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# STUDY ON THE IMPACT OF GOVERNMENT ON INDUSTRY COMPETITIVENESS

Prepared for

## MEAT AND LIVESTOCK AUSTRALIA

By

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## Contents


| | Page |
|---|---|
| FOREWORD | 3 |
| EXECUTIVE SUMMARY | 4 |
| STRATEGIC RECOMMENDATIONS | 7 |
| 1. INTRODUCTION | 10 |
| 2. CONTEXT FOR THE STUDY | 14 |
| 3. CONCEPTS AND APPROACH | 27 |
| 4. THE IMPACT OF GOVERNMENT ON MEAT INDUSTRY COMPETITIVENESS | 38 |
| 5. STRATEGIC ANALYSIS AND RECOMMENDATIONS | 76 |
| APPENDICES | |
| A. AUSTRALIAN GOVERNMENT LICENCE AND PERMIT FEES | 82 |
| B. USA FEDERAL BEEF AND SHEEPMEAT PROMOTION AND RESEARCH ASSISTANCE PROGRAMS | 86 |
| C. EXAMPLE OF USA STATE ASSISTANCE PROGRAMS | 89 |
| LIST OF TABLES | 93 |
| LIST OF CHARTS | 93 |
| REFERENCES | 94 |

# FOREWORD

This research study, funded by Meat and Livestock Australia, breaks new ground in quantifying the level of government influenced costs and charges on the beef and sheepmeat industries of Australia, New Zealand and the United States. Having regard to the qualifications which must necessarily accompany a "first" research project of this kind, the overall findings are significant.

The US government at all levels is only lightly involved through cost and charges interventions in its beef and sheepmeat industries. In contrast, Australian and New Zealand governments intervene (negatively) much more – and thus damage the competitiveness of their industries. To make matters worse for Australia, the US government is much more generously involved in dispensing subsidies and assistance.

To date Australia's concern over international competitiveness has focussed on how US subsidisation and assistance to agriculture is unfair. This Study shows that in the crucial area of domestic economic efficiency/cost competitiveness Australian governments collectively (Commonwealth, State and Local) are unwittingly working against, rather than for, the beef and sheepmeat industries compared to the situation in the United States.

This is an important finding. This Study quantifies for the first time the long held feeling of the meat industries that the government "take" from the industry in Australia is excessive, and this retards our international competitiveness. In other words, the government "take" has a cost.

Strategies must be implemented by the Australian meat and livestock industries to "pull back" the level of government-influenced costs and charges in Australia to internationally competitive levels. Failure to halt, and reverse, the inexorable increase in these costs and charges must inevitably contribute to the long-term decline of Australia's industries.

The researchers wish to thank those organisations, companies and farmers in Australia and overseas who assisted with commercially confidential data, and for their insights and guidance on the issues addressed in this Study.

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# EXECUTIVE SUMMARY

Meat and Livestock Australia (MLA) commissioned SG Heilbron Economic and Policy Consulting to undertake research on the impact of Government charges/costs and assistance/subsidies on the Australian meat industry's competitiveness particularly in comparison with the United States and New Zealand. This report represents the results of the research undertaken.

The research brought together the livestock, feedlot and processing sectors of the industry and this enabled analysis of data along the value chain. The research drew upon data sources at national, sub-national (State and Local) and international levels, and both public and private data. It has produced valuable new information for the industry on its competitiveness position that can be used to improve the prospects in all parts of the value chain.

The research goes beyond the traditional focus of the meat industry on areas such as inspection charges by encompassing a wide range of costs and charges that are influenced directly or indirectly by Government. This includes labour on-costs, utilities and fuel, meat-specific costs/charges (licenses, meat inspection charges and levies), and others (including environmental costs).

## *KEY FINDINGS*

- Australian livestock and meat producers generally have ***higher Government-influenced costs and charges*** overall than their key international competitors, and ***receive less assistance*** from Government.

- To illustrate the charges/costs situation for livestock producers - an ***Australian*** mixed sheep-beef producer pays around ***one-third*** of their livestock revenue (excluding wool) and around ***one-fifth*** of their livestock revenue (including wool) in Government-influenced costs and charges. By contrast, the average ***New Zealand*** mixed sheep-beef farmer pays around ***one-sixth*** of their livestock revenue (excluding wool) and ***one-tenth*** of their livestock revenue (including wool) in such charges. ***US sheep farmers would pay least of all,*** around ***one-eighth*** of their livestock revenue (with little wool being produced).

- To illustrate the situation for feedlots - private data from a number of ***large Australian commercial feedlots*** indicated Government-influenced costs/charges account for 3.1 to 3.3 per cent of revenue. However data from a large ***USA feedlot operator produced a far lower percentage*** of just 2.1 per cent, indicating a significant advantage.

- For processors, the largest ***Australian (non-service) works pay around 4 to 5 per cent*** of their revenues in Government-influenced charges and costs. ***Smaller works pay upwards of 7 per cent.*** Whilst the percentages above seem small, two points must be remembered:
  1. Whilst these percentages as a proportion of total sales revenues may be small, they are ***very large in absolute dollar terms.*** The beef and lamb processing industries have revenues estimated at around $A6.6 billion (*Australian Bureau of Statistics Consultancy Stats),* so even the low figure above of around 4 to 5 per cent of revenue implies ***the payment of up to $A330 million in these charges/costs.***
  2. ***Relative to meat industry profitability,*** the above percentages of sales are very significant. The ***profit margin for the meat processing industry is only 2 per cent*** (measured as the percentage of operating income available as operating profit in 1998-99 – *Australian Bureau of Statistics Consultancy Stats).*

- ***US processors pay significantly less as a proportion of revenue*** in Government-influenced charges/costs. Overall, the largest Australian processors pay over ***twice*** as much as US processors, and smaller Australian processors over ***four*** times as much as US processors. If Australian low cost processors were to experience the same level of government influenced costs and charges as their US counterparts it would mean ***a saving of over $A200 million in costs to the Australian industry.*** If Australian high cost processors were to achieve US low cost levels it would mean ***a saving of over $A400 million.***

- Based on analysis of the major cost categories, the Australian ***livestock sector*** should focus its strategies in seeking reduction in Government-influenced costs/charges in the areas of ***oncosts; other costs (mainly rates); and utilities and fuel.***

- For Australian ***feedlots,*** the major areas of disadvantage relative to the USA are in respect of ***oncosts and meat-specific charges*** (cattle and grain levies).

- The key challenge for the ***Australian processing sector is to close the gap on the far lower proportion of costs/charges experienced by its United States competitors***. The Australian processor is clearly being handicapped with a government imposed competitive disadvantage. The meat industry needs to develop strategies – to make governments aware, and - to remove this cost handicap, across all categories of government imposed costs.

- On the assistance side, this report finds that ***Australian producers and processors overall receive less assistance than their major competitor,*** the United States, and similarly low levels to New Zealand. The USA is far less of a subsidiser of its sheep and beef industries than the EU, and it provides relatively little assistance to these products compared to others in agriculture.

- Nevertheless the USA heavily subsidises lamb production, and ***Federal and State Governments provide a range of programs*** available to livestock producers and processors. State assistance is provided through tax and other regulatory concessions, and business assistance programs.

- It appears that ***the internationally accepted measures of government assistance do not adequately capture State and Local (or sub-national) government assistance***. In the United States (and of course in the EU and in many other countries) this is apparently large. In Australia's case it is also significant.

- The full extent of State and Local assistance remains unknown by even the major international organisations (the OECD and WTO) responsible for monitoring assistance. The current estimate is that ***$US2 billion out of the $US54 billion in assistance to US agriculture comes from various States***, and some of this would be available to sheep and beef producers. These subsidies can affect downstream parts of the value chain too.

- Progress on resolving the sub-national government assistance measurement problem can clearly ***best be progressed in a trade policy context through the Australian Government***. Pushing for action on this front by the established international trade research and policy analysis organisations.

# STRATEGIC RECOMMENDATIONS

Basic Principles

1. The Australian meat and livestock industry (livestock, feedlotting and processing) must ***give greater weight and attention in its dealings with Government*** (Federal, State and Local) to reducing the adverse impact of Government-influenced costs and charges on its international competitiveness.

2. The industry should not seek to redress the fact that it pays more in cost/charges and receives less assistance by simply seeking more government assistance. The priority should be on improving the industry's efficiency and hence its international competitiveness. This should be achieved by ***getting Government influenced cost/charges down so as to enhance efficiency*** rather than retard it.

Focus on Key Charges/Costs Categories

3. A priority for the industry is to address the impact of oncosts. The major focus for this should be developing ***a campaign aimed at State Governments that are responsible for excessive payroll tax and workers compensation costs***.

4. Another priority for the industry is to ensure that utilities and infrastructure costs reflect the need for efficiency in the industry. The industry should assess the extent to which it should ***become involved in the price determination processes of Federal, State and Territory utility and infrastructure regulatory bodies to reduce those key input costs. This will require effort and persistence – but over a period cost-reducing results can be achieved.***

5. Regarding meat-specific costs/charges, and consistent with recommendation 2, the industry should ***aim for meat inspection charges to reflect orthodox economic efficiency pricing principles – that is marginal cost pricing.*** The present "full cost recovery" regime based on accounting principles should be terminated. Inspection charges could be reduced substantially as a result, potentially saving the industry at least around $A15 million.

6. The industry should make ***a strategic assessment as to whether it should seek to negotiate directly with Government to achieve recommendation 2 or whether it should seek the introduction of a Regulator-General into the inspection system*** (in common with the situation in utility and infrastructure regulation). Current potential changes to the inspection system that might see AQIS inspection outsourced could affect the strategic choices to be made in this regard.

7. The industry should undertake a ***review of State Government licensing charges*** to assess whether they are being determined in accordance with economic principles that encourage efficiency.

8. Recognising the growing importance of environment driven policies the industry should ***undertake more research into the area of comparing environmental charges and systems internationally*** to deepen its understanding of the extent to which the Australian industry is being over-regulated or over-charged relative to its international competition.

Trade Policy

9. The meat and livestock industries should ***bring a new emphasis into Australian trade policy on increasing the scope and accuracy of information on assistance provide by State and Local (or, in other words, sub-national) Governments internationally*** to ensure that international trade negotiations to reduce subsidies can properly and accurately take such assistance into account. This potentially massive form of subsidy at sub-national government level has apparently not been a focus of trade policy officials to date. The Australian meat and livestock industry should urge the Commonwealth Government to ensure that organisations such as the OECD and the WTO have sufficient financial and research resources to accomplish this aim.

Further Initiatives

10. The industry should build upon the foundation of this research by ***continuing to update and monitor regularly the government influenced charges/costs situation***. This should aim to deepen the analysis and discover how the situation has changed (has it improved/deteriorated?) over an appropriate period of time.

11. The industry should encourage ***the improved collection of data of costs/charges by management of farms, feedlots and processors*** which can be used to identify and track the various costs/charges, and hence feed in to the updating and monitoring process recommended above. This could be facilitated by purpose designed interactive electronic data information collection from industry stakeholders.

# 1. INTRODUCTION

## 1.1. Objectives of the Study

Meat and Livestock Australia (MLA) commissioned SG Heilbron Economic and Policy Consulting to undertake research on the impact of Government charges and assistance/subsidies on the Australian meat industry's competitiveness particularly in comparison with the United States and New Zealand.

The objectives of the study as identified in the Terms of Reference for the project were:

- To identify the magnitude and composition of government charges for services provided to Australian cattle/sheep producers and beef/sheepmeat processors
- To identify the magnitude and composition of industry specific government assistance to the Australian livestock and meat industry
- To measure the impact of government charges and government assistance on the cost structure of the Australian industry
- To repeat the above for the US beef industry and New Zealand sheepmeat industry
- To provide analysis on the relative competitive advantage or disadvantage sustained by the Australian industry as a result of government charges and assistance relative to industries in the US and New Zealand
- To construct arguments for possible future use by the Australian industry in seeking modification by Government on imposts imposed on the Australian industry or assistance provided.

This report represents the results of the research undertaken

## 1.2 Research Conducted for the Study

The research methodology adopted for this research comprised the following:

- Development of a framework for analysis of data on a comparative basis.

- Identification of available sources of data both at official levels at various layers of government (Federal, State and Local) and at commercial levels in Australia and overseas.
- Obtaining the data from reliable and verifiable sources.
- Analysis of the data on government charges and assistance/subsidies measures.
- Documentation and evaluation of the charges and assistance measures.
- Identification of broad strategic implications and options available to the industry to rectify relative disabilities identified
- Preparation of a readable, authoritative report containing the results of the analysis and recommendations.

