe Australian domestic sales should be viewed on an equal basis with overseas markets when dividing up export quotas.

However, most companies recognise proposals to modify the US/global trade ratio would be unacceptable to other businesses. Submissions and discussions showed growing recognition that it would be preferable to move to an unallocated FCFS system to provide access to companies representing a broad spectrum of business models as well as new entrants, without favouring one type over another.

5.2.2. Allocation base

Several submissions commented on the appropriate base for calculating company allocations. The calculation currently uses export records for the previous three shipping years to the US and globally (including the US). The shipping year runs from 1 November to 31 October (the quota year runs 1 January to 31 December).

Most companies appear satisfied the current three-year rolling average protects against unforeseen events by smoothing out the impacts of a bad year and obviating the need for a discretionary quota allocation component based on adverse circumstances.

Periods less than three years are vulnerable to short-term influences and can encourage non-economic use of quota to ensure its retention in future years. Periods longer than three years are not considered responsive enough to changing market conditions and lock in market share (which can reward inefficient companies for too long a period).

However, as noted above, others believe a three-year average is one of the barriers to new entrants and to the expansion of operations by existing companies with insufficient quota. They support a shorter period on the basis that:

- a one-year base will provide easier access and faster growth of allocation, particularly if accompanied by an increased global share in the formula.
- companies no longer active in beef exporting will not retain residual quota, freeing up quota for others to use.

5.2.3. Minimum allocation

Where the calculations for a company result in an allocation of fewer than 12 tonnes, no allocation is made for that company and the amount calculated is incorporated into a pool for re-allocation across other holders.

Consultation identified no particular dissatisfaction from current exporters with this minimum threshold for the US market. A few companies actively supported its retention, arguing it is the smallest possible commercially sized consignment of beef to the US and "any smaller amount would simply result in fragmentation of entitlement holdings"[22]. Another company said "this floor approximates the weight of the smallest sea-freight consignment and avoids the fragmentation of quota into sub-commercial parcels with attendant administrative costs"[23]. There were, however, a number of specialist producer-group exporters seeking access to small tonnages for initial market development.

5.2.4. Administration system

From submissions and discussions, it is apparent that while many participants supported an allocated process in 2002 given the TRQ was expected to be filled, the majority of companies (over 80%) now believe that under prevailing market circumstances no allocation of entitlements at the commencement of a quota year are warranted and an *open trade* approach is preferable (see Figure 6 below).

Of these companies, over 60% prefer an administrative system incorporating a trigger mechanism to enable allocations to be made during a quota year in the event the TRQ is likely to be reached. Two models in particular were floated:

- the 'Larkin' model[24] in which allocations are triggered if 80% of the TRQ is filled by 1 October. Allocations for the final 20% of the TRQ are known to all companies at the commencement of the year but only take effect if the 80% threshold is triggered. The two variants of the model are differentiated by whether allocations are made on the basis of 100% US shipments or in accordance with the current 80:20 ratio of US to global shipments. The former has greater industry support on the basis that if allocations are triggered, demand for quota will be high and allocations should not be locked up by companies with no interest in servicing the US market and may not be able to transfer quota quickly. In any case, all exporters whether predominantly US, global or new would have access to the US during the open trade period[25].
- the 'Quilty' model[26] with three trigger points for allocating remaining quota as well as additional rules governing penalties and incentives to encourage quota usage or transfer.

[22] Teys Brothers (Holdings) Pty Ltd submission to the 2005 QRP
[23] Nippon Meat Packers Australia Pty Ltd submission to the 2005 QRP
[24] Developed by David Larkin for the *AMIC U.S. Beef Quota Working Group - Discussion Paper,* 23 December, 2004
[25] This model was analysed in a submission prepared by Hunt Partners on behalf of The Free Trade Quota Group.
[26] Developed by John Quilty of Q-exports International Pty Ltd, submission to the 2005 QRP

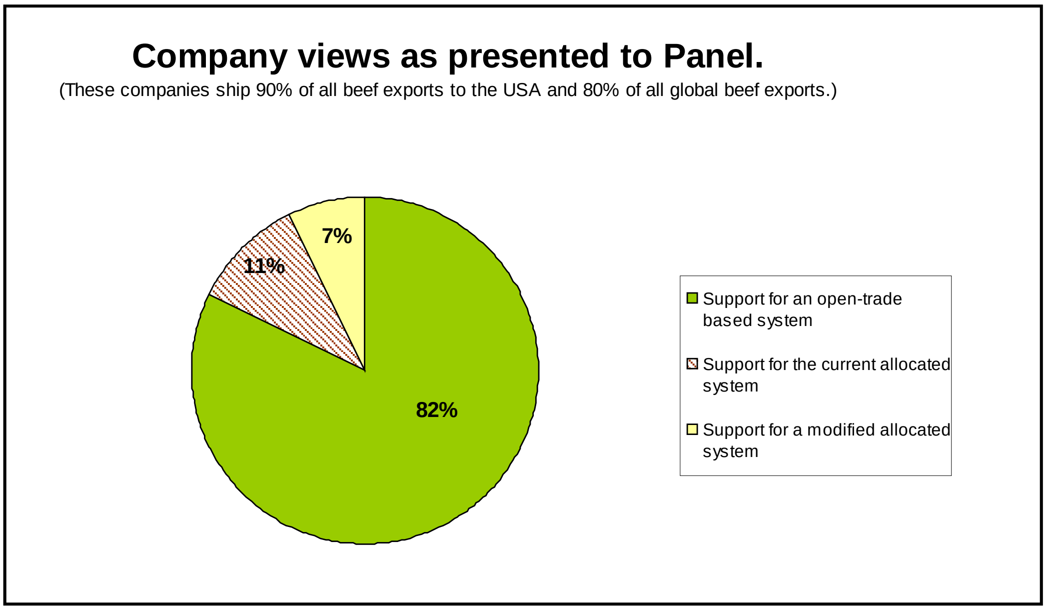

Figure 6: Company views

Companies supporting an open trade approach cover a broad range of business models. Many had strongly supported allocation during the negotiations in 2002. This particularly applies to US market specialists who sought a 100% US basis to allocations. Global companies preferred a 100% global basis. Although these companies remain polarised on this issue under an allocated system, most now consider that quota allocation at the commencement of the year is unnecessary.

The current allocation system is considered by the majority of companies to be inequitable and a distortion of trade. A globally diversified company stated the "current system creates 'preference' and does not deliver a 'free trade' environment to all accredited processors in the industry"[27]. A common theme was that companies feel compelled to export to the US to maintain quota entitlement rather than as a response to market signals; this can create significant distortions, potentially affecting returns to cattle producers.

