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Addendum to economic analysis to inform LiveCorp's submission

Dear Sam

Following our discussion with you, this document provides an addendum to the economic analysis provided on 16 March 2016 to support LiveCorp's submission in to the Productivity Commission's review into the regulation of agriculture.

As this report provides further information to the report provided on 16 March 2016, I must note that it is important that the full report be read in its entirety including the applicable scope of work and any limitations in addition to this addedum.

If you would like to clarify any aspect of this addendum or discuss other related matters then please do not hesitate to contact me on (02) 6267 3846.

Yours sincerely

Andrew Metcalfe AO
Partner

NOTICE

This is an Addendum to the Ernst & Young's report prepared on 16 March 2016. The results of Ernst & Young's work, including the assumptions and qualifications made in preparing the report, are set out in the Report ("Report"). In addition to this Addendum you should read the Report in its entirety including the applicable scope of our work and any limitations. A reference to the Report includes any part of the Report. No further work has been undertaken by Ernst & Young since the date of the Report to update it.

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1. Additional clarification on method used to conduct economic analysis to inform LiveCorp's submission: Productivity Commission review into the regulation of agriculture

1.1 Our scope

EY was engaged by LiveCorp to undertake an analysis of the costs and benefits of ESCAS requirements. This analysis was conducted through literature review of publicly available information, stakeholder consultation with live exporters and information provided by LiveCorp.

1.2 The method used in our cost analysis

EY prepared an excel template to collect quantitative data from each of the exporters, this template was provided to each of the exporters, and an interview was used to talk through the template and information. Follow up interviews were conducted where necessary. The workbook set out separate sheets to describe:

- The exporter profile (including animal type, country, number of approved supply chains, number of facilities and number of animals shipped)
- Administrative costs (collection of bottom up costs noting time, wage costs, frequency and/or unit costs for: Preparation and submission of ESCAS application; Preparation and submission of variation to an approved ESCAS; Engagement of independent auditors; Making, keeping or providing records as required by the Department; Provision of information and assistance to official inspectors undertaking performance audits while animals are in the supply chain; Other Costs - Engaging expertise to assist compliance with ESCAS e.g. lawyers, translators etc.; Other Costs - Capital costs made specifically for the purpose of meeting an information obligation; Other costs)
- Substantive compliance costs (collection of bottom up costs noting time, wage costs, frequency and/or unit costs for: Negotiation and implementation of contracts with importers to ensure control and traceability within the supply chain; Costs associated with the training of staff domestically to ensure compliance with required standards; Costs associated with the training of staff in importing country facilities to ensure compliance with required standards; Capital costs associated with providing infrastructure in the importing country to align facilities with the required standards; Capital costs associated with technology requirements e.g. RFID, CCTV; Other cost)
- Delay costs (collection of bottom up costs for Application delays - Preparation of ESCAS application; Preparation of variation to an approved ESCAS application; Completion of audits; and Approval delays - Approval of ESCAS application, Approval of variation to an approved ESCAS application, Other)
- Other costs (e.g. ESCAS fees charged by Government for services rendered; Illustrative examples of loss of market access/share to competing exporters/countries; Illustrative examples of loss of business at peak festival slaughter times due to bottlenecks caused by ESCAS; Illustrative examples of inefficiencies in compliance requirements; Illustrative examples of common difficulties of enforcing ESCAS; Ability to pass compliance costs associated with ESCAS to importers).

We interviewed a sample of five exporters to collect information to inform the analysis. Each exporter provided different levels of data and information. Data was analysed and cross-checked for consistency. Data from exporters was combined with information from LiveCorp and publicly available information to provide robust estimates of the costs to exporters.

The self-reported data from the exporters was escalated to represent the live export market of 21 exporters and 866 facilities.

We found costs of compliance to be $22.3m per annum. This comprises of $15.4m in administration costs, $6.1m in substantive compliance costs and 0.8m in ESCAS fees.

Delay costs were not specifically valued as they can vary substantially based on the lost income opportunities, standby costs of capital (e.g. demurrage costs) and labour (e.g. animal welfare officers), and costs to maintain the animals (e.g. feed and agistment). An example of the extent of delay costs was provided, and it was estimated that a conservative 10 per cent reduction in delay costs could save the industry over $0.6 million per annum.

1.3 How it compares to RIS, MLA and ESCAS

Three other studies have estimated the costs of the ESCAS regulatory system. One study was based on an estimate of costs (DPMC, RIS, 2011), another on a discussion of costs (MLA/LiveCorp, 2014) and the third study used a business cost calculator to estimate the cost to exporters (ESCAS Review, 2015).