A number of unique features of the approach were:

- Analysis of data along the value chain, i.e. including livestock production, feedlotting and processing;
- Data sources at national and international levels were utilised where available e.g. international data on subsidisation of producers collected by international organisations such as the Organisation for Economic Cooperation and Development (OECD) and the World Trade Organisation (WTO);
- Analysis of public information at Federal, State and Local levels where appropriate;
- Collection of data from both public and private sources, utilizing information from industry organisations, companies and farmers where available.

This approach enabled the information from one source to be verified against that from another, and makes more "real" the findings generated by the research and analysis.

The work commenced on 28 June 2000, and entailed desk research augmented by investigations in New Zealand, Europe and the United States in September and October 2000. The researchers wish to express their appreciation to the numerous individuals and organisations in New Zealand, Europe and the United States who cooperated with the consultants in the providing information, much of it commercially confidential, for this work.

## 1.3 The Consultants

***SG Heilbron Economic and Policy Consulting*** provides specialist economic and policy consulting services to major Australian and international corporations as well as Government and industry organisations. The firm focuses on providing economic and policy analysis, trade and investment strategies, and Government affairs advice. The consulting team for this study was:

**Dr Selwyn G Heilbron** - a senior business economist and corporate consultant with special expertise in Australian and international agribusiness, food and beverages industries. He has served as Research Consultant with the World Bank, Washington, DC., Senior Economist with the Department of Trade, Canberra, and as Manager (Planning) and Chief Economist of Elders Agribusiness, Melbourne. Dr Heilbron is a Bachelor of Arts from Kent University, Master of Science in Agricultural Economics from the University of London and Doctor of Philosophy from Cambridge University, UK.

**Terry Larkin** - a Canberra based consultant in economics and agribusiness where he has provided consulting services to agribusiness and food groups, corporations, and industry and government agencies. He has served as Chief Economist and Director, KPMG Peat Marwick and was previously a senior government official in Canberra serving in numerous positions including Director, Australian Bureau of Agricultural and Resource Economics; First Assistant Secretary, Agricultural Trade Division, Department of Trade, and Assistant Secretary, Commonwealth Treasury. Mr. Larkin is a Bachelor of Economics from the University of Sydney and Master of Economics from Harvard University. He is also a Master of Public Administration from the John F Kennedy School of Government, Harvard University.

**Fiona Roberts** - a Brisbane-based agribusiness economist and management consultant who developed strong analytical skills as an economist, Australian Wool Corporation, Strategic Analyst, Elders Agribusiness, as Manager Agtrade-SE Queensland with the Queensland Department of Primary Industry and as Senior Consultant RCS Hassall, prior to establishing Agri-Focus in 1994. She has undertaken numerous industry analyses, including in the feedgrain and meat industries. She has the qualifications of B.Ag.Sc. and Master of Business Administration from Melbourne University.

## 1.4 Structure of the Study

Following this introduction, Chapter 2 explains the context for the study, including the background to the study and a review of previous relevant Australian reports.

Chapter 3 discusses the conceptual approach adopted for the work. Chapter 4 analyses the impact of Government costs and charges on the livestock and meat industries, and the impact of assistance/subsidies. Chapter 5 outlines the strategic issues and recommendations that arise from the work.

# 2. CONTEXT FOR THE STUDY

## 2.1 Background

The Australian beef and sheepmeat industries are amongst Australia's foremost exporting industries. Principal competitors to Australia in international beef and sheepmeat markets are the US (beef) and New Zealand (sheepmeat). To a much lesser extent Ireland (beef) and the UK (sheepmeat) provide some direct competition. Some data on those countries is presented in this Report, as is some information on feedlotting. (Competition in the broad sense from the EU and other countries arising from corrupt trade and domestic agricultural policies is, as is well known, very damaging to Australia and has been pursued over the years in WTO trade policy negotiations and other multilateral and bi-lateral economic fora. This broad issue of corrupt world agricultural trade is not addressed in this research project.)

As is typical of commodity markets, customers for beef and sheepmeat products in international markets are extremely sensitive to the prices offered by alternate suppliers. Relatively minor price differences can result in major changes in market share.

A significant influence on industry costs, and therefore price levels, is the impact of government policies, particularly those imposing charges on the industry or providing assistance. Amongst other things the Australian industry bears the full or partial costs of government services associated with meat inspection, residue identification, disease eradication and market reporting. The Australian industry also receives government assistance, particularly for research activities.

The purpose of the proposed research is to identify the impact on costs of varying levels of government charges and government assistance on the meat and livestock industries of Australia, US and New Zealand. Assistance measures encompass both government grants to industry and industry specific services supplied by government either at no cost or at a reduced cost.

This research can be useful to industry in possible future representations to the Australian Government to modify imposts on industry or assistance measures. It can also be used to provide a better understanding of the dynamics of the international cost competitiveness of Australia's beef and sheepmeat industries.

## 2.2 Previous Relevant Australian Studies

As part of the literature review database searches were undertaken of the following:

- ABOA, Australian Bibliography of Agriculture (1975-September 1999);
- ARRIP, rural research in progress (1984-2000);
- AGRICOLA, Agricultural Online Access (1992-March 2000);
- CAB Abstracts (1987-2000);
- AGNR:CARRP, rural research completed;
- Dissertations (1998-1999);
- Web sites of various Federal, State and Territory government departments;
- Web sites of such organizations as the National Competition Council, the Australian Competition and Consumer Commission and searches of their relevant publications databases.
- Web sites of various US organizations such as USDA, General Accounting Office, Bureau of Census, Federation of Tax Administrators, Internal Revenue Service and some State governments.
- Web sites of international organisations such as WTO, OECD and IMF/World Bank.

There have been a few studies analysing aspects of the international competitiveness of the Australian red meat industry. These have mainly focused on the results of benchmarking of the processing industry.

Animal production comparative analysis programs operating in Australia have not focused on the government costs area; generally because government costs tend to be consistent across participants and are factors that participants feel they have little control over (Beattie personal communication dated 19 October 2000). For example: the South West Victorian Monitor Farm Project; an ongoing 30 year comparative analysis of

grazing industry farms in south west Victoria (including beef cattle and prime lambs), has collected rates data for 29 years but not other data which could be useful in this study. These analyses above do not seek to obtain data that would be useful for the purposes of analysing the impact of Government on industry competitiveness.

A pilot study for implementing a comparative analysis program in the northern Australian beef industry, funded by the MRC in 1993 included government costs, although only individual farmer reports were prepared, with no consolidated report available (Taylor Byrne 1993).

State environmental regulations were investigated in the 1994 paper *Interstate Differences in the Cost of Complying with Feedlot Environmental Regulations: an initial investigation.* The study aimed to measure the cost of complying with environmental regulations by large commercial feedlots in various states. The average cost of compliance to environmental regulations was calculated to be $41/head in NSW and $27/head in Queensland (1991 dollars) (Ridley, Morison and Griffith 1994).

The Queensland Department of Primary Industries (QDPI) has analysed the Queensland beef industry in terms of the value chain from farm gate to consumers in Japan and China (QDPI 1998). The report quotes industry sources as saying

> *'...for medium companies which specialize in the value-added part of the meat business, the current AQIS charges amount to approximately 2% of our gross sales for export product. As such the system is a barrier to new entrants into the meat industry as it highly favours the large abattoir/producer....'*

However no more detail is provided as to government costs.

In another report *Integrated Beef Industry Strategies Queensland Meat Processing Trends* the QDPI flagged WorkCover premiums as the Government fee of greatest concern to the industry, with workers compensation having the potential to add up to 10% of payroll to operating costs. Payroll tax was seen as a disincentive for further value adding, while stamp duty acted as a barrier to the rationalization of organizations. Efficient transport infrastructure was seen as critical for high capacity utilization through allowing effective sourcing of cattle. No quantitative data on government costs were used (QDPI 1999).

In *The Value Chain For Meat and Livestock Products,* the researchers detailed costs in production, feedlots and processing to the level of 'overhead costs' or 'services' but these were not broken down further. In the processing sector AQIS and AMLC costs were estimated to account for 3.8% and 8.79% of total external inputs costs (inputs purchased from outside the meat and livestock industry) (AACM 1993).

In the MRC's 1995 study *Australian Meat Industry Costs and Competitive Cost Benchmarking* the average cost of government charges for the beef processing industry were illustrated graphically to be around 7.5 cents/kg finished weight in 1993 and 6.25cents/kg finished weight in 1994 (AACM 1995).

The report *NSW Meat Processing Industry Restructuring Program* highlighted workers compensation insurance premiums as the most significant expense after livestock purchases and wages for the NSW industry. Best practice targets for Australian processing costs were listed, with industry and inspection charges 3% of beef processing costs and 11% of lamb processing costs (Hassall & Associates 1999).

The recent major ABARE Study *The Australian Beef Industry 1999* is limited to domestic issues in the upstream sector of the industry and, as a consequence, is of little value for industry wide international competitiveness purposes (ABARE 1999).

While some research has recognised the impact of Government "user charges" what has been lacking is a comprehensive analysis that identifies the impact of these measures – both government charges and government assistance/subsidies - on the meat industry relative to its key international competitors namely the United States and New Zealand.

Only by quantifying and exposing Australia's international competitive disadvantage in terms of government imposed charges and assistance/subsidies can the Australian industry hope to "rebalance" the playing field in its favour.

Previous benchmarking and other studies have had relatively little to say about the link between government charges and industry competitiveness. The Booz Allen & Hamilton 1993 *International Comparisons in the Beef*

*Processing Industry* included a brief discussion of government charges and inspection costs. It concluded that total government and inspection charges for an Australian best-in-class facility on a cents per kilo finished weight basis was around 6.3 cents, for a New Zealand best-in-class traditional facility the figure was 3.1 cents, for a New Zealand hot-boning facility 2.3 cents. By contrast, for a United States best in class facility the figure was 0.3 cents and for an Irish facility 0.9 cents.

However these comparisons are not clear. For example, the Australian figure included inspection charges and government levies but excluded producer levies. In New Zealand, processors recover all inspection costs from farmers. The report points out only that the cost of inspection in New Zealand and Australia are quite similar.

The report points out that in the US the Government pays for virtually all the costs of inspection and industry research, with inspector salaries fully covered except during overtime, which rarely happens due to double shifts which apply at most US facilities.

The report also analyses costs for services such as water, electricity/telephone and fuel/coal/gas. It concludes that the costs of these services to the Australian best-in-class is 7.1 cents per kg, compared with just over 5 cents in New Zealand facilities, and far above the US at 1.5 cents and Ireland at 3.3 cents. The report attributes this primarily to electricity costs, with Australian rates being higher, product being held longer, and relatively less efficient storage.

The 1995 *MRC Sheepline Benchmarking Study* indicated that Quality Assurance and inspection costs were similar in Australian and New Zealand export facilities, but that Australian energy and other utilities costs were almost twice those of New Zealand sites. The study found that Australian managers believed several factors limited their cost and market performance. Costs were seen to be limited by the availability of livestock, capital and skilled people, the ability to stabilise or maximise throughput, labour agreements and government costs. However Government costs were not defined or measured.

The Industry (now Productivity) Commission's 1994 report on *Meat Processing* compared two Australian abattoirs and similar operations in New Zealand. From the comparison, inspection manning of Australian abattoirs

was thought to be high and inspector productivity low. The Commission estimated the relative components of total Australian meat processing costs, excluding livestock purchases; these are listed in the table below.

| **Processing Cost** | **Abattoirs with killing floor only % of total processing costs** | **Abattoirs with killing floor & boning room % of total processing costs** |
|---|---|---|
| Government Levies | 7.0% | 2.3% |
| Inspection | 5.3% | 2.3% |
| Labour on-costs | 5.3% | 4.6% |

Source: IC estimates

The 1998 Report by Sandra Welsman *Rules Impacting on the Meat Industry* aimed to provide a comprehensive review of the regulatory environment impacting along the livestock and meat supply chain. The report found that, inter alia, the meat industry is extremely regulated and there is scope to devolve many responsibilities back to managers. For the study, efforts were made to collect case studies and cost information from industry to measure the impact of regulation.

Unfortunately very little quantitative data or specific evidence could be obtained from operators, and most of the commentary recorded is anecdotal and obtained in interviews. Only one set of indicative figures in relation to costs of regulation was received, relating to compliance costs for a sheep/beef processing plant.

Nevertheless, and, in spite of the paucity of quantitative evidence available as illustrated from the range of studies abovementioned, there has been increasing interest more broadly in the rural community, and in the Australian business sector more generally, about the increasing charges being applied, both by Government agencies and by privatised formerly government-owned instrumentalities.