By contrast, some companies (including three of the largest five exporters) argue the current system should be retained. These companies believe there is no need for a "company based allocation scheme when it is clear that the quota will not be filled"[28]. They also consider there is a strong chance the TRQ will be reached in at least one of the next three years. In their view the current system works well overall, and should continue because "the viability of our … beef business requires orderly access to the US market over 12 months of the year"[29]. They consider adjustment costs have already been met and "revised arrangements would result in additional costs and administrative problems"[30]. Some of these companies recognise imperfections in the current arrangements and argue for modifications such as increasing the share of global exports in the allocation formula or freeing up new entrant access.

[27] Kilcoy Pastoral Company Limited submission to the 2005 QRP
[28] Australian Meat Holdings Pty Ltd submission to the 2005 QRP
[29] Australian Meat Holdings Pty Ltd submission to the 2005 QRP
[30] Australian Meat Holdings Pty Ltd submission to the 2005 QRP

All companies supporting the 'status quo' argue uncertainty inherent in a mid-year introduction or suspension of an allocated system can cause speculation that results in surges (a 'gold rush') and uneconomic use of the quota, thereby distorting the market. Unallocated access in the early part of a year could also damage those plants that peak later in the shipping year and are committed to supplying US customers on a regular basis. One of these companies considered the consequences of turning off the system for a whole or part year are "more damaging to the industry than keeping the scheme in place"[31].

Submissions to the Panel on preferences for a management system broadly accord with industry discussions reported by AMIC (the Australian Meat Industry Council). In January 2005, AMIC conducted a member survey on three options: the 'status quo', and both variants of the unallocated Larkin Model. The results of the AMIC survey are indicated in Table 5.

Table 5: AMIC member survey on the basis for quota allocation

	Status Quo	Larkin Model	Larkin 80:20 Model	Total
No. of companies	**5**	**25**	**8**	**38**
% of total respondents	**13.16**	**65.79**	**21.05**	**100.00**

Notes:: 1. The raw survey results including companies with more than one vote were as follows:

Status Quo	Larkin Model	Larkin 80:20	Total
9	30	9	48

2. While company support for the Status Quo in the survey represented 13.16% of the total results, they represented commercially at least 15 plants as per the 2003 Top 25 Processor Survey, and close to 43% of total beef production.
3. The group also represented approximately 57% of actual quota beef shipments to the U.S. in the 2004 quota year.

Source: AMIC Submission to the 2005 Beef Quota Review Panel

Although AMIC did not provide recommendations on an appropriate management model for the future, it confirmed and supported an industry-wide position that "if we are not going to fill the quota then we don't need a quota scheme" or a "company-based allocation".

Other industry representative bodies expressed a range of views in their submissions. The Cattle Council of Australia (CCA) believes that models for quota management such as Larkin and Quilty appear compatible with CCA principles and may "fulfil industry's requirements most fully"[32]. The CCA also considers it is likely the Larkin Model will receive wide industry support from a number of producer bodies. The ALFA is in favour of an allocated system, citing MLA forecasts that suggest the TRQ may be filled at some stage in the next few years. The Australian Beef Association strongly believes quota should not be allocated because the TRQ is unlikely to be filled in the foreseeable future and it is inconsistent with competition principles.

[31] Teys Brothers (Holdings) Pty Ltd submission to the 2005 QRP
[32] Cattle Council of Australia, letter dated 7 June 2005

However, it does consider if an allocation scheme is retained it should not be based on a 100% global export record[33].

5.3. Administrative agency

Administration is currently undertaken by the Quota Administration Unit of the Department of Agriculture, Fisheries and Forestry.

A few participants in the review process argued quota management would be more appropriately handled by industry itself through either MLA or AMIC. However, the majority of industry appears to be comfortable with the current administration of the quota by DAFF, with some adding that industry would be unable to take on this role because commercial positions would militate against consensus.

[33] Australian Beef Association submission to the 2005 QRP

6. Analysis of quota administration options

This section summarises the Panel's evaluation of options for TRQ administration in future years against the Principles set out in *Section 3*. The Panel also considered industry perspectives (*Section 5*) and those of market and economic analysts.

The Panel identified the following quota administration options:

- <u>Current</u> annual allocation
- <u>Modified</u> annual allocation
- Annual allocation with a <u>low-fill suspension trigger</u>
- <u>No quota allocation</u> ('first come first served' until TRQ filled)
- No allocation with a <u>high-fill trigger</u> to introduce allocation.

The Panel also discussed the notion of auctioning some or all of the TRQ (as did the 2002 QMP) [34]. An auction mechanism, at least in theory, would be capable of distributing the TRQ quantity in an economically efficient manner, so to maximise any benefit flowing from it to the Australian community[35]. Auctioning has little or no support within industry or government and has not been considered further.

6.1. Current annual allocation

The current quota scheme is outlined in Table 4 of *Section 5* above. Allocations are made to exporters each year on the basis of the previous three years' shipping volumes with 80% weighting given to US shipments and 20% to global.

Principle 1: Minimise government intervention

The current arrangements involve a high level of government intervention. Regulations govern access to quota and limit the amount of product individual companies can export to the US under the TRQ. Such arrangements are warranted only when it is evident they will significantly enhance the competitiveness or value of the market and the benefit to the Australian community. This may be the case where the TRQ level is regularly reached and limits Australian supply, processing and export decision making.

Recognised issues associated with marketplace regulation include distortions, inefficiencies and anti-competitive effects (*Section 3*). The Panel notes a number of industry participants have stated the current system does have these impacts on their business operation and development and on the maximisation of commercial returns.

The Panel considers a regulated annual allocation scheme might be beneficial if a sustained period of TRQ fill were forecast but any benefits potentially arising would need to be examined against regulatory costs and effects. A number of companies support the retention of current arrangements on the basis that it allows for the orderly conduct of trade each year. However, it is noted the US beef market is predominantly commodity-based and characterised by shorter term trading arrangements.

[34] Quota Management Panel, *Quota Allocation Arrangements for Beef Exports to the US – Year 2002 and Beyond*, October 2002.
[35] Industry Commission, *Report on Meat Processing*, 1994

The Panel also recognises the demonstrated capacity of industry including producers, processors of all types and trading agents to operate and compete in a range of market conditions. A number of long standing industry members, through the histories of their enterprises and their submissions to the Panel, have highlighted this. Innovation and competitiveness on all fronts is vital for the Australian beef industry and its participants. Arguments such as the need to protect capital investments are reminiscent of the thinking of earlier decades. MLA reinforced this in a recent publication with the observation the "US meat-processing sector is a good predictor of what may happen to Australian processors who fail to change. Alarmingly, only three or four key players now dominate the US market" [36].

Principle 2: Optimise the TRQ's commercial value to Australia

The introduction of quota controls in 2003 appears to have influenced beef shipping patterns to the US; month-on-month aggregate shipment volumes are more regular and export volumes peaked notably later in the 2003 and 2004 years (Figures 2 and 3 in *Section 2*). The Panel identified no single explanation for this shift but notes the current scheme at times provides incentives to use the TRQ in a non-commercial manner.