The first two studies were based on a per animal cost, which varies depending on species, destination and transportation method. Each study, however, yield significantly different results. While they provide high level costs, neither study was able to place specific costs on compliance activities. Finally, we understand that the ESCAS Review used the MLA/LiveCorp's costs per head to update results in 2015 using the Department of the Prime Minister and Cabinet's business cost calculator.

The post-implementation regulatory impact statement conducted by the Department of Prime Minister and Cabinet identified two sets of costs for exporters under ESCAS – a one-off implementation cost of $0.5 million per exporter and ongoing costs of $2 per animal for cattle exported to Indonesia.

A MLA/LiveCorp study in 2014 estimated compliance costs from $0.77 to $13.0 per animal depending on the species and transport method. Based on these costs per head and the number of livestock exported in 2013-14, the total cost to exporters of complying with ESCAS can be estimated at $13.2 million.

The MLA/LiveCorp study:

- undertook consultation with 12 exporters as well as secondary research
- did not isolate costs associated with specific components of ESCAS compliance, and only considered the direct costs of compliance with ESCAS requirements incurred by the supply chain
- noted costs were often shared along convoluted international supply chains and the disclosure and understanding of these costs are therefore incomplete
- noted that the staged implementation of ESCAS and changing nature of the audit and administration systems means that ongoing costs have not yet been established
- reported the most frequently reported cost number (the mode) across the sample of exporter supply chains (see page 39, MLA/LiveCorp). In table 5 set out on page

50 of the report the mode is on the low end or the same as the high and low economic costs reported. However, for air transport the most frequently reported cost is at the high end of the range.

The ESCAS review estimate of costs does not provide details of its analysis other than using the DPMC business cost calculator. The business cost calculator allows the calculation of costs by either constant or variable costs; by size of business or no size constraints; and then by cost category.

It is difficult to compare the three studies to that undertaken by EY as there is very little publicly available information on the method used to conduct each analysis. At a high level the:

- 2011 study was based on estimated costs whereas the EY study was based on actual costs self-reported by exporters.
- MLA/LiveCorp study, it is understood, conducted primarily qualitative interviews with each of the 12 exporters (see Appendix 1 of MLA/LiveCorp study). Costs were collected based on self-reported processes and policies in place to achieve ESCAS compliance on a per animal basis. Costs did not include the full on-going costs associated with the requirements. Whereas, the EY study conducted interviews and collected quantitative data from five exporters reported on a per requirement basis. The EY study included costs that have been realised in most recent years such as costs of surveillance and stunner maintenance.
- ESCAS review conducted an estimate using the business cost calculator calculation. It is unclear how it sourced the costs associated with this calculation. However, if the ESCAS review applied MLA/LiveCorp costs, then the limitations of the MLA/LiveCorp cost analysis have been brought forward into the ESCAS review estimates.

1.4 The reason we chose the method

The studies report costs differently, MLA/LiveCorp uses a per animal approach, whereas, EY used a cost per exporter approach. This is because the emphasis of the EY study was different. Our objective was to provide a breakdown of compliance costs. As set out above, we worked through each stage of ESCAS compliance with each exporter and collected specific costs related to these. A number of the costs are based on establishing a supply chain, and therefore, a per exporter basis was chosen for the EY analysis.

The EY method reflects guidance material adopted by the Commonwealth Office of Best Practice Regulation, and by the Victorian Department of Treasury and Finance (in particular Victorian Guide to Regulation Toolkit 2 - Cost-benefit analysis) in measuring regulatory costs. This is a commonly used approach when preparing regulatory impact analysis.

Using this method, EY costs are more than 50 per cent higher that those reported by MLA/LiveCorp and the ESCAS review. We suggest that there are a number of reasons behind this:

- A different methodology is used
- A different population base is applied (EY - per exporter, MLA/LiveCorp - per animal, ESCAS Review - it is understood that it is per exporter using per animal costs). A number of the administrative and compliance costs are not based on the number of animals, but on other requirements, such as the supply chain. We have therefore based costs on a per exporter basis.

- The costs of compliance with ESCAS had yet to be fully realised when the MLA/LiveCorp study was undertaken. Due to the staged introduction of ESCAS and modifications to the audit regime, the ongoing cost of compliance with ESCAS had not yet been fully realised. Tranche 2 and 3 countries had not yet been in operation for 12 months and the audit regime post 12 months for Tranche 1 countries was yet to be implemented (see MLA/LiveCorp, 2014, p.49). If the ESCAS Review costs are based on the MLA/LiveCorp costs, then these same limitations apply to this study. The EY analysis was completed once implementation was complete and therefore the costs and regulatory requirements are more likely to be fully realised.

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