These concerns have to date not been taken up as a priority policy issue by the agriculture and food processing industries.

## 2.3 The Rise of Government Influenced Costs and Charges

The serious impact of government imposed "user charges" and regulatory price determination processes on Australia's international competitiveness was first identified by the Business Council of Australia in major studies published in 1993 and 1995.

In its 1993 Study the Business Council of Australia said, *"...In reality, 'user charging' appears more and more to be all about revenue raising rather than economic efficiency. As the Prices Surveillance Authority notes, 'The revenue interests of State governments may impact on any proposal to extend competition and prices policy to cover what are now State authorities'. The Industry Commission baldly concedes: 'Indeed, there is a risk that water authorities and other Government Business Enterprises could be treated as milch cows by State Governments under the banner of promoting economic efficiency."* (BCA 1993).

The 1995 Business Council Study elaborated further the serious problems inherent in the emergence of "user charges" (Box 1).

***Box 1***

*"It is essential that the Hilmer reforms are not hijacked by governments to introduce a new form of indirect tax under the guise of "user charges" and government 'dividends'.*

*This would negate the potential benefits of microeconomic reforms and adversely impact on business costs, inflation and Australia's international competitiveness.*

*Abundant, low-cost, world ranking infrastructure available at a price equal to the marginal cost of providing the service is essential for competitiveness in today's global economy. Australia must re-focus on where it is going on infrastructure provision and business taxation before it is too late. Australian governments would be ill advised to subject business to hidden taxation through the abuse of natural monopoly pricing disguised by asset revaluations and other accounting devices."*

Source: *Refocusing Microeconomic Reform*; BCA, 1995; px

More recently a major study by RIRDC *Infrastructure Pricing, Provision and Process* (RIRDC, 1999) has further exposed the steady growth of disguised taxation through government "user charges" and other regulatory processes in Australia's National Competition Policy (Box 2).

***Box 2***

*"But rural and regional Australia should be concerned if competition policy is being sidetracked into becoming a profit or revenue raising exercise whereby inflated asset values and over-generous rates of return allowed by regulators may adversely affect downstream competition and international competitiveness. Rural and regional Australia needs to enter the processes of national competition policy to ensure that this does not happen and that its margins are not squeezed by unjustified domestic infrastructure costs; it needs representation in the ongoing processes of policy debate and regulatory review to ensure that basic economic principles about external benefits or cost-benefit analysis are not abandoned to a narrow short-term revenue-maximising insistence on uneconomic and futile "user pays" pricing."*

*"...Profound changes have occurred – disguised perhaps by the NCP process – in the pricing of infrastructure services. This quiet revolution towards a full "user pays" basis of infrastructure pricing has profound implications.*

*Inevitably rural and regional Australia will lose international competitiveness as it is forced to pay higher prices for infrastructure. Higher prices are the inevitable outcome of much of the NCP process to date."*

Source: *Infrastructure Pricing, Provision and Process*; RIRDC, 1999, pp100, 101.

Overall, there have been many in the livestock and meat industries who have believed that their industries have been charged excessively by Government agencies or as a result of Government regulation, and that industry receives little by way of subsidies or assistance to compensate for these charges and costs. Further, they have believed that these imposts penalise the industry in competing internationally.

It is clear that, as pointed out by the Business Council of Australia and RIRDC Studies cited above that taxes disguised as "user charges" damage Australia's international competitiveness and retard the viability of our industries. It is important to note as the RIRDC Study points out *"... Strictly speaking, any price above marginal cost is a tax, even if that price is below average cost. Thus a cost accountant may denounce as a 'subsidy' a price which an economist would regard as already in excess of marginal cost – and thus a tax."* (RIRDC 1999, p43).

Concerns over the emergence of disguised taxation under the banner of "cost recovery" and user charges has led to the recent announcement of a Productivity Commission Inquiry into Cost Recovery (PC 2000). As the Productivity Commission notes in its Issues Paper:

> *"... Cost recovery has been implemented by a wide variety of agencies in many different situations. In some cases the revenue raised is substantial. One of the key tasks of this inquiry is to report on the nature and extent of cost recovery arrangements across Commonwealth Government regulatory, administrative and information agencies, including identification of the activities for which cost recovery is undertaken."*
>
> *"... As discussed previously cost recovery arrangements may be implemented for a variety of reasons. The rationale may relate to their effects on economic efficiency (influencing demand and resource use), equity (apportioning costs), cost effectiveness, and quality of service. More pragmatically they are means of raising revenue and to some extent may substitute for general taxation."*
>
> *"... The fees and charges set by regulatory, administrative and information agencies may have important economic implications. The design of some schemes may influence resource use, impose barriers to market entry and constrain competition. Cost recovery arrangements are also an alternative to general revenue raising, and hence need to be seen in a broader fiscal context, and they may have impacts on businesses, consumers and the agencies themselves."*

> *"... The pressure on general budget allocations has focused attention on ways in which fees and charges can be raised to augment revenue and provide additional resources (*Source: Productivity Commission *Cost Recovery Issues Paper,* October 2000*)."*

As long ago as 1993 the Business Council of Australia Study noted that *"... The rate of increase in public utility taxation in Australia has reached alarming proportions."* That Study calculated that "user charges" in infrastructure incorporated an estimated 10% flat rate tax and the cascade effect overall of this disguised taxation added 0.36% to business costs in Australia (BCA 1993, p37). The more recent RIRDC Study (RIRDC 1999) shows how utility "taxes" also have increased further (Box 3).

**Box 3**

*"... That this new form of indirect tax has grown at a truly meteoric rate can be gauged from the fact that income transferred to governments from all public trading enterprises in Australia (other than banks) jumped from $0.4 billion in 1987-88 to $6.8 billion in 1996-97 an increase of 1,700 per cent! Over 40% of the annual revenue of public trading enterprises in Australia is now transferred to governments compared with only 9% seven years ago. The new "tax milch cow" status of public trading enterprises as revenue generators for governments can be seen from the following chart (Chart 6). This shows that while their gross fixed capital expenditure is shrinking public trading enterprise revenues are being siphoned off to governments at a rapidly increasing rate. In 1990-91 "dividends" stripped from public trading enterprises were $1.4 billion while their gross fixed capital expenditure was $11.1 billion. By 1996-97 dividends had jumped to $6.8 billion at the expense of capital expenditure which had dropped to $9 billion."*

*Source: RIRDC 1999, p14.*

Australian industries concerned have had little by way of evidence to support their beliefs that government imposed taxes and charges are damaging their competitiveness - apart from the Business Council and RIRDC Studies abovementioned. The RIRDC 1999 Study is soon to be complemented by a further in-depth study of disguised taxation and user-charges on Australia's rural industries (*Cost Methodologies and Processes in Infrastructure Regulation – a Study for Rural and Regional Australia*, RIRDC 2001 forthcoming).

The serious concern by business generally over taxes and user charges in Australia has also been heightened recently by the publicity surrounding the current Productivity Commission Inquiry. This was the subject of a recent feature article in the *Financial Review* which observed in part *"...The Commonwealth's cost-recovery practices are under attack from business, which claims that the Government has turned fees for service into a taxation device. Business says some charges raised by the Commonwealth are illegal, that most federal agencies abuse their monopoly position and that departments have little incentive to offer an efficient, effective service."* (Financial Review, 24 January 2001, p28).

This MLA sponsored study aims for the first time to provide some objective information to analyse and verify this problem of government influenced charges and taxes so far as the Australian beef and sheepmeat industries are concerned. Given that it is a "first" Study of this kind this study must of necessity be considered a starting point in the collection and analysis of such data rather than the definitive and final results of such an endeavour. Its aim, however, is to take the methodology suggested by the Business Council and RIRDC Studies to a new level of detail, and provide the beef and sheepmeat industries with quantitative research on which to build strategies and policies to further enhance competitiveness.

This study has entailed the use of data from various sources, relying primarily on publicly available survey, census and international published data, augmented by private data from informants and collaborators. For gathering private data on charges and assistance, information was sought by means of a checklist indicating the information required and personal interviews by the researchers.

The methodology and approach taken in this study, particularly on the input cost side, represents a first attempt in Australia (and indeed in any other

country) to estimate the impact of government influenced charges and taxes on the red meat industries having regard to the earlier path-breaking research studies of the Business Council of Australia and RIRDC on the disguised taxation implicit in "user charges"and "cost recovery" and the potential of such government policies to damage international competitiveness.

This research project on the red meat industries is not designed to be a comprehensive benchmarking study – which would entail a far greater level of data collection and research effort. Rather it is intended to quantify for the first time the size and scope of industry costs which are under the influence of government and hence outside the power of individual companies and farmers in the red meat industries to influence. The study does not address those input costs that could reasonably be assumed to be determined by the ordinary forces of private competitive markets. Future studies relying on the methodology adopted in this study could no doubt refine and improve the approach and widen the scope of the data collected. However, for the time being this research this study should be illuminating and valuable for industry stakeholders and policy makers alike.

## 2.4 Government Assistance

Government assistance to rural industries has, in contrast to government influenced costs and charges, been the subject of considerable research, measurement and policy discussion over many years at the national and international level. Indeed, Government assistance to industry has been a public issue in Australia since its Federation in 1901 and with the formal establishment by the Federal Government of the Tariff Board in 1921, and its successor agencies the Industries Commission and the Productivity Commission, the economic impact and measurement of government assistance to rural and other industries has been addressed in considerable depth. Apart from industry specific Reports, the Productivity Commission measures and publishes annually the level of assistance to Australian industries – beef and sheepmeat included – in its annual publication *Trade and Assistance Review*.

Largely at the urging of Australia, and triggered by the widely publicised "Red Book" study (*Agricultural Policies in the European Community: Their Origins, Nature and Effects on Production and Trade*, Bureau of Agricultural Economics, 1985) international action to measure and publish government assistance to agricultural industries on a consistent methodology

began in the late 1980s. These assistance measures are now collected and published annually by the OECD in its publication *Agricultural Policies in OECD Countries, Monitoring and Evaluation*, and by the WTO in its annual *World Trade* reports.

These published measures of assistance will be reviewed in subsequent Chapters. At the outset it should be noted, however, that in contrast to industry costs the measurement and public policy discussion of government assistance to agricultural industries is well developed and accepted both at the national and international level.

# 3. CONCEPTS AND APPROACH

## 3.1 Charges and costs

In analysing Government charges and assistance, the starting point is to define conceptually what is to be analysed.

**Concepts**

For the purposes of this study, coverage will include the following types of charges and costs. These are:

*Financial charges* – these are financial payments made as a result of Government legislation or regulation, whether paid to a Government agency or otherwise. Payments made to Government agencies are clearly Government charges and their level is subject to determination by Government. However even if payments are made to a private entity but the level of these payments is subject to regulation or intervention by Government (be it Federal, State or Local Government), then Government can influence either directly or indirectly the charge/cost and hence its ultimate impact on industry competitiveness.

*Economic costs* – these are costs incurred from a charge being set, as a result of Government legislation, regulation or intervention at a level over and above that which would prevail if an economically efficient competitive market were to prevail in setting the price. In economic terms, this efficient price level is the marginal cost of providing the good or service. Any level of charge over an economically efficient competitive market price entails a loss of efficiency – damages Australia's international competitiveness - and is, in effect, a tax or a monopoly rent.

**Coverage**

For the purposes of this study, the following charges/costs are included for analysis.

- *Operational costs/charges only* (i.e. not income, fringe benefits or other broad based national taxes e.g. GST). The focus of the analysis is on operational competitiveness rather than on seeking to compare different

taxation rates or systems in different countries. However in some cases where taxes are specifically applied to livestock or processing production or are considered an operational cost, they are considered. (Equally where taxation concessions are given specifically to such production they are considered in the analysis of assistance).

- *Oncosts.* For this study, oncosts are analysed because paying them is both a requirement to operate, and payment is either made to Government or subject to Government regulation or intervention. Definition of what constitutes oncosts is based on the Productivity Commission definition i.e. payroll tax, superannuation, training and recruitment costs, leave entitlements and workers compensation and occupational health and safety (see 1998 *Work Arrangements in the Australian Meat Processing Industry*). However this definition is subject to adjustment in the case of other countries where different categories of oncosts may apply. In these cases, the test remains that of costs that are required to be paid by Government or subject to regulation or intervention by Government. Labour costs other than oncosts are not considered in this study. Although Governments regulate them, there has been considerable study of labour costs in the meat industry and a reduction in Government involvement in labour markets (labour market de-regulation) is underway in Australia to that extent direct labour costs (as distinct from oncosts) are not a priority for investigation in this study.
- *Utilities.* Public utilities have been subject to considerable privatisation in Australia in recent years. Notwithstanding this, utilities are underpinned by regulatory control on pricing, including through the operation of conditions of access by distributors to the utility suppliers. As recent studies have shown the role of regulators is, in effect, to ameliorate disguised taxation and monopoly rent seeking under Australia's new regime of de-regulation and privatisation (Fels 2000, RIRDC 1999 and 2001 and World Bank 1996).
- *Fuel.* Whilst fuel prices are generally unregulated, excise duties are applied and in many cases play a major role in influencing the level of fuel prices.
- *Licensing.* Licenses are commonly required from Government agencies as a prerequisite for operating.
- *Inspection.* Inspection of products or facilities by Government agencies is commonly a requirement to sell meat products.
- *Rates.* Local authority rates or property taxes are required to be paid and are generally considered an operational cost item.