The scheme calculates future year quota allocations on the basis of about 88% of shipments to the US, averaged over the three previous years (*Section 5*). These two elements can encourage companies to maintain exports to the US year-in year-out, even where there are higher returns from selling to Japan, Korea or elsewhere, or domestically. As 'quota driven sales' to the US are likely to take place to some extent each year, Australian or other export consumers and/or Australian cattle producers will be cross-subsidising US consumers.

In addition, as the 2002 Senate Committee Inquiry noted, allocations based on historical records relate to past market conditions and do not necessarily reflect a company's current commercial capacity to use any quota allocation effectively[37]. A number of industry participants addressed this issue in submissions to the Panel. Although using a three year average dampens the effect of one-off sales designed to boost future quota allocations (as the effect is reduced by two thirds) patterns suggest such sales in the 2003 and 2004 quota years.

The current 80/20 US/Global formula was structured in part in response to arguments presented during 2002 that a quota allocation system should offer support for market diversification. As noted in *Section 3*, this Panel agrees with the 2002 Panel's assessment that diversification should come about through operation of a marketplace with minimal distortions or obstacles.

Another level of marketplace distortion arises from the current formula. Those highly dependent on the US manufacturing beef market have a comparative disadvantage to global exporters. The current 20% global element increases their costs as they must acquire quota early even when the TRQ is ultimately not filled (and sometimes at premium prices) from companies receiving a 'global' allocation but not using it. This

[36] MLA *Feedback*, 'Australian meat processor face need for change', Jan 2005 p10

[37] Senate Rural and Regional Affairs and Transport Legislation Committee, *The Australian Meat Industry Consultative Structure and Quota Allocation. Interim Report: Allocation of the US Beef Quota*, September 2002

is a cross-subsidisation of exports to destinations outside the US and also penalises US specialists.

Principle 3: Minimise barriers to exporting

The current arrangements limit the ability of companies to enter the US beef market and can also constrain entry to other export marketplaces; the result is a reduced capacity for the TRQ to be used and filled in an optimal manner. Contributing factors include the following.

Tradability

Records show that quota trading between companies (as distinct from intra-company transfers) has occurred each year, including around 49 000 tonnes in 2004 (or 13% of the total TRQ). The Panel acknowledges that tradability can be a mechanism for redistribution of allocated quota to those who can use it most efficiently. However, the current tradability provisions are not operating as intended by the 2002 Panel.

From submissions and discussions with industry participants the Panel ascertained the level of fluid trading required is inadequate to enable this secondary market to function effectively. Quota ‘lending’ is common, although this was not intended in the 2002 Review. The Panel notes that incentives for quota-driven sales and arrangements to retain ‘performance’ for the next year also influence decisions to loan, or keep quota until the withdrawal date. This will reduce the portion of quota allocated on the basis of global shipments available for outright purchase.

In addition, under current arrangements, companies highly reliant on the US market need to acquire essential quota early each year. Available quota flows to these purchasers but increases their operating costs even if ultimately the TRQ is not filled. These trades reduce the amount of quota available for acquisition by new entrants or expanding businesses. Estimates from across the industry suggest only around 10 000 tonnes of quota was available in 2004 or 2005.

The secondary quota trading market is also influenced by annual allocation. The value of quota is cyclical; it increases as the year progresses to a point prior to the redistribution of uncommitted amounts, after which it has no value. Companies that can sell quota have an incentive to delay sales to inflate prices. This influences availability (or conversely, the ‘stickiness’ of quota) throughout the year.

Uncommitted amounts

The current system for redistributing uncommitted quota is also a barrier to optimising TRQ usage. Unused quota allocations lapse and are withdrawn for redistribution on 29 October each year. There are no incentives to hand back quota earlier or penalties for not using quota. ‘Stickiness’ of quota and late release of unused quota restricts the ability of others to use it effectively. Potential access to unused quota late in a year also does not provide a basis for development or expansion of plants. The Panel noted the 2004 TRQ underfill of 6 000 tonnes is about the size of Australia’s eighth largest beef market, or the output of a sizeable processing plant.

New entrants

In theory, under the 2002 current arrangements new entrants would obtain quota by developing an export record through sales to non-US markets, by purchasing quota and/or by accessing uncommitted amounts towards the end of each quota year. For reasons discussed in the sections above, the Panel concludes that this mechanism is not working as intended and, it is understood from submissions, is now restricting aspiring new entrants and expansion plans.

Minimum allocation

Current arrangements limit quota allocations to twelve tonnes and over. Companies must export above a threshold of 100 tonnes per year for three years to destinations other than the US before they can receive any TRQ allocation. The twelve tonnes is based on a shipped container of beef. However, once the minimum of twelve tonnes is reached, quota allocations are made to companies to the nearest kilogram and holders may request TRQ Certificates from DAFF for export in small quantities.

The Panel considers this rule is an unnecessary barrier to the US market and TRQ access for some companies. Emerging business models, including the export of high-value produce in small volumes using air freight, are being encouraged through policy and investment strategies such as the Australian Government’s New Industries Development Program (NIDP). These should not be discouraged or stopped by any quota arrangements.

The current procedure of allocating quota to ‘shipper of record’ (exporter) rather than processor of record has been examined. If quota is to be allocated, the Panel considers it should be allocated to exporters. This arrangement is administratively efficient and equitable because beef processors can become registered exporters.

Principle 4: Consider commercial arrangements

The Panel recognises commercial arrangements in the export beef industry have been developed over a long period, many well before the introduction in 2003 of the TRQ administrative arrangements. When this system was introduced it had impact on some commercial arrangements but generally industry has adapted to the changes. This was facilitated by the US market being highly competitive, contracts shorter term, and world market signals directing the flow of product to overall commercial and national benefit.

The introduction of quota allocation in 2003, and the 80/20 formula also meant some companies received ‘windfall’ allocations of US TRQ quota that they could sell. The Panel does not see these as ‘existing commercial arrangements’.

Principle 5: Administer consistently, transparently and efficiently

The Panel considers current arrangements are appropriately administered by the Quota Administration Unit.

Conclusion

The Panel understands the 2003 quota allocation scheme was a considered and practical model in the context of market conditions and industry expectations in 2002. These arrangements were designed to achieve effective use of the TRQ. Changed market conditions, distortions and their consequences mean the current scheme is not achieving intended outcomes.

This Panel considers the current model is not appropriate for the next five years and beyond for reasons identified above.

6.2. Modified annual allocation

This option assumes an annual allocation will continue but with a number of modifications to the current system which aim to address some of the issues identified in 6.1 above. These could include changes to the following:

- *Allocation reference years:* from a three year rolling average to one or two years to reflect changing capacities of companies, and to enable competitive companies to earn quota allocations more quickly through active exporting.

  It may be necessary to establish discretionary provisions to cover special circumstances. This could reduce allocations to other participants, increase administrative costs and introduce discretionary, political processes.

- *Allocation base records:* changing the weighting given to US exports in the allocation formula to assist some exporters (but disadvantage others).