- *Levies.* These are considered only where they are mandatory, or effectively mandatory (i.e. underpinned by legislative threat of compulsion). Voluntary levies are not considered.
- *Environmental charges.* These are included since they are a requirement to operate, whether paid to a Government agency or otherwise. They are restricted (for the purposes of this Study) to annual operational cost of meeting environmental requirements and exclude capital costs.
- *Registration/permits/other.* Other charges for registration or permits required by Government are included.

Apart from the above cost items, the major operational costs for a typical livestock producer not covered in the analysis would include raw materials such as livestock purchases and imputed farm labour. For feedlotters major items not covered would include livestock and grain costs. For processors, they would include ordinary labour costs (discussed above), and livestock. Whilst some of these could be considered as influenced by Government, they are not considered as important as the items analysed for the purposes of this study.

**Data Sources**

This study uses a range of data sources for quantifying the impact of government-influenced costs and charges on livestock production, feedlotting and meat processing. Data on the categories of costs cited above was gathered from public and private sources, as well as data on the revenue earned by the producers, feedlotters and processors. The costs identified were estimated as a percentage of revenue to allow comparisons of the impact of costs on competitiveness across the three countries concerned. It was decided to apply the government-influenced costs as a percentage of revenue (gross sales/turnover) rather than as a percentage of total production costs owing to revenue considered as being a somewhat less commercially sensitive and confidential number in private data gathering.

For *livestock production*, data was used from the following sources:

Australia – The study uses specially commissioned Farm Surveys public data from the Australian Bureau of Agricultural and Resource Economics for sheep and beef farms covering 1999-2000. The survey data for a population of 18479 beef farms and 11317 sheep farms was produced with the categories of costs and revenue items specified above, and most of the

requirements could be met in the data produced. Financial transaction fees were mixed with bank fees and legal charges. Transaction levies paid by producers on livestock sales were imputed based on transaction type. ABARE does have a miscellaneous taxes and government charges category which could be expected to pick up many of the remaining government charges.

The private data collected for Australian livestock production was based on a checklist of the data categories itemised above, followed up with telephone calls to clarify data responses when required. The commercially confidential responses were from a selection of beef and sheep farms of varying sizes in a number of States. Given the comprehensive nature of the public data available, the private data was used predominantly for cross-checking and comparing with the public data.

New Zealand - The study uses specially commissioned public data from a detailed survey of sheep and beef farms carried out by the New Zealand Meat and Wool Boards Economic Service. The data uses a 1998-99 base from which current year estimates are derived. The survey data was able to cover all the categories of costs and revenue that are applicable in the case of New Zealand.

For oncosts, these include Employment Contracts Act and Holiday Pay Act entitlements, for example, whilst there are no New Zealand equivalents of the mandatory payroll tax, superannuation or training entitlements in Australia. Water charges are included in land rates. Levies are paid by processors and specifically deducted from producers' returns, so these were allocated to processors to enable comparisons to be made with the USA (where the same occurs) and with Australian processors' levies. A similar allocation was made in the case of inspection charges for the same reason.

As was the case in Australia, the private data used for New Zealand livestock production was based on a checklist of the data categories itemised in pages 25-28 above, followed up with telephone calls and farm visits to clarify data responses when required. Given the comprehensive nature of the public data available, the private data was used predominantly for cross-checking and comparing with the public data.

United States – The study uses statistics from the National Agricultural Statistics Service (NASS) Census of Agriculture for 1997. This includes a

Summary by North American Industry Classification System, which identifies costs and revenue for 656,181 beef cattle ranches and farms, as well as 43,469 cattle feedlots, and 29,938 sheep and goat farms. Estimates were derived of costs per farm based on total expenditure reported in the Census divided by the number of farms reporting, so the results are not the same as a representative and weighted sample of farms surveyed.

One category of costs which had to be imputed was oncosts - imputed by applying the mandatory federal and state social security, Medicare and unemployment insurance and workers compensation percentages for blue collar workers, as determined by the Bureau of Labor Statistics for 1998, to the Census data for hired labour costs). Livestock levies were allocated to processors and inspection charges are paid by processors.

It should also be noted that the livestock revenue data includes the market value of cattle and sheep sales (with wool sales not separated), and the farm revenue data includes grain crop sales, government payments and other farm related income. Private livestock data was obtained to cross-check the public data for a number of sheep and beef farms, based on the same checklist as for the Australian and New Zealand data, save only for the terms used for oncosts being amended to be relevant for the USA context.

For *feedlots*, the data used was from the following sources:

Australia – There is no equivalent of the public data available for feedlots in the United States, so data was sourced from private sources. These included a number of large commercial feedlots in a number of States. Data was based on the checklist for Australian livestock producers followed up by telephone calls to clarify data where required.

New Zealand - No data was collected for New Zealand, as there are negligible large commercial feedlots there.

United States – As discussed above, public data on cattle feedlots is available from the Agricultural census. The same features of the livestock data as discussed above apply to the feedlot data. Private data was gathered which covered a number of large, medium and small commercial feedlots across a number of States, using the USA livestock checklist and augmented by telephone calls and site visits where required.

For *meat processors*, the following data sources were used:

Australia – The study used a data checklist almost similar to the livestock segment to gather commercially confidential information from private sources given the absence of public data in the form and detail required. Data was provided for 1999-2000 by a number of small, medium and large sheep and beef single species and multi-species processors in three states. Data from own-account and service works was obtained through the checklist, augmented by telephone calls where required.

New Zealand – Given the absence of public processing data, the study used a checklist to obtain commercially confidential information for 1999-2000 and Budgeted Estimates for 2000-2001 covering a number of medium and large multi-species processing facilities.

United States – Unlike in Australia and New Zealand, comprehensive processing expenses and revenue data is available in the USA through the US Census Bureau Manufacturing Industry 1997 Economic Census. This data covers animal slaughtering (except poultry but including pork slaughtering), in 1393 meat packing establishments. As in the case of US livestock public data, oncosts were imputed by applying the mandatory federal and state social security, Medicare and unemployment insurance and workers compensation Bureau of Labor Statistics 1998 percentages for blue collar workers, to the Census data for hired labour costs.

Inspection costs were imputed by estimating the red meat slaughtering industry's share of total user fees – using data on user fees and red meat production from the US Department of Agriculture. Levies were imputed by multiplying the number of cattle and calves killed by the levy rate. The public data on the cost of purchased refuse removal including hazardous wastes was used for the category of "environmental costs".

Private commercially confidential data was obtained using a checklist covering a number of fat cattle and cow plants in a number of States. Data could not be obtained on sheep plants owing to the sensitivities associated with a US-Australia lamb trade dispute that was taking place at the time of data collection.

## 3.2 Assistance

### Introduction

Research of government provided assistance/subsidies is an essential element of this Study. Assistance/subsidies to red meat industries worldwide is the "opposite side of the coin" so to speak of government imposed charges and taxes.

Australia's beef and sheepmeat industries appear to be at a competitive disadvantage with their counterpart industries abroad that enjoy not only lower charges and taxes on the one hand, but also much higher assistance and subsidies on the other.

The task of this Study is to quantify as far as practicable the size of that competitive disadvantage which Australian beef and sheepmeat industries bear.

The massive subsidies and assistance provided to agriculture worldwide are well known. Australian rural industries have been seriously damaged over the years by these subsidy/assistance policies that corrupt world trade. Australia has campaigned internationally for the reduction and abolition of agricultural subsidies/assistance most notably in the WTO, OECD and other multilateral fora and in bi-lateral trade negotiations (Box 4).

In spite of Australia's leadership in the campaign to reduce world agricultural assistance/subsidies and its status as chair of the Cairns Group protectionism is on the rise worldwide.

As the OECD reports: *"The upward movement in support to agriculture, first evident in 1998, continued in 1999, with support reaching the high levels of a decade earlier. Low world commodity prices, and the resulting pressure they put on farm incomes, led many OECD countries to introduce new measures or to provide additional support to farmers. The ways in which these measures were implemented were, in many cases, inconsistent with the longer-term principles of agricultural policy reform."* (OECD 2000, p11)

**Box 4**

*"...Since the mid-1980s, major changes have occurred in the ways in which governments assist agriculture in North America and Europe. The main change has been toward direct payments to producers, with less emphasis on price support. This change was reflected in the reforms agreed to under the Uruguay Round of multilateral trade negotiations. It is also likely to be a key influence on future negotiations under the World Trade Organization, which are scheduled to commence in 1999.*

*To Australian farmers, such changes may appear remote. However, Australian agriculture will be markedly affected by them as it is relatively open to the world market and, for most commodities, government assistance is low (Industry Commission 1995). For most major agricultural products, prices to Australian farmers are formed on world markets. These largely externally generated prices are a major determinant of the size and prosperity of Australian agriculture. In turn, policies pursued by the countries of North America and Europe have a major influence on world market prices for commodities of importance to Australian agriculture."* Source: I Roberts, ABARE, *Outlook 97*.

The key summary measures of how government assistance/subsidies has recently increased is summarised by the OECD below:

- *"**The level of support to agriculture increased again in 1999:** total support to agriculture rose by almost 3 per cent, to an estimated US$361 billion in 1999 equivalent to 1.4 per cent of GDP on average over the OECD area. Of this amount, nearly four-fifths went to agricultural producers individually. Another 15 per cent paid for general services provided collectively to agriculture, such as infrastructure, research, marketing and promotion, and public stockholding.*

- ***Support to producers has mounted steadily over the last three years:** rising from 31 per cent of total gross farm receipts in 1997 to 40 per cent in 1999 – and is now, in percentage terms, back to where it was in the mid-1980s.*

- ***Market price support and output-related payments still dominated:*** *around two-thirds of support to producers was provided via market price support in 1999; budgetary payments based on output provided another 6 per cent.*

- ***Trade barriers are falling, but agricultural markets are still distorted:*** *the Uruguay Round Agreement on Agriculture (URAA), with its disciplines on market access, export subsidies and domestic support, provided a framework for opening up trade in agricultural products. Implementation of these commitments in 1999 – as in every year since the URAA went into effect in 1995 – has helped further integrate agriculture into the multilateral trading system. But many trade distortions remain. As well, some countries raised applied tariffs for some commodities in 1999, and several made greater use of export subsidies, export credits or other export-enhancing policies to encourage the disposal of domestic supplies on foreign markets, thereby further distorting trade."* (OECD 2000, p11)

One task of this Study is to evaluate and quantify assistance/subsidies relevant to beef and sheepmeat industries. For this purpose the following approach has been taken.

## Concepts

Coverage includes the following types of assistance:
*Financial assistance* – this includes payments from Government programs to producers and processors.
*Economic assistance* – this includes the value of support provided at above market prices for output or at below market prices for inputs.

For the purposes of this study, the following charges/costs are included for analysis.

## Coverage

*Livestock producers:* two systems of identifying and measuring support to livestock producers are used in this study. One is that used by the OECD, and the other is used by the WTO.

These are discussed below in terms of data sources, but they essentially provide the basis for international comparability of support to farmers in the countries covered by the data, and both systems cover Australia, New Zealand and the United States.

*Processors:* this study covers payments or above/below market price assistance given to meat processors. Information has been sought from meat processors about any such assistance received by them. However given the private nature and commercial confidentiality of any assistance received by processors, this study also covers such assistance by identifying relevant Programs provided by Governments for which processors would be expected to be eligible.

While the focus is limited to Australia, New Zealand and the United States some relevant material on the United Kingdom and Ireland will also be reported in the analysis in the following chapters.

**Data Sources**

For *livestock* producers, the data sources used are as follows:

The OECD system – this includes the Producer Support Estimate (PSE), which is an indicator of the monetary value of gross transfers to agricultural producers measured at the farm gate arising from policy measures (including the effects of tariffs and subsidies in raising or lowering prices above or below world market price levels). PSE estimates are available for individual commodity groups, including beef and veal, and sheepmeat. The OECD also produces a General Services Support estimate (GSSE), which indicates the monetary value of transfers provided to agriculture collectively, including policies such as research and development and inspection services.