  This may give greater weight to global shipments and allocate more quota to companies exporting to non-US markets; it would also increase the amount of quota that US specialist companies must purchase. A move to 100% US exports as the quota basis will eliminate this effect but exclude new entrants. The addition of out-of-quota exports to the US (if any) would improve the position of US specialists but the tariff cost penalty is high.

- *New entrant provisions:* setting aside an effective quantity of TRQ each year (say 20 000 tonnes) for distribution to new entrants or for expansions.

  This might overcome some access barriers but would introduce efficiency and discretionary decision making problems (including an increase in government intervention) and would reduce the allocations of existing quota holders.

Conclusion

The Panel considers modifications to the current system cannot resolve identified problems without creating countervailing difficulties. This option would likely increase government intervention while not advancing the delivery of appropriate, effective and efficient quota administration.

6.3. Annual allocation with a low-fill suspension trigger

Under this option annual allocations would be made to companies but the regulatory scheme would include a mechanism to suspend quota controls part way through the year if predetermined criteria are met. Once allocations were suspended, any exporter could apply for TRQ export certificates on a FCFS basis[38].

[38] In mid 2004 AMIC on behalf of many in the industry urged the Government to suspend the quota allocation system because it appeared likely the TRQ would not be filled that year. This option was not advocated in any formal submission, nor adopted by AMIC during its October 2004 workshop.

The option seeks to moderate the negative impacts of quota allocation in years where TRQ fill rate is low, allowing the market to function in response to demand and supply signals.

The Panel considers this approach allows for the extent of government regulation of TRQ usage to be varied, but does not reduce intervention. It could introduce lobbying about the decision to suspend the administration scheme.

In addition, for this option to work reasonably in optimising the commercial value of the TRQ to Australia, the allocation criteria would need to be modified to address identified issues with the current arrangements, including distortions and barriers to export. It will be administratively (and perhaps commercially) more complex.

Conclusion

The Panel reiterates that government intervention in the market should be considered only where there is need and benefit. It is not evident that these will be met in this model. There was also no support for this option in any industry submission.

6.4. No quota allocation (first-come first-served until TRQ filled)

Under this option the market would operate freely, with approvals to ship being issued on a FCFS basis until the TRQ is reached. This situation existed between 1995 and 2002. Once the TRQ is reached product which enters the US will require payment of the relevant *ad valorem* tariff.

All those presenting views to this Panel indicated a preference for an open market approach and a number stressed that the meat industry is well-versed in handling market risk. Many stated that an open market would operate most effectively when it is clear the TRQ will not be filled. The TRQ then becomes a limit on the overall market for Australian beef into the US.

If administrative procedures for acquiring TRQ certificates are clearly defined, market signals should steer commercial decision making; distortions from the quota system should not then occur. There would be no in-built incentive for companies to export to the US to retain or expand quota allocations for later years, nor would it favour particular business models. The Panel considers no allocation reduces the impact of non-market influences on company behaviour where exporting is not limited by the TRQ.

The Panel also recognises that not allocating quota minimises restrictions on an individual company's capacity to export to the US and other markets. Decisions to export to the US, including investment in production or processing capacity, will be directed by efficient, competitive and sustainable business practices and innovation in each should also be rewarded. This will assist in optimising the value of Australian beef exports to the US because companies, including new entrants, will not face barriers that occur in allocated systems, such as the cost of purchasing quota.

The Panel notes the current allocation system has only operated since 2003 and many existing commercial investments and arrangements reflect decisions taken prior to 2002. Over the last few decades, beef exporting firms have operated under both periods of open trade and quota allocation systems. Companies, larger ones particularly, are best placed to make adjustments to accommodate changing circumstances.

In effect, this option is a return to the pre-2003 TRQ administration. An annual allocation system may on the face of it provide some companies with sufficient quota for a more orderly platform for their business. As indicated in *Section 6.1* others will face obstacles in pursuing current or new commercial arrangements. A return to non-allocation will change the market environment, but the Panel considers the industry and companies within it have demonstrated capacity to make adjustments as needed.

An open market model should simplify administrative arrangements as the administrators will only need to issue TRQ export certificates, monitor progress of beef exports against the TRQ limit and issue invoices for cost recovery. Although invoicing costs could increase as they would be based on shipments not annual allocations, there would be no requirement to calculate quota allocations, monitor and approve quota transfers or deal with unused quota allocated to individual firms. Transaction costs for many individual firms should also be reduced through removal of the need for quota purchases, transfers and associated commercial negotiations. The Panel also considers administration of this option would be simpler than current arrangements, more transparent and have few if any discretionary elements.

Conclusion

Overall, no allocation of TRQ to companies would be the optimal administrative approach where the TRQ is unlikely to limit beef trade to the US.

However, if TRQ fill is approached during the year there may be rushes to use TRQ, with distorting effects on the market and commercial decisions hence the potential for reduced returns to the Australian economy. Government intervention may be sought to smooth access to TRQ before the limit is fully reached.

As there is some uncertainty about future TRQ fill rates (*Section 4*), the Panel considers non-allocation alone would be inappropriate. There is a need to provide for situations when TRQ fill becomes probable.

6.5. No allocation with a high-fill trigger

Under this option each TRQ year would commence with no allocation of quota to individual companies. Shipping approvals would be issued on a first-come first-served basis. The system would include a specified mechanism for triggering allocation arrangements when it becomes evident the TRQ will be filled that year. A final portion of the TRQ would be allocated in accordance with predetermined rules. Such a model was strongly advocated in submissions received by the Panel and has the support of a large number of processing and exporting companies plus some industry associations on behalf of their members (*Section 5*).

The Panel considers this option should deliver the benefits associated with an unallocated system (as outlined in option 4) and avoids the major issues associated with an allocated system.

Option 5 (no allocation/high fill trigger) should provide Australian companies with greater certainty about the rationing of the remaining TRQ as year end approaches.

This should enable companies to plan subsequent business activities and manage any potential effects by utilising ‘carry-over’ tools well established in the industry.

If quota allocation is triggered, administrative costs would be higher than option 4. However, administrative offsets during the main part of the year should mean costs are likely to be lower than those associated with current arrangements.

The Panel considers option 5 will maintain minimal government intervention through non-allocation of quota and open trade up to the high fill trigger point if reached. The existence of clear post-trigger administration arrangements should be beneficial to the community and industry by moderating uncertainty and distortionary behaviour if TRQ fill appears likely.

The Panel considers a no allocation/high fill trigger model will optimise returns to industry participants when TRQ fill is not expected, but will also provide acceptable rules to accommodate periods of high fill if they occur. Such a model should be effective over the next 18 years.

7. Recommended TRQ administration

Based on market projections (*Section 4*) the Panel considers the TRQ is unlikely to be filled in the foreseeable future (2006-2010). With reference to the principles in *Section 3,* and to industry submissions (*Section 5*), the Panel recommends the beef export market to the US should be allowed to operate as freely as possible. This will optimise Australia's utilisation of the TRQ and returns from all markets.