The WTO – the WTO system uses a measure known as the Aggregate Measure of Support (AMS), which includes some measures in the PSE (namely market price support, direct Government payments and input cost reductions, but does not include the effect of import restrictions and export subsidies) nor general government services/benefits to various agricultural programs provided by State/local governments (often referred to as sub-national governments). It should be noted that the PSE ostensibly includes State/local Government assistance, while the AMS as originally developed did not include State/local level assistance.

Apart from the above public data, the checklist used for gathering information on costs from livestock producers also requested information on assistance received from all government sources for the livestock operation. Any data provided by the producer on this was used for cross-checking and comparison purposes.

For *feedlotters*, data was assumed to be covered in the public livestock production data as above. However the checklist used for gathering information on costs from feedlotters also requested information on assistance received from all government sources for the feedlot operation. Any data provided by the feedlotters on this was used for cross-checking and comparison purposes.

For *meat processors*, there is virtually no internationally comparable public data on assistance similar to that available for livestock production discussed above. The WTO Subsidies Agreement information base was searched without obtaining data on assistance to meat processors. Accordingly, for each country information was sought from a number of public and private sources. Public sources included various Government Departments in the Federal and States systems where applicable for information on assistance programs which had benefited processors or for which processors might be eligible. Private data was sought from processors via the checklist on costs/charges, requesting requested information on assistance received from all government sources for the processing operation.

In summary, a substantial amount of valuable policy and commercially-relevant data was collected for the purposes of this study over a very brief period from September to November 2000, which enabled the unique approach of this study (particularly insofar as costs and charges are concerned) in using public and private data sources in a complementary manner to be achieved.

# 4. THE IMPACT OF GOVERNMENT ON MEAT INDUSTRY COMPETITIVENESS

## 4.1 Competitiveness and efficiency

The title of this research project refers to the impact of Government on industry competitiveness. Indeed if a Government is acting, either directly or indirectly, to harm the competitiveness of its meat industry then this is a matter of importance not only for the industry but for that economy and its community more broadly.

However it is equally possible for a Government to enhance the competitiveness of its meat industry and whilst this would inevitably be welcomed by the industry such action would equally have wider implications for the community and the economy more broadly. These implications in an economic sense may be both positive and negative. On the positive side, such action may generate additional export income or jobs.

However equally it may result in inefficient allocation of resources and lower economic welfare for the community as a whole, if producers and consumers are given false signals about what to produce and consume as a result of the action to improve competitiveness (e.g. through a subsidy). In economic terms, maximising the efficiency of resource allocation generates maximum economic growth and welfare for the community.

The purpose of this study is not to measure the industry or economy-wide economic impacts of Government action. The project seeks to identify the Government charges and assistance that impact on Australia's meat and livestock industry in comparison with experience internationally.

To the extent that such differences are significant, a higher level of such charges in Australia relative to our key competitors may adversely impact on our industry's competitiveness. However it may not necessarily impact on our industry's efficiency. They will do so if they are based on principles and approaches that are not economically rational.

Maximising efficiency, rather than competitiveness, will generate the greatest economic net benefits for the Australian industry. Ideally what we want are efficient industries that are competitive internationally.

## 4.2 General cost and charges levels

The results of the cost analysis research presented below show that Australian livestock and meat producers generally have higher Government-influenced costs and charges overall than their key international competitors.

Costs/Charges for Livestock

Taking all the charges itemized in Chapter 3 above together, and allowing for some marginal differences in the coverage of data in the different countries analysed, Australian sheep producers on average pay over *one half* of their livestock revenue (excluding wool) and around *one quarter* of their livestock revenue (including wool) in government influenced costs and charges.

In comparing these charges with New Zealand, it is more appropriate to compare the charges for a mixed sheep-beef producer in both countries, given that in New Zealand the livestock farms are overwhelmingly mixed sheep-beef operations. An Australian mixed sheep-beef producer pays around *one-third* of their livestock revenue (excluding wool) and around *one-fifth* of their livestock revenue (including wool) in such charges.

By contrast, the average New Zealand mixed sheep-beef farmer pays *around one-sixth* of their livestock revenue (excluding wool) and *one-tenth* of their livestock revenue (including wool) in such charges. US sheep farmers would pay least of all, *around one-eighth* of their livestock revenue (with little wool being produced).

| TABLE 1 Sheep Farm Government Charges & Costs as % of Revenue | | | |
|---|---|---|---|
| | % Livestock Excl. Wool | % Livestock Incl. Wool | % of Farm Revenue |
| Australia Sheep Farms | 56.8 | 23.9 | 18.3 |
| Australia Sheep-Beef Farms | 30.9 | 21.1 | 17.9 |
| New Zealand Sheep-Beef Farms | 13.1 | 10.3 | 9 |
| United States Sheep Farms | 12.7 | 12.7 | 8 |

Notes: Australia data is from ABARE; New Zealand is from Meat and Wool Board Economic Service (adjusted to allocate inspection costs and levies to processors); United States is from Census of Agriculture and Bureau of Labor Statistics (for imputed oncosts).

Whilst the figure for Australian sheep farm costs/charges as a percentage of livestock revenues may appear very high in absolute terms, it must be remembered that the revenue figure excludes wool, which is especially significant in the case of Australian sheep farms. Once wool revenue is taken into account, the costs/charges percentage of revenue falls by over one half.

If we look at the major components of the government-influenced costs/charges for Australian ***sheep*** producers, for example, we find the following percentages of livestock revenue (excluding wool):

*Oncosts:* 10.3% (2.6% superannuation, 7.7% workers compensation with data on payroll tax, training and leave entitlements not separately identified)
*Utilities*: 24.8% (electricity 3.5%, gas 0.2%, water 1.3%, and other – mainly fuel – 19.8%)
*Rates:* 8.8%
*Levies*: 6.9%
*Registration* 1.8%
*Other*: 4.2% (including bank and legal fees, scale and saleyard charges, and miscellaneous government charges)
*TOTAL:* 56.8%

By comparison, if we look at the major components of the government-influenced costs/charges for Australian ***sheep-beef*** producers, for example, we find the following percentages of livestock revenue (excluding wool):

*Oncosts:* 5.0% (1.0% superannuation, 4.0% workers compensation with data on payroll tax, training and leave entitlements not separately identified)
*Utilities*: 13.6% (electricity 1.8%, gas 0.1%, water 0.7%, and other – mainly fuel - 11.0%)
*Rates:* 5.2%
*Levies*: 2.8%
*Registration* 1.2%
*Other*: 3.1% (including bank and legal fees, scale and saleyard charges, and miscellaneous government charges)
*TOTAL:* 30.9%

However the make-up of the total government-influenced costs/charges identified in both cases is similar – that is, oncosts account for roughly the same share of the total percentage of government-influenced costs in both cases. This indicates that it is the changes in revenue resulting from including or excluding wool revenue that accounts for the higher absolute percentages in the sheep case, rather than any inherent difference in the significance of the charges in total revenue.

Similarly, on a more general level, the major *non*-government influenced cost items *excluded* from consideration for the purposes of this study include items such a hired labour and purchased animals. These may not be very considerable cost components of livestock farms. However they are very considerable in the case of feedlots and meat processors, so the government-influenced percentage of their revenues will tend to be naturally smaller than for livestock producers.

The composition of the major items of government-influenced costs and charges for the main types of producers, feedlotters and processors is analysed across the various categories for Australia, New Zealand and the United States in the Strategic Cost/Charges Analysis in Chapter 5 below.

Australia's largest sheep-beef producers (measured as the top 20% of revenue earners) pay around *27 per cent* of livestock revenue (excluding wool) and *18 per cent* including wool in these charges, whereas the largest 20% in New Zealand would pay around 8 *per cent* and 6 *per cent*

respectively. One New Zealand sheep-beef producer interviewed by the researchers who had a significant stud operation (and hence higher revenue) paid only *3 per cent* of farm revenue in charges.

**TABLE 2 Top 20% Sheep-Beef Farms: Government Charges & Costs as % of Revenue**

| | % Livestock Excl. Wool | % Livestock Incl. Wool | % of Farm Revenue |
|---|---|---|---|
| Australia Top Sheep-Beef Farms | 27.3 | 18.2 | 15.0 |
| New Zealand Top Sheep-Beef Farms | 7.6 | 6.3 | 6.1 |

Notes: Australia data is from ABARE; New Zealand is from Meat and Wool Board Economic Service (adjusted to allocate inspection costs and levies to processors).

Australian beef producers are much better off than sheep counterparts in terms of the levels of their charges. Australian beef producers pay around 17 per cent of their revenue (both including and excluding wool), about the same level as the average US and New Zealand producers.

The composition of the Australian ***beef*** producer's charges as a percent of total revenue is as follows:
*Oncosts:* 2.3% (0.3% superannuation, 1.9% workers compensation with data on payroll tax, training and leave entitlements not separately identified)
*Utilities*: 8.1% (electricity 1.8%, gas 0.1%, water 0.4%, and other – mainly fuel – 6.8%)
*Rates:* 3.1%
*Levies*: 0.9%
*Registration* 0.6%
*Other*: 1.7% (including bank and legal fees, scale and saleyard charges, and miscellaneous government charges)
*TOTAL:* 16.7%

The relatively high US figure may reflect the scale of properties reporting expenditure in the US Census of Agriculture data used for the purposes of the above US calculation. (The farms reporting had on average only 80 cattle). Moreover cattle farms included in the US cattle data also reported having some sheep, suggesting they should be properly considered to be mixed sheep-beef properties rather than specialist cattle ranches.

However US cattle producers generate considerable revenue from non-livestock sales (mainly grain). Accordingly the Australian beef producer pays around *12 per cent* of total farm revenue in government influenced costs and charges, whilst the US farmer pays only *9 per cent*.

**TABLE 3 Beef Cattle Farm Government Charges & Costs % of Revenue**

| | % Livestock Excl. Wool | % Livestock Incl. Wool | % of Farm Revenue |
|---|---|---|---|
| Australia Beef Farms | 16.7 | 16.6 | 12.2 |
| Australia Sheep-Beef Farms | 30.9 | 21.1 | 17.9 |
| New Zealand Sheep-Beef Farms | 13.1 | 10.3 | 9.0 |
| United States Cattle Farms | 18.5 | 18.5 | 8.9 |

Notes: Australia data is from ABARE; New Zealand is from Meat and Wool Board Economic Service (adjusted to allocate inspection costs and levies to processors); United States is from Census of Agriculture and Bureau of Labor Statistics (for imputed oncosts).

The public data used for the Australia, New Zealand and USA calculations was compared with the results of analysis of 11 farms in the countries concerned to check whether there were any results which were clearly out of line. This analysis confirmed that the levels of overall cost as a proportion of revenue were similar to those indicated in the public data. For example, a US sheep farm produced the following results in comparison to public data.

**TABLE 4 Private and Public Data Comparisons**

| | Total Government Charges | Livestock Revenue | % of Revenue |
|---|---|---|---|
| USA Sheep Public Data | $US4,227 | $US33,497 | 12.6 |
| USA Sheep Private Data | $US8,901 | $US69,000 | 12.9 |
| Australia Sheep-Beef Public Data | $A23,761 | $A76,812 | 30.9 |
| Australia Sheep-Beef Private Data | $A71,400 | $A300,000 | 23.8 |

Notes: Australia public data is from ABARE; United States public data is from Census of Agriculture and Bureau of Labor Statistics (for imputed oncosts).

As could be expected, the disparities between the revenues in the public and private data above reflect the fact that the private data is from illustrative operations which were analysed to check the comparability of data. The private data was for larger operations as distinct from the public data which reflects information from very large samples of farms.

Costs & Charges for Feedlots

Selected data was also obtained on feedlots in Australia and the USA (there being negligible feedlot activity in New Zealand).

In Australia, there is no public data available on feedlots, but private data from a number of large commercial feedlots indicated Government charges account for 3.1 to 3.3 per cent of revenue.

These proportions are very similar to those in the United States public data obtained. Public data from the Census of Agriculture is available for 1997 on cattle feedlots in the USA, and indicates Government-influenced charges & costs accounting for 3.1 per cent of revenue, although this data does not include environmental costs. Private data from a small feedlot in the USA including environmental costs indicated total charges accounting for 3.3% of revenues.

However data from a large USA feedlot operator produced a far lower percentage of just 2.1 per cent indicating a significant advantage for a large USA feedlot relative to its counterpart in Australia.

Costs & Charges for Processors

Australian meat processors clearly have higher Government-influenced costs and charges overall than their key international competitors.