The Panel believes an open market approach (options 4 and 5) offers important advantages over current arrangements or a modified allocation scheme by:

- minimising government regulatory or discretionary involvement in the marketplace **(principle 1)**
- ensuring market signals are clear and the potential for distortions is minimised, to optimise commercial use of the TRQ value **(principles 2 and 3)**
- ensuring new entrants or expanding businesses are not restricted from competing in the US beef market (**principle 3**)
- providing access to TRQ to all exporters irrespective of location (as was the case from 1995 to 2001) to minimise obstacles to exporting and effects on established commercial relationships **(principles 3 and 4)** and
- potentially reducing industry compliance and government administration costs vis-à-vis an allocated system **(principle 5)**.

The Panel recognises there is a degree of uncertainty about beef export projections and filling of the TRQ in later years (2008 and beyond). The Australian industry has demonstrated its capacity to manage commercially in a dynamic marketplace but TRQ access arrangements continue to be debated. In these circumstances, the Panel considers a safeguard is warranted and option 5 (no allocation/high fill trigger) would have advantages over option 4.

The longer the period that exporters are able to operate in an unconstrained manner, the better the market will work. Although there is a possibility the allocation system will be triggered in some years, this is outweighed by the benefits of allowing the market to operate freely for as much of the time as possible.

The Panel also considers:

- TRQ exports to the US should not be viewed simply in twelve month cycles. The industry has the capacity to smooth export operations over time to manage regional supply variations and seasonal conditions, and to deal with US entry arrangements.
- An early allocation trigger that might prompt companies to rush to fill TRQ is not operating in the best interests of industry or the economy. A range of commercial decisions can be made if the TRQ is close to being filled later in the year, including delayed shipments and bonded storage.
- Participants have advised that industry is able to manage a 10 000 to 15 000 tonnes buffer of US product at year end, prior to the new TRQ year. Exporters should continue to take responsibility for managing marketplace variability.

A no allocation high fill trigger arrangement (option 5) will align with the majority industry desire to be allowed to operate freely as it has done for most of the preceding period. The Panel notes an unallocated model with safeguard is advocated by the majority of exporting and processing firms within the Australian industry. The recommended system should be resilient to market dynamics over the next 18 years.

7.1. Recommended model – no allocation with high fill trigger

The key features follow.

7.1.1. No company allocations at the commencement of a quota year

For reasons set out in the sections above, the market should operate freely without government intervention or discretion. Exporters can apply for TRQ certificates on a FCFS; the beef industry operated under similar conditions through most of the 1990s.

7.1.2. A mechanism to smooth access to the TRQ if the limit is likely to be reached

- **The safeguard would trigger if TRQ shipments to the US reach 85% of the TRQ based on certificates issued on or before 1 October in any quota year (the high fill trigger).**

  If the high fill trigger is not reached by this date open trade will continue. If triggered, the remaining 15% of the TRQ will be allocated to exporting companies. For example, in 2006, 56 732 tonnes will be allocated if 321 482 tonnes are shipped on or before 1 October. In 2007 with the additional AUSFTA amounts, 59 732 tonnes will be allocated if 338 482 tonnes are shipped by 1 October.

  Before deciding on an 85% fill trigger, the Panel reviewed a range of possible settings with variable timings, quantities and multiple trigger points, including those detailed in the Larkin and Quilty models, and the Hunt Group submission.

  The Panel considers a single 85% trigger by 1 October best meets the objective of allowing the market to operate as freely as possible while retaining a mechanism to manage a sizeable quantity of TRQ if the need arises. The amounts that will be managed after the trigger in future years are shown in Table 6.

Table 6: Allocation amounts where TRQ triggered

Year	TRQ (tonnes)	Trigger level (85% of TRQ)	Volume to be administered
2006	378 214	321 482	56 732
2007	398 214	338 482	59 732
2008	398 214	338 482	59 732
2009	402 214	341 882	60 332
2010	402 214	341 882	60 332

Appendix 4 sets out exports to the US for the past three years; at an 85% high fill trigger point, allocations of 15% would have occurred in 2002 and perhaps 2003.

The Panel considers the use of multiple trigger points would add substantial complexity to administrative processes without preventing manipulation to trigger an allocation system early in the year.

An 80% trigger point at 1 October, as advocated in the Larkin model, would have the potential to leave quota unused in a year where demand was strong. Also, historical data indicates an 80%/1 October trigger would have been activated even in years where the TRQ was not filled.

The Panel evaluated the concerns of some companies that northern plants could be disadvantaged in the early part of the year under an unallocated system because production and processing slow down in summer. Export data indicates:

- in absolute terms, the production capacity of northern plants is much greater than that of southern plants (Figure 7) and northern plants ship a lower proportion of their exports from January to March
- some northern companies compensate for lower shipments early in a quota year by shipping larger amounts in November and December, some for entry into the US in the next quota year
- seasonal production also affects southern plants but in the middle of the year and
- exports from the south during the first quarter of the year (i.e. the northern low production period) are on average half the exports of northern plants.

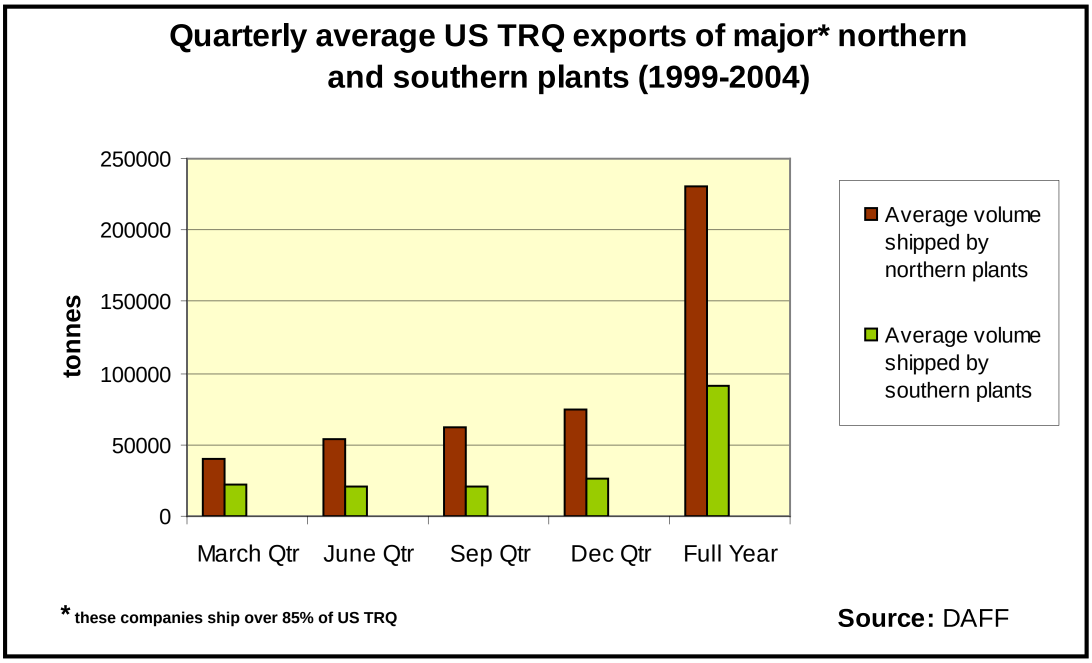

Figure 7: Northern and southern beef production patterns

- **If 85% of the TRQ is not reached by 1 October then quota will not be allocated**

  Under these circumstances, the marketplace is free to determine optimum quota fill on a commercial basis. There will be no distortion of market access due to 'stickiness' of unused quota, new entrants will have access to the TRQ, and entitlements will not be constrained by an allocation mechanism in years when the quota is not filled. The compliance and administrative costs are minimised and the winners and losers issue is virtually eliminated.