Given the absence of public data with the required detail in Australia and New Zealand, private data from a selection of processing operations was used for the purposes of analysis.

The data indicates that the largest Australian (non-service) works pay around 4 to 5 per cent of their revenues in Government-influenced charges and costs. Smaller works pay upwards of 7 per cent.

Service works pay much higher percentages of their revenues given that they charge a service fee rather than purchasing cattle and selling the beef processed on their own account. For service works Government–influenced charges are in the range of 20 to 25 per cent.

Whilst the percentages above quoted for non-service works appear small, two points must be remembered:

- Whilst these percentages as a proportion of total sales revenues may be small, they are very large in absolute dollar terms. The beef and lamb processing industries have revenues estimated at around $A6.6 billion (*Australian Bureau of Statistics Consultancy Stats)*, so even the low figure above of around 4 to 5 per cent of revenue implies the payment of up to $A330 million in these charges and costs.
- Relative to the profitability of the meat industry, the above percentages of sales are very significant. The profit margin for the meat processing industry in Australia is only 2 per cent (measured as the percentage of operating income available as operating profit in 1998-99 – *Australian Bureau of Statistics Consultancy Stats)*. This would broadly equate to the operating profit before tax as a percentage of sales revenue. Clearly the proportion of revenue accounted for by Government-influenced costs is well in excess of the profit being earned by the industry as a whole, and any reduction in those costs would therefore have a substantial leverage effect on industry profitability.

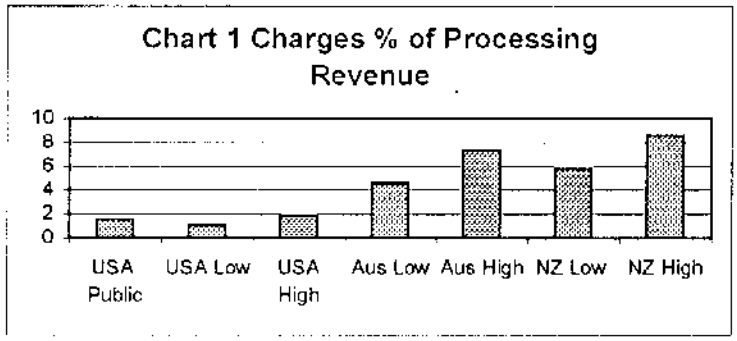
New Zealand processors pay around the same as their Australian counterparts, but given that the scale of the New Zealand operations investigated was smaller than their Australian equivalents, and some of the charges analysed are in the nature of fixed costs (e.g. some licensing fees), New Zealand processors would probably be operating under an effectively lower burden of charges than their Australian counterparts overall.

US processors pay significantly less in Government-influenced charges/costs as a proportion of revenue. Overall, the largest Australian processors pay over twice as much as US processors, and smaller Australian processors over 4 times as much as US processors. If Australian low cost processors were to experience the same "burden" as their US counterparts it would mean a saving of over $A200 million in costs to the Australian industry. If

Australian high cost processors were to achieve US low cost levels it would mean a saving of over $A400 million.

It should be noted that there is public data available on USA processing costs through the Economic Census, which amalgamates red meat (including pork, lamb and beef) slaughtering plants and includes most of the categories of data sought for comparative purposes. The remaining categories can be imputed from other sources (e.g. inspection costs and levies paid from the USDA, labour on-costs from the Bureau of Labor Statistics).

This public data was verified by private data from fat cattle and cow cattle slaughter operations, and the two sets of data were found to produce very similar results.




In the case of New Zealand, inspection charges and levies are paid by processors but deducted from payments to producers for livestock. As processors generally do not record these as cost items they were imputed to processors for the purpose of this analysis. Where necessary, a similar process of imputing levies was undertaken for the USA data to facilitate comparability.

In conclusion, the key finding of this analysis is that at a general level, for the range of Government-influenced costs and charges which apply to the meat and livestock industry, these charges are higher overall for the Australian livestock and meat industry than for the industry's key competitors, especially the United States. Even though the proportion of revenues involved in these costs may appear small, the impact in dollar terms is large indeed.

The impact in profitability terms is equally profound. Owing to the need to maintain the commercial confidentiality of the data gathered, it is not possible to illustrate this by reference to individual farm, feedlot or processor profitability.

However the following gives an indication of the relative size of government-influenced costs on revenue and profitability in selected Australian and United States examples.

Australia Sheep-Beef Farms 1998-99

| | $A |
|---|---|
| Livestock revenues (excluding Wool) | 76,812 |
| Total cash revenues | 132,300 |
| All cash costs | 112,960 |
| Cash income (before family labour, depreciation and changes in trading stocks) | 21,000 |
| Cash income % of total revenues | 15.9% |
| Government-influenced costs | 23,761 |

Sources: ABARE Farm Surveys Report 2000, and analysis based on commissioned ABARE data from farm surveys (for Government-influenced costs).

As can be seen, Government-influenced costs total ***more*** than the cash income available to the sheep and beef farm before family labour, depreciation and changes in trading stocks are taken into account.

For United States farmers, by contrast, Government-influenced charges have a far lesser impact on profitability. For US sheep farmers, census data suggests that farmers' net cash return from agricultural sales is around $US 2,000 per farm, equivalent to around 10 per cent of the market value of all agricultural products sold.

Once Government payments and other farm-related income are taken unto account however, farm cash returns rise substantially (to approximately $US9,000 per farm or around 40% of agricultural sales).

With government-influenced payments being around 12 per cent of livestock revenue and 8 per cent of farm revenue as calculated by this study, it can be seen than US farmers face a far lower impact on their profitability from these payments than Australian farmers.

For Australian processors, the impact on profitability is equally profound. On the basis of Government-influenced charges accounting for around 5 to 7 per cent of (non-service works) processing revenues, the impact on profitability is indicated below.

Australia Meat Processing 1998-99

| | $Am |
|---|---|
| Sales and service income | 6628.2 |
| Cost of sales | 5221.2 |
| Trading Profit | 1406.9 |
| Labour costs and other expenses | 1135.5 |
| Earnings before interest, tax and depreciation | 271.4 |
| Operating profit before tax | 129.4 |
| Operating profit margin % of sales | 2.0% |
| Implied Government-influenced costs/charges | 330 to 460 |

Source: Australian Bureau of Statistics Consultancy Stats, private data.

As can be seen, the government-influenced charges account for significantly more than the entire processing industry's profitability.

By contrast, for US processing, the profitability of the red meatpacking industry would appear to be roughly similar to that in Australia. Total operating income (net sales minus cost of sales and operating expenses before tax but after interest, and depreciation) for the top 40 packers is around 2 per cent of sales according to the USDA (Packers and Stockyards Statistical Report 1998 Reporting Year, published in 2000).

But the proportion of revenue accounted for by government-influenced costs is much lower at around 0.5 to 2 per cent of revenues. All things being equal, the impact on profitability in the United States would therefore be concomitantly lower too.

However notwithstanding the above conclusions it is necessary to go beyond this to look specific aspects or categories of costs and understand why it is the case that the Australian meat and livestock industries face this situation.

## 4.3 Specific Cost and Charges Levels

For purposes of analysis, the various cost items on which data was gathered have been segmented into a number of groups of items in which there is particular interest in the meat industry, namely:

- Labour oncosts
- Utilities and fuel
- Meat industry-specific costs – inspection, licensing and levies
- Environmental costs.

***Labour oncosts***

Australian on costs are considerably above levels of our competitors and account for a meaningful proportion of total revenue. As an indication, ABS data on manufacturing establishments identifies the following as a ratio of wages and salaries for the food, beverage and tobacco industry:

| Australia | |
|---|---|
| Employer Superannuation contributions | 5.9% |
| Workers compensation | 4.1% |
| Payroll tax | 5.4% |
| TOTAL | 15.4% |

By contrast, in the USA (according to the Bureau of Labour), legally required benefits paid by employers for blue-collar workers, are as a proportion of total compensation:

| USA | |
|---|---|
| Social Security | 5.9% |
| Federal Unemployment Insurance | 0.2% |
| State Unemployment Insurance | 0.6% |
| Workers Compensation | 3.1% |
| TOTAL | 9.8% |

It should be noted however that these benefits do vary from State to State. For example workers compensation costs vary from 0.403% in Utah to 1.646% in Louisiana, and unemployment insurance taxes vary from 0.4% in New Hampshire to 3.9% in Pennsylvania (source: Expansion Management Atlas & Guide 2000).

Clearly having oncosts on average nearly 60% higher than one's competitor, especially in the more labour intensive industry sectors of the livestock and meat industry such as meat processing, is a major source of competitive disadvantage for Australia.

This cost disadvantage is confirmed by the data collected for this research. The following Table summarises the oncosts situation by country and value chain segment. It should be noted that Australia has a disadvantage both in comparison with the USA and also New Zealand.

**TABLE 5 Oncosts as % of Revenue**

| | Livestock | | Processing (non-service) | |
|---|---|---|---|---|
| | Public data | Private data | Public data | Private data |
| Australia | 2-10% | 2-10% | NA | 2 to 4% |
| New Zealand | 1% | 0.5% | NA | 1.5 to 1.9% |
| USA | 0.5% | 1% | 0.2% | 0.4-0.6 |

Notes: Australia data is from ABARE; New Zealand is from Meat and Wool Board Economic Service (adjusted to allocate inspection costs and levies to processors); United States is from Census of Agriculture and Bureau of Labor Statistics (for imputed oncosts).

For Australian livestock producers, the major components of its high oncosts are workers compensation, superannuation and payroll tax. For Australian processors, the major items are leave entitlements followed by workers compensation, payroll tax and superannuation.

Public data covering some oncosts is available from ABS Consultancy Data. This indicates that for the meat processing meat industry payroll tax, workers compensation and employer superannuation contributions amounted to 3.3% of sales in 1998-99. This figure is consistent with the private data indicated in Table 5 above.

***Utilities and Fuel***

Most notably in natural monopoly infrastructure services – such as electricity, gas, telecoms, rail, roads, and water – but more recently in a wide range of traditional government services privatisation and de-regulation is rapidly occurring. The withdrawal of governments from direct provision of their services has however been accompanied by elaborate systems of

government regulation to ensure that competitive markets are simulated and monopoly exploitation is avoided.

As a recent World Bank Study observes *"...Government-run monopolies were once justified by the low production costs associated with large-scale operations and by the need to protect consumers from voracious private monopolies. But now there is growing recognition that private initiative – disciplined in part by competitive market forces – often has the upper hand in efficiently delivering infrastructure. While the* government as a provider *is being outmoded (especially in sectors such as telecommunications and electric power)* the government as a regulator *protecting the public interest – is acquiring a more prominent role."*(World Bank 1996, pxiv.)

Regulatory systems imposed by governments are in place in all developed countries including the United States and New Zealand. In Australia the regulatory system was formalised in the National Competition Principles Agreement signed by all governments in Australia in April 1995 (PC 1999, p5).

Utilities and fuel are major cost items for Australian livestock and meat producers. For sheep producers they can total from 10 to 20 per cent of revenue, for cattle producers around 5 to 10 per cent (although for one cattle property recorded this was reduced to under 3%).

These cost are generally higher than international competitors. New Zealand sheep-beef producers have a comparative figure of 7.2% and the top 20% of producers has 2.7%. For the USA, sheep farmers pay around 6 to 8 per cent and cattle producers around 12 per cent, the major factor in cattle costs being electricity charges. Electricity charges are the subject of some controversy in the USA at present (Box 5, *The Economist*, 13 January 2001, p64 ).

Australian processors pay 0.5 to 1 per cent of their revenue in these costs, compared to 0.3 to 0.7% in the USA. These costs appear to be higher in New Zealand, where they are 1.8 to 2 per cent of revenue.

*Box 5*

**US Panel Proposes Big Market Change to Curb California's Electricity Prices**

"The Federal Energy Regulatory Commission proposed sweeping changes in California's deregulated electricity market in a bid to push down high electricity prices.

The proposed order, which will be open to industry and public comment before being implemented, comes as Californians are suffering record high electricity prices.....The move also marks the first time the Federal Government has intervened to make major changes in a state market since the era of electricity deregulation began four years ago.....

The draft order proposes to cap wholesale electricity prices for two years at $150 per megawatt hour but to allow electricity plant owners to receive higher prices on a case-by-case basis, if they can demonstrate they deserve it.....

The four-member commission, in authorizing the new "soft cap" for wholesale prices charged in California, dismissed a variable-price scheme adopted last week by the California Independent System Operator, the organization responsible for keeping enough electricity on hand to meet actual demand". *Wall Street Journal, 2 November 2000.*

**Meat Industry-Specific Costs**

Of particular interest to the meat industry are a series of costs that apply specifically to that industry and not in Australian industries generally.

For Australian livestock producers, the major components on their high utilities and fuel costs are fuel (net of the diesel fuel rebate, which is included in the analysis of assistance estimated by the OECD below) and electricity.

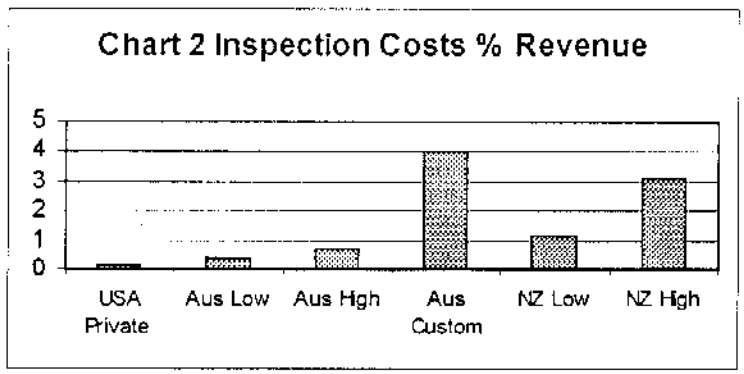
Fuel accounts for around 6 per cent of the Australian beef cattle producer revenue, around 16 per cent of the sheep producer and 9 per cent of the sheep-beef producer revenue. The New Zealand sheep-beef cattle producer pays around 4.5 per cent, the USA cattle producer about the same, and the USA sheep producer only 3.3 per cent in fuel costs.

*Inspection Charges*

Inspection charges for Australian (non-service) processors based on private data account for around 0.4 to 0.7 percent of revenue.

This amounts to a considerable cost for the processing industry – roughly equivalent to $32 million to $45 million.

It is also significantly higher than in the USA. Private data from US processors indicated that inspection only accounted for 0.1 per cent of revenue. However, for New Zealand processors (with inspection costs imputed from livestock producers to processors) the figure was 1.2 to 3.1 per cent of revenues.




Meat Inspection charges have been a matter of concern to the Australian meat industry for many years. The policy of successive Governments towards meat inspection has been to recover costs from users of inspection services (*Budget Paper No 1 1990-91*, p4.16). AQIS recovers over $A55 million from the meat industry in accordance with this policy of "full" cost recovery of the service provided.

This contrasts with the situation in the USA, where charges are made to processors only to cover overtime or unscheduled meat inspections. USDA's Food Safety and Inspection Service raised only $US85 million in FY1996 through these charges, about 13.5 per cent of total FSIS outlays *(ERS/FSIS Survey of Meat Inspection Agencies*, in *MacDonald et al, 1999*).

An important issue to consider is what exactly is included in the costs being recovered. In the US, fees are based on hourly charges for inspectors' time. Hourly charges are generally based on "full inspector costs", including benefits, travel and downtime, and supervisory expenses.

In Australia, it would appear that the following costs associated with providing the meat inspection service are recovered:

A) Fixed costs (including Central Office, Area Offices, and purchases of support services including finance, technology and human resources) - total 1999-2000 budget expenditure being $A7.6 million.

B) Service delivery costs (including meat inspectors and veterinarians) – 1999-2000 budget expenditure being $A35.5million.

C) Area Technical Managers - 1999-2000 budget expenditure being $A2.1 million million.

D) Overtime – $A2.5 million

E) EXDOC (Export Documentation) - $A2.0 million

TOTAL - $A49.7million (see *ANAO 2000, Appendix 15*)

In New Zealand, user fees "...cover not only the direct costs of inspection but also the indirect costs such as the cost of negotiations with importing countries; setting standards; audit of compliance; and the overhead costs of running the Ministry of Agriculture – including the appropriate share of the costs of the Director General and his team; legal costs; accommodation; depreciation and capital charges etc" *(MacDonald et al 1999).*

The key question which must be addressed is what costs should be recovered and from whom? Economic theory provides a framework for making choices in these areas.

As the extensive discussion of economic theory in BCA 1993, 1995 and RIRDC 1999 and 2001, reviewed briefly in Chapter 2.2 above, attests the proper approach to the pricing of government services, and most particularly government monopoly services, is the principle of marginal cost. Price must equal short run marginal cost. If price exceeds marginal cost a tax is being extracted by the provider (in this case the government) from the user. If price is below marginal cost then a subsidy is being given (Box 6).

*Box 6*

*"... Strictly speaking, any price above marginal cost is a tax, even if that price is below average cost. Thus a cost accountant may denounce as a "subsidy" a price which an economist would regard as already in excess of marginal cost – and thus a tax."*

Source: RIRDC 1999, *Infrastructure Pricing, Provision and Process: Implications for Rural Australia*, p43.

The paradox between economic theory and accountancy – which the publications cited above explain – is that pricing of government services at marginal cost will result in a loss.

This for private sector business would be a disaster and result in bankruptcy. Hence, in private sector business it is essential that accounting theory be pursued and there be full cost recovery.

That is, every business in the private sector – to be viable – must stand on its own feet and "pay its way". This is not correct for the public sector.

Optimal economic efficiency is achieved in the case of the public sector and the economy more broadly if services are provided at marginal cost and the "losses" are recouped through general taxation revenue.

These important issues of principle were identified in the 1930s by the US economist Harold Hotelling (Hotelling 1938) and have an extensive history in economy theory as the publications cited above attest.

As the Business Council of Australia said in its 1993 Study *"... In a justly famous article called 'The General Welfare in Relation to Problems of Taxation and of Railway and Utility Rates' in* Econometrica *in 1938 Harold Hotelling drew attention to the implications of the economic desideratum of setting price equal to marginal cost. Hotelling pointed out that when it comes to user charges for natural monopolies such as railways, water and sewerage systems, highways, electricity and telephone grid systems and so on, the principle of average cost pricing so beloved of accountants and those who favour full cost recovery on a user pays basis is dead wrong."* (BCA 1993, p21).

The Business Council has observed that while Hotelling's prescription of marginal cost pricing with fixed costs being "subsidised" by lump sum taxation has been accepted as theoretically correct there have been objections on the grounds that, firstly, there are no lump sum taxes available since all taxes are distorting and, secondly, that in the long run all costs are marginal (BCA 1993, p22).

The extensive publications of the Business Council of Australia and the Rural Industries Research and Development Corporation since 1993 have shown the theoretical and practical flaws in these objections to the marginal cost rule and disposed of the nebulous argument that because all taxes are distorting there is nothing wrong with full cost recovery.

Equally those publications have disposed of Ramsey pricing (charging what the market will bear) as a second best alternative to marginal cost pricing. Since the path-breaking work of the Business Council in 1993 there has been more debate on the issue of disguised taxation in the form of user charges and "full cost recovery".

Indeed it should be noted that the issues associated with marginal cost pricing for Government services are a focus of contemporary policy debate in Australia (*Financial Review*, 24 January 2001,p28).

The Productivity Commission is currently conducting an Inquiry on Cost Recovery arrangements by Commonwealth Government agencies and also an Inquiry on the National Access Regime. In the case of the former Inquiry, the Issues Paper released by the Commission in October 2000 includes a discussion on costing issues that contains an analysis of alternative methods for allocating costs (reproduced in Box 7 below).

In regards to the supposed "difficulty" of measuring marginal cost this is also a doubtful practical objection. The substantial effort and analysis undertaken by Treasurers and Departments of Finance to provide detailed rules for Departments (AQIS included) for calculating "full cost recovery" would surely not be exceeded in developing marginal cost principles. It is also relevant that issues of capital cost estimation as referred to by the Productivity Commission in Box 7 do not arise (BCA 1993, 1995; RIRDC 1995).

*Box 7*

**Methods for allocating costs**

**Fully Distributed Cost.** Under this method the total costs of an agency are allocated across all outputs. Direct costs are allocated to their respective output, while indirect costs are allocated across all outputs. Indirect costs can be allocated in a number of ways. They can be allocated on a pro-rata basis according to the number of staff involved in the activity as a percentage of the total number of staff. They could also be allocated on the basis of shares of resources or direct costs devoted to different activities. Activity-based costing which allocates costs to products using criteria which reflect usage by each product, is a more sophisticated way of fully distributing costs.

**Marginal costs.** Costs can also be allocated on the basis of the marginal cost of producing an additional good or service. Marginal costs will generally include direct costs that vary with output and some indirect costs. This method can either exclude the cost of capital if capital is fixed , particularly in the short term (known as short run marginal cost allocation) or include it is capital is able to be acquired or disposed of in the long term (known as long run marginal cost allocation). Under long run marginal cost allocation indirect costs which are fixed are excluded. Marginal costs can be difficult to measure, particularly when identifying capital costs and treating joint costs.

**Incremental** or **avoidable costs**. Incremental costs refer to the increase in costs attributable to the production of a particular type of good or service (rather than the marginal cost of producing an additional unit of that good or service). Avoidable costs include all the costs that would be avoided if an output was no longer provided by the agency. In practice there is generally little difference between incremental and avoidable cost. Source: *Cost Recovery Issues Paper*, Productivity Commission, October 2000, p. 21.

Fortunately also for MLA and similar organisations, the National Farmers Federation has strongly supported the reasoning and approach of the BCA and RIRDC. The NFF has made a strong submission to the current Productivity Commission Inquiry on the National Access Regime.arguing, inter alia, for marginal cost pricing principles. As the NFF states *"... The Industry Commission made its reputation in fighting fearlessly against the deadweight losses imposed on Australia and her export industries through tariffs. It would be a sad situation were its successor to lend intellectual*

*legitimacy to the imposition of hidden taxes on Australian industry in the form of specious charges for access to essential infrastructure. Marginal cost pricing is the rule for economic efficiency and we expect the Commission to defend that rule against the vested interests of infrastructure owners (often governments) who are more concerned with maximizing monopoly rents (for short term budgetary* purposes) at the expense of Australia's long-term growth and productivity." (NFF 2000)

The current fashion in many countries (Australia included but notably not in the United States in the case of meat inspection) of "full cost" recovery for public services is – as even the Productivity Commission now concedes (PC 2000) – driven by revenue raising motives of Treasuries and Finance Departments rather than principles of economic efficiency. This fashion, while yielding buoyant tax revenues for governments, unfortunately damages the economic efficiency and international competitiveness of business – the Australian beef and sheepmeat industries included.

The full cost recovery of meat inspection in Australia, for example, is underpinned by a confidential high level Memorandum of Understanding between the Department of Finance and Administration and the Department of Agriculture, Forestry and Fisheries (ANAO 2000). There seems little doubt this "full cost recovery" directive follows accountancy principles and is revenue driven (Budget Paper No 1 1990-91, Statement 4). The disguised indirect taxation imposed on the Australian meat industries and the deadweight costs of this measure are significant.

As the data collected in this Study shows the New Zealand meat industry experiences a similar burden from misguided "full cost recovery" directives from its Treasury Department. In contrast the United States meat industry experiences no such burden.

It is also instructive to consider the position of some other countries. For example, in the EU the policy of cost recovery as set out in EU Directive (85/73/EEC) allows Member States considerable flexibility in interpretation.

There is no rigid requirement for **full** cost recovery as administered in Australia and New Zealand. There is only a requirement to "cover the costs" incurred by the "competent authority" for **selected** salaries and administration. That this EU Directive may be interpreted as loosely, or as harshly, as individual Member States wish is attested to in recent UK

Reports which show that the UK (who like Australia is driven by Treasury Directives for full cost recovery) pays far higher meat inspection levies than other EU States (Box 8).

Personal communications to the researchers confirm that the Ireland meat industry pays charges some 40% less than full cost recovery, while numerous countries in the EU similarly avoid the adverse economic impact of full cost recovery.

***Box 8***

*"...Across the 10 Member States studied the Meat Inspection Charges Directive is being implemented, and charges are in place (although it was unclear as to the extent to which collection of the charges in Spain was carried out). Most Member States operate national inspection systems similar to the UK's MHS, but two Member States, Germany and Italy, use regionally based approaches.*
*The level of charges for meat inspections would appear to be very variable in the EU. All Member States, studied charge on a headage basis, except for the GB and the Netherlands, which use an hourly rate."*

*...Current levels of charging in GB place it at the* ***higher end*** *of the spectrum in the EU.* ***The proposed increase in charges will worsen that differential.***"

Source: UK Meat and Livestock Commission; *The Impact of Further Changes to Meat Inspection Charges and Other Enforcement Costs*, July 1999.