- **Companies will be informed of a Provisional Trigger Allocation (PTA) in January each year**

  Advising companies of their PTA at the commencement of the quota year should assist end of year planning.

- **The PTA will represent an eligible exporter's proportion of 15% of the TRQ calculated on shipments to the US only, using a rolling two-year average.**

  A two-year average calculation should minimise distortions arising from potential 'gold rush' behaviour that concerns some companies. As only 15% will be allocated, any incentive to 'earn quota' (e.g. by diverting product from more lucrative markets) is reduced. A company exporting 5 000 tonnes per annum to the US would receive a PTA of about 750 tonnes. To increase this PTA to 900 tonnes two years later, that company will need to ship an additional 1 000 tonnes to the US each year, an unlikely decision just to earn PTA (which does not become 'quota' unless the high-fill trigger is reached).

  PTA should be based on US, not global shipments. PTA should not be allocated to companies that may have no interest in servicing the US market. In those years when allocations are triggered, demand for quota will be high and obstacles to access should not exist. All exporters, whether predominantly global or US focused, would have access to the US through the 85% of the TRQ available during the open trade period.

- **PTA calculations will be made on the basis of shipper-of-record**

  The Panel considered suggestions that allocation should be based on processor output but decided against change as processors have the option of obtaining export licences and engaging in the marketing of product.

- **If the high fill trigger is reached, companies will have ten working days from the trigger date to apply for quota allocations against their PTA**

  Applications will be made through the Quota Administration Unit in DAFF. Ten days is an adequate period given that industry will be aware of market circumstances and the likelihood of a trigger event. TRQ fill rates will be monitored with regular updates provided by DAFF.

- **Companies will be able to trade their PTA during the application period but the transferee will need to apply for an allocation by the tenth day**

  The Panel recognises the importance to industry of quota tradability and that quota should be able to flow where it is best utilised under any allocation scheme. This is particularly important in years where TRQ fill rates are high, as evidenced by the triggering of allocations.

- **Applications to convert PTA to quota will require evidence of intent to ship**

  This is a current requirement for the re-distribution of unused quota late in the year. On the eleventh working day, allocations will be confirmed and remaining TRQ will be available by application (supported by appropriate documentation). Bids in excess of available TRQ will be allocated *pro rata*. Checking applications and supporting documents should be the only point of administrative discretion in this model.

- **The minimum allocation for the PTA and quota will be 1 tonne**

  TRQ certificates will continue to be issued for smaller quantities.

- **A penalty should apply for non-use of allocated quota**

  It is important that companies receiving post-trigger quota allocations make full use of it. The Panel considers an amount equivalent to the unused portion of allocated quota be deducted directly from the company's PTA the following quota year.

7.1.3. Administrative agency

The TRQ should be administered by the Australian Government. TRQ certificates for manufactured beef should be first issued against the AUSFTA component of the overall TRQ.

7.1.4. Commencement date

These arrangements should take effect from 1 January 2006 with the industry notified as soon as possible.

7.2. Overall conclusion

The Panel is confident these changes to the administration system will be supported by most industry participants. It is a model that allows a dynamic processing sector to operate in an unconstrained market driven manner to optimise the return from the TRQ until 2023 when the AUSFTA effectively removes the TRQ limitation.

Imperfections inherent in an allocation-based regulatory system will largely disappear, administration of the TRQ will be simpler, and there will be better market outcomes.

Appendix 1: List of submissions

(This list relates to those whose submissions were directly related to the US beef quota review).

- Australian Beef Association
- Australian Lot Feeders' Association
- Australian Meat Holdings Pty Limited
- Australian Meat Industry Council
- Bindaree Beef
- Burrangong Meat Processors Pty Ltd
- Cargill Beef Australia
- Cattle Council of Australia
- Certified Australian Angus Beef Pty Ltd
- Fletcher International Exports Pty Ltd
- Greenmountain Trading Co. Pty Ltd
- Hunt Partners – on behalf of the Free Trade Quota Group
    - Bindaree Beef Pty Ltd
    - E C Throsby Pty Ltd
    - Fletcher International Exports Pty Ltd
    - H W Greenham & Sons Pty Ltd
    - Homebush Meat Export Co Pty Ltd
    - John Dee (Export) Pty Ltd
    - Kilcoy Pastoral Company Limited
    - Liberty Meats
    - Midfield Meat International Pty Ltd
    - Monbeef Pty Ltd
    - Norvic Food Processing Pty Ltd
    - OBE Beef
    - Ralph Meat Company
    - Riverina (Australia) Pty Ltd
    - Stanbroke Beef Pty Ltd
    - Stockyard Pty Ltd
- Hunt Partners – on behalf of the Market Specific Quota Group
    - H W Greenham & Sons Pty Ltd
    - Monbeef Pty Ltd
    - Midfield Meat International Pty Ltd
    - E C Throsby Pty Ltd
    - Bindaree Beef Pty Ltd
- H W Greenham & Sons Pty Ltd
- John Dee Exports
- Kilcoy Pastoral Company Limited
- Liberty Meats
- Monbeef Pty Ltd
- Nippon Meat Packers Australia Pty Ltd
- Northern Co-operative Meat Company Ltd
- P & M Quality Smallgoods (Primo)
- Q-Exports International Pty Ltd
- Riverina Australia
- Stanbroke Beef Pty Ltd
- Tasman Group Services Pty Ltd
- Teys Bros (Holdings) Pty Ltd
- W.A. Meat Exports Pty Ltd

Appendix 2: Australia's top ten beef export markets by value

AUSTRALIA'S TOP 10 BEEF MARKETS

2005 (J-M)		
COUNTRY	A$M	TONNES
Japan	569.44	103,243
USA	223.11	61,067
Korea	144.00	32,669
Taiwan	25.83	5,563
EU-25	10.98	1,269
Indonesia	8.63	2,046
Hong Kong	6.20	653
Canada	4.44	1,122
Singapore	4.09	448
UAE	3.75	342
Sub Total	1,000.47	208,422
Remainder	24.99	6,887
Total	1,025.46	215,309
Top 10	98%	97%

2004		
COUNTRY	A$M	TONNES
Japan	2,252.89	405,695
USA	1,409.73	356,340
Korea	483.88	104,454
Taiwan	127.20	27,131
EU-25	65.57	7,049
Canada	38.23	7,667
Indonesia	31.55	8,459
Hong Kong	28.73	2,565
Singapore	21.54	2,600
Malaysia	18.50	7,362
Sub Total	4,477.82	929,322
Remainder	134.86	32,308
Total	4,612.68	961,630
Top 10	97%	97%

2003		
COUNTRY	A$M	TONNES
USA	1,356.55	374,648
Japan	1,388.09	280,059
Korea	270.78	67,307
Taiwan	128.97	31,657
Canada	114.76	30,017
EU	50.00	5,587
Indonesia	49.67	16,887
Philippines	27.25	10,202
Malaysia	21.32	9,407
Mexico	19.25	5,108
Sub Total	3,426.64	830,879
Remainder	176.73	41,063
Total	3,603.37	871,942
Top 10	95%	95%

2002		
COUNTRY	A$M	TONNES
USA	1,598.80	387,101
Japan	1,242.92	237,984
Korea	331.61	83,282
Canada	318.15	82,328
Taiwan	152.38	34,377
Indonesia	61.00	19,322
EU	56.45	6,816
Philippines	41.40	14,735
NZ	37.00	9,836
Malaysia	30.00	11,021
Sub Total	3,869.71	886,802
Remainder	246.53	60,872
Total	4,116.24	947,674
Top 10	94%	94%

2001		
COUNTRY	A$M	TONNES
Japan	1,730.61	319,694
USA	1,714.69	410,228
Korea	257.34	63,829
Canada	195.74	48,719
Taiwan	133.40	29,425
Philippines	56.70	19,999
EU	51.78	6,914
Indonesia	48.64	12,852
Mexico	30.80	6,497
Malaysia	24.01	8,160
Sub Total	4,243.71	926,317
Remainder	236.52	45,935
Total	4,480.23	972,252
Top 10	95%	95%

2000		
COUNTRY	A$M	TONNES
Japan	1,517.05	321,434
USA	1,207.54	362,786
Korea	241.84	80,207
Canada	144.53	40,473
Taiwan	122.27	29,926
EU	58.24	8,708
Indonesia	45.95	15,220
Philippines	38.03	15,854
Malaysia	21.52	7,907
Mexico	21.32	5,835
Sub Total	3418.29	888,350
Remainder	148.84	39,913
Total	3567.13	928,263
Top 10	96%	96%

1999		
COUNTRY	A$M	TONNES
Japan	1391.43	318,558
USA	827.00	299,045
Korea	196.29	75,854
Taiwan	124.97	35,230
Canada	120.32	40,791
EU	74.31	10,760
Philippines	41.15	21,768
Indonesia	35.41	12,557
Uzbekistan	19.72	8,884
Malaysia	19.44	7,262
Sub Total	2850.04	830,709
Remainder	146.11	46,144
Total	2996.15	876,853
Top 10	95%	95%

1998		
COUNTRY	A$M	TONNES
Japan	1323.32	324,384
USA	749.57	290,240
Canada	110.12	40,550
Taiwan	109.16	34,098
EU	94.54	17,768
Korea	93.60	35,589
Russia	53.55	22,315
Philippines	42.31	20,827
Hong Kong	27.46	7,250
Iran	23.42	6,416
Sub Total	2,627.05	799,437
Remainder	206.06	77,324
Total	2,833.11	876,761
Top 10	93%	91%

1997		
COUNTRY	A$M	TONNES
Japan	1223.00	317,124
USA	507.07	223,970
Korea	139.13	58,837
Taiwan	113.05	35,164
EU	76.64	15,103
Canada	76.00	32,987
Indonesia	60.29	24,793
Philippines	53.54	27,969
Russia	27.45	12,540
Singapore	21.04	6,798
Sub Total	2,297.21	755,285
Remainder	147.65	60,309
Total	2,444.85	815,594
Top 10	94%	93%

1996		
COUNTRY	A$M	TONNES
Japan	1091.35	283,078
USA	357.93	181,923
Korea	139.68	59,789
EU	76.16	15,586
Taiwan	63.72	23,629
Canada	62.30	30,341
Indonesia	41.71	17,108
Philippines	37.78	21,204
Poland	18.80	9,793
Hong Kong	18.34	4,921
Sub Total	1,907.77	647,372
Remainder	135.99	60,405
Total	2,043.76	707,777
Top 10	93%	91%

1995		
COUNTRY	A$M	TONNES
Japan	1533.70	318,871
USA	514.83	220,069
Korea	172.90	65,264
Taiwan	111.65	30,771
Canada	81.00	32,917
EU	66.00	11,361
Indonesia	31.10	10,539
Philippines	31.07	15,458
Hong Kong	22.27	5,368
Singapore	20.19	5,756
Sub Total	2,584.71	716,374
Remainder	105.26	48,499
Total	2,689.97	764,873
Top 10	96%	94%

Source: ABS

Appendix 3: Quota rent

The concept of 'quota rent' arises often in discussion of quota administration schemes. Quota rent can be described as the price preimum that companies can obtain by being able to access a particular marketplace at a low in-quota tariff while the price in the market is higher.

Quota rent from the TRQ is available only where US import demand is sufficiently strong that the desired volume of exports from Australia will exceed the TRQ. Faced with restricted supply buyers in the US will be prepared to bid up prices to secure product.

Under a tariff quota, such as the US beef quota scheme, Australian exporters benefit from having access to the preferential tariff rate and, under certain market conditions, from the potential to obtain quota rent. These benefits are identified for three particular market cases:

- The quota is not binding
- The quota is binding
- Imports exceed the quota

Quota is not binding

In Figure 8 the import demand schedule for Australian beef in the United States is represented by DD. The quota is denoted by the fixed volume of imports, Quota, and the landed price of imported product is P (the preferential access tariff under the Australia-United States FTA is zero). In this case the United States import the quantity OM at import price P. In the absence of the tariff quota, the import price would be Pto because the MFN tariff rate (out-of-quota tariff) would apply. At that price imports would be OQ1, much less than under the tariff quota. While importers in the United States would pay Pto, Australian exporters would receive the price, P. Therefore, having access to the preferential tariff means that Australian exporters benefit from being able to export an additional quantity Q1M at price P. In this situation import demand is not strong enough to fill the quota and no quota rents are available.

Benefit

- *Rent:* none
- Increased exports: Q1 to M

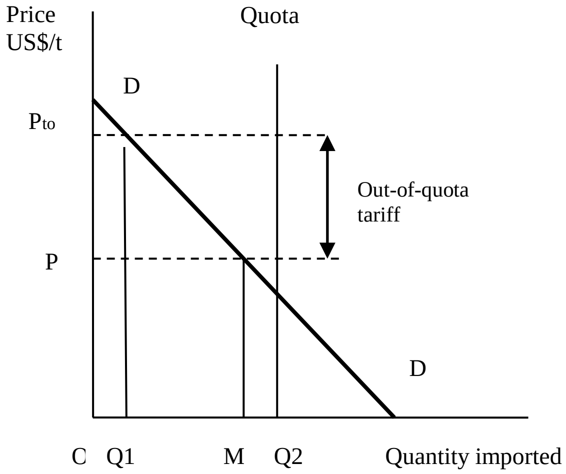

Figure 8: Potential for rent where quota is not filled

The quota is binding

For the market situation where the quota is binding (Figure 9) Australian exporters can potentially capture quota rent as well as gaining the benefit of having access to the preferential tariff. Demand is sufficiently strong so that the desired volume of imports exceeds the quota constraint. At the landed import price, P, consumer demand for imports is OQ3, a quantity that exceeds the quota volume. The quota acts to limit supply in the domestic market and, as a result, buyers in that market bid up prices to secure product. Imports fill the quota volume, OM, and the price consumers are willing to pay is Pq. The quota rent that potentially can be captured is the difference between Pq and the landed price for the imported product multiplied by the quota (indicated by the shaded area).

Without the tariff quota, exporters would face the MFN tariff rate (over-quota tariff) and the import volume would be OQ1. In this case, the preferential access tariff confers a benefit to exporters by allowing additional exports, Q1M.

Benefit

- *Rent*: (Pq-P)*OM
- *Increased exports*: Q1 to M

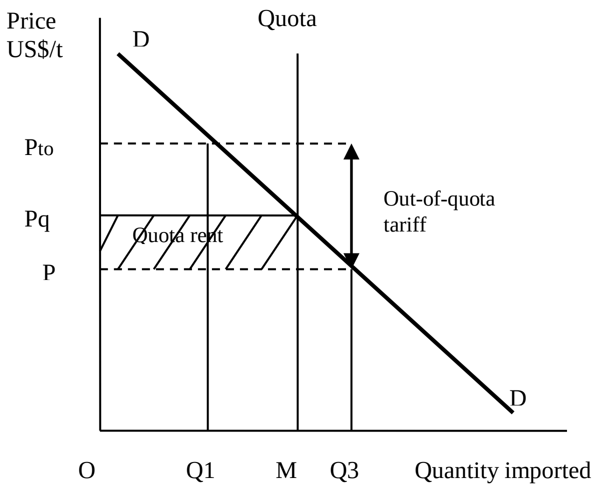

Figure 9: Potential for rent where quota is filled

Imports exceed the quota

When import demand is strong enough, beef is imported at the out-of-quota tariff rate and imports exceed the quota. In this case imports are OM and the price consumers pay Pto, the landed price of imports plus the out-of-quota tariff. Imports of beef above the quota volume that attract the out-of-quota tariff rate are Q2M. The price premium that can be captured by imports within the quota OQ2, will be the difference between the MFN tariff rate and the in-quota tariff rate (Pto minus P). The potential quota rent obtained in this case is indicated by the shaded area in Figure 10.

In this case having access to the preferential tariff confers no additional benefit to exporters.

Benefit

- *Rent:* (Pto-P)*OQ2
- *Increased exports:* none

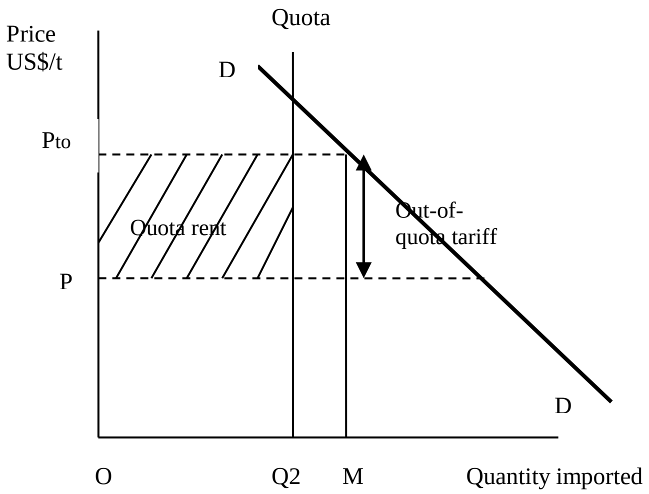

Figure 10: Potential for rent where imports exceed the quota

NB: Appendix 3 supplied by ABARE

Appendix 4: Australian beef to the US based on TRQ certificates issued

Month	Week	2002 YTD Total (tonnes)	2003 YTD Total (tonnes)	2004 YTD Total (tonnes)	2005 YTD Total (tonnes)
January	1		57,026	48,871	23,847
	2		61,649	52,104	28,206
	3		66,238	55,669	31,994
	4		70,615	58,997	34,494
February	5		78,260	63,741	40,204
	6		84,694	66,682	44,092
	7		89,276	73,350	45,952
	8		95,664	79,050	52,270
March	9		101,856	85,107	61,408
	10		108,456	90,684	69,125
	11		114,016	96,317	75,131
	12		122,031	101,221	81,047
April	13		127,397	109,184	89,125
	14		135,712	114,511	97,179
	15		141,469	120,600	105,177
	16		148,157	127,436	111,698
	17		154,699	134,032	121,588
May	18		163,133	139,696	128,448
	19		170,573	147,070	136,405
	20		178,569	155,416	146,270
	21		184,142	163,824	154,796
June	22		193,239	172,177	163,800
	23		197,539	181,290	171,740
	24		206,581	186,626	181,382
	25		213,305	195,348	189,134
July	26	238,813	220,022	207,666	
	27	242,677	222,964	213,106	
	28	247,347	234,961	218,721	
	29	262,743	241,122	227,279	
	30	270,878	249,229	235,555	
August	31	278,350	256,862	244,523	
	32	286,143	263,756	253,055	
	33	290,356	270,952	261,455	
	34	296,676	278,444	269,718	
September	35	300,914	286,183	278,077	
	36	306,345	294,172	285,395	
	37	310,342	302,465	294,321	
	38	319,051	309,960	302,639	
	39	325,213	318,532	311,213	
October	40	334,993	323,163	318,762	
	41	339,034	332,531	327,331	
	42	348,784	339,870	336,050	
	43	356,334	348,181	343,869	
November	44	360,242	352,910	350,664	
	45	364,173	362,038	358,461	
	46	367,000	370,771	366,060	
	47	368,192	373,998	371,368	
December	48	368,495	374,427	372,074	
	49	368,906	375,385	372,662	
	50	369,168	375,696	372,636	
	51	369,177	375,718	372,348	
	52	374,403	377,825	371,842	378,214

------- **The 85% trigger point (certificates for 321 482 tonnes issued by 1 October)**

15% of TRQ (56 732 tonnes) would have been allocated during this period under an 85% trigger.

Source: DAFF