*"...As both the MAFF survey in 1998 and the subsequent MLC 'Pratt' report clearly indicate, the interpretation and implementation of the Charges Directive varies considerably between Member States, as does the level of meat inspection charges levied. The Pratt report indicated that on the basis of information provided by the MHS and collected from other Member States during the study, the levels of charging in GB place it at "the higher end of the spectrum" in the EU, across all red meat species. Since the MHS figures used in the Pratt report comparison were average charges, this means that smaller plants in GB (which generally are charged above the average level) are even more severely disadvantaged when compared to their EU counterparts than might otherwise appear to be the case.*

*... The differences in the way the Directive is being applied in Member States, and the wide variations in the levels of the charges being levied, as revealed by these various studies, clearly indicates that the aim of the Directive (i.e. to avoid distortions of trade between member states) is not being met. As the Pratt report concluded, 'the British meat industry is seriously disadvantaged by higher costs'."*

Source: *Meat Inspection Charges Task Force* (Maclean Report), June 2000.

The serious competitive disadvantage of the UK meat industry in relation to its EU counterparts in pursuing a misguided "full cost recovery" policy is also confirmed in the Pooley Report (1999) as follows: *"... Some have alleged that other EU Member States, which are subject to the same rules about charging industry for meat hygiene inspections, do not levy the charges in the same way as done by the UK Government and that this leaves the UK industry at a competitive disadvantage vis-à-vis other countries. Following an earlier report by MAFF, the Meat and Livestock Commission (MLC) undertook a short investigation of these allegations (the Pratt report), which showed that while not conclusive, there is clear evidence that the British meat industry is seriously disadvantaged compared to other Member States through a whole range of costs to do with meat inspection and BSE."* (Pooley Report, pp12,13)

In the United States, as already noted above, meat inspection charges amount to around 13% of Agency outlays. This probably is close to a true marginal cost of the service. It would be wrong to assert as a consequence that by not following a (misguided) policy of full cost recovery that the United States is, in this particular area, subsidising its meat industry.

Rather it would be more appropriate to regard the difference between the US 13% and Australia's 100% recovery impost on its meat industry as a measure of the economic cost - and hence handicap to its international competitiveness – which Australia imposes on itself!

It is enlightening in this context to consider a recent USDA/ERS Report on the subject of meat inspection costs prepared against the background of considering what would be an appropriate regime should Congress, in the future, change its long standing opposition to user charges and cost recovery.

As the USDA Report points out (*Macdonald et al 1999*), agencies must decide on some basis for setting charges. Direct users of a service are those who pay the fees – in the case of inspection charges, these are processing establishments. Meat consumers are indirect users of inspection charges because they gain public health benefits but do not pay the user fees.

When a fee accurately reflects the costs of providing a service, direct users will purchase units of that service as long as the benefits exceed the costs. If direct users obtain a large share of the benefits, then we can reasonably say the public will receive the service as long as the benefits to the public exceed the costs, and that it is worthwhile for Government to provide the amount of service that is taken.

Direct users and their share of the benefits become an issue only if the demand for the service is sensitive to the size of the fee. However because Federal inspection is mandatory for meat products, the demand for services will not be sensitive to the fee.

Economic analysis generally focuses on achieving allocative efficiency i.e. determining the proper amount of a service to offer. But since the demand for inspection services is not sensitive to the fee, issues of allocative efficiency are not relevant.

However a fee system does generate administrative costs for Government providers and compliance costs for direct users, and these costs can exceed those imposed by reliance on general revenue to fund the operations of the inspection system. "As a result, the economic case for user fees must rely on the possibility that user fees will lead to a more efficient operation of the inspection system and on the uncertainties associated with obtaining general revenue financing" (*USDA, page 19).*

As the USDA observes, most user-fee systems are designed to help finance the agency. They may also aim to help the agency operate efficiently by producing services for which benefits to society are at least equal to costs and by producing services in the most cost-effective manner.

"The primary rule for setting fees is the same for each of these goals; fees for specific services should reflect the incremental cost associated with providing that service. The incremental cost is the additional cost the agency bears by providing an additional unit of the service.

In the case of inspection services, the incremental cost of inspection services provided to a plant includes the number of inspector hours included in a service, priced at the value of the wages and fringe benefits associated with those hours, plus the costs associated with supervising inspection hours *(page 20)*.

The analysis points out that most agencies also carry fixed costs associated with management, standard setting, research and compliance and since these costs cannot be reliably attributed to the actions of particular payers, there is no best way to set those fees. However it does argue that an effective way to recover these costs is through charges on bases that are insensitive to the fee (e.g. through a fixed charge per unit of output, which tend to be small as they are imposed on a large base).

It could be argued however that pricing inspector hours at the value of wages and benefits of the inspectors also fails to reflect economic principles, since the value should reflect the opportunity cost of those labour inputs. In effect this would mean pricing the hours at the cost of the next alternative use. In the case of Australia it appears that the basis of cost allocating and charging decisions does not reflect economic principles.

As such one would conclude that they are not conducive to efficiency in the operation of the service.

It is instructive that the USDA/ERS comes down firmly on the side of incremental cost pricing (which can be regarded as a practical approximation of marginal cost pricing) rather than full cost recovery. In particular the USDA/ERS Report recognises the serious economic consequences which arise when a government monopoly administers full cost recovery.

In Australia's case on the basis of the principles of incremental cost recovery identified above, the only costs that should appropriately be recovered from a plant should be:

a) Costs of meat inspectors including any overtime undertaken (with wages priced at their opportunity costs). This would suggest a recovery of $A35.4 million in meat inspection expenditure equivalent to a maximum of around 70 per cent cost recovery rather than the 100 per cent currently. However, as is discussed above, the hours worked

by inspectors for plants should be priced at the opportunity cost of that labour, so the actual costs to be recovered could vary from the actual costs as recorded by AQIS.

b) According to the USDA analysis some fixed costs should also be recovered. However they should be limited to any incremental fixed costs of management, standard setting, research and compliance. The costs apparently being recovered by AQIS appear to go well beyond this, although more detail on actual fixed cost expenditure incurred is required.

The purpose of the above analysis is to identify some key economic principles that should be applied in determining the extent of cost recovery rather than determining the exact amount to be recouped.

Clearly however the analysis points to the potential for significant savings to be achieved for the meat industry if an economically rational inspection charging system were to be adopted. Such savings could amount to in the region of 30% of the current inspection costs to the industry, or around $A15 million if an incremental cost recovery regime applied. The application of rigorous marginal cost pricing methods – rather than the less well-defined term of incremental cost - should result in even more substantial relief for the Australian meat industry from the present burden of unjust (and economically damaging) taxes it bears arising from the present "full cost recovery" meat inspection charging regime.

*Levies*

Levies are paid by Australian livestock producers and processors. Processor levies are voluntary but underpinned by legislation making them compulsory under certain conditions.

In the USA, there is a mandatory levy on cattle sold, which is paid by processors and recouped from livestock producers. In New Zealand, there are a series of livestock levies paid by processors and recouped from producers.

For Australia levies account for from 1 to 7 per cent of livestock producers' revenues (public data) and 0.6 to 6.7 per cent (private data), and 0.2 to 0.7 per cent of processor revenues (private data). In the USA they account for 0.1 per cent of processor revenues (private data), and in New Zealand they

account for around 0.7 to 1 per cent of processor revenues (based on imputed private data).

Levies paid by the Australian meat and livestock industry are higher than our international competitors. It should be noted that some of the costs which producers and processors in Australia and New Zealand pay for through levies are for services that are subsidised by Government the USA. Subsidies to the US industry are discussed further below.

*Licencing*

Livestock and meat processors in Australia are required to obtain an extraordinary number of licences by Federal, State and Local Governments. These are listed in Appendix A.

By contrast, producers and processors in the USA appear to have a far lesser burden in this regard. For example, Federal licences to operate an approved processing plant in the US are subsumed within the Federal inspection requirements. A similar situation exists in New Zealand.

In Australia, even processing plants that are approved for export by AQIS and pay a license fee to export also have to pay State authorities, even though the standards of product required for export may be higher than for product destined to the local market.

And unlike AQIS charges, which have at least been subject to some scrutiny in terms of the efficiency-basis of the costs being recovered, there has been little such scrutiny in the case of State licences.

Not surprisingly, licensing costs for an Australian processor can reach measurable levels as a percentage of revenue: 0.7 per cent in one case of a small (non-service) works analysed for this study (private data).

*Environmental Costs*

Environmental costs are commonly not measured in livestock accounting systems. However there is evidence that environmental regulations are beginning to have measurable impacts on livestock production in New Zealand, where some farmers are incurring costs associated with meeting the Resource Management Act.

In feedlots, environmental costs in Australia and the USA are clearly becoming significant. Two small USA feedlots indicated environmental costs, mainly associated with removal of waste amount to 0.7 to 0.8 per cent of revenue. However a large feedlot operator reported costs at only 0.1 per cent. Private data from Australia indicates a wide variation in such costs too, from 0.2 to 1.2 per cent of revenue.

Environmental costs in a number of feedlots examined in Australia and the USA were especially small as a proportion of revenue. However it is not known to what extent this reflects different regulatory imposts or is due to commercial initiatives such as feedlots having their own lagoons for treatment of waste and the effluent; effluent being applied to feedlot-owned land; and farmers being paid to remove yard manure for use on their properties.

In processing, environmental costs (mainly associated with effluent treatment and waste removal) account for 0.1 to 0.2 per cent of revenue in both USA and Australian operations (public and private data). In New Zealand, environmental costs range from 0.1 to 0.5 per cent.

It would appear that the rapidly emerging area of environmental costs is one that warrants further research on an international comparative basis, including analysis of State and Local regulations affecting the livestock and meat industry.

## 4.3 Subsidies

Whilst the livestock and meat industry in Australia faces generally higher levels of Government-influenced charges than its key competitors, especially the United States, it receives less assistance from Government when compared with other countries.

Assistance to Livestock Producers

For livestock producers, there are a number of sources for data that compares assistance provided by Governments. One source is the Organisation for Economic Cooperation and Development (OECD), which produces a number of measures of support to agriculture.

Among these measures are:

- The Producer Support Estimate (PSE) an indicator of the annual monetary value of gross transfers from consumers and taxpayers to agricultural producers, measured at the farm gate level, arising from policy measures which support agriculture regardless of their nature, objectives or impacts on farm production and income. The PSE is expressed as gross transfers as a percentage of gross farm receipts valued at farm gate prices, including budgetary support.
- The General Services Support Estimate (GSSE), an indicator of the annual monetary value of gross transfers to general services provided to agriculture collectively arising from policy measures. The GSSE percentage is expressed as a percentage of the Total Support Estimate to agriculture (TSE)
- The TSE is an indicator of the annual monetary value of gross transfers from taxpayers and consumers arising from policy measures which support agriculture, net of the associated budgetary receipts. The TSE percentage is expressed as a percentage of Gross Domestic Product.

The PSE's for Australia, New Zealand and the United States, as well as for the EU are summarised in the Table below.

**TABLE 6 Producer Support Estimates 1999**

| | Beef Per tonne | Beef % | Sheep Per tonne | Sheep % |
|---|---|---|---|---|
| Australia | $A52.2 | 2.7 | $A33.9 | 2.5 |
| New Zealand | $NZ21.9 | 1.0 | $NZ8.9 | 0.4 |
| United States | $US90.7 | 3.5 | $US415.9 | 12.8 |
| European Union | ECU2674 | 60.1 | ECU2839 | 53.8 |

Source: OECD Database 2000 Edition

In effect, as measured by the PSE the USA beef producer receives 3.5 per cent, the Australian beef farmer 2.7 per cent and the New Zealand beef farmer 1 per cent of their receipts though Government assistance. The USA producer receives substantially more per tonne than the Australian and New Zealand producer of beef, who receive only marginal assistance, and as a percentage of gross farm receipts this difference is reduced. The US sheep producer receives substantially more than the producer in Australia or New Zealand, both in terms of dollars per tonne and percentage of farm receipts.

It should be noted however, that relative to the EU even the USA provides relatively little by way of assistance to beef and sheep producers. The EU PSE percentage for sheep is 54 per cent and for beef 60 per cent, indicating that over half of farm receipts for these farmers is assistance from Governments. Moreover within the EU, farm assistance can be augmented by special national schemes and joint-member State-European Union subsidies. For example, the Irish agricultural sector enjoys very substantial subsidies both from domestic and joint EU subsidy programs. Some examples are provided in Box 9 below.

*Box 9*

**Irish Farm Subsidies: Some Examples**

***The CAP Rural Development Plan:*** This Plan for 2000-2006 involves matching EC and national government funding of IP4 billion ($A8 billion). It embraces a *Rural Environment Protection Scheme*, an *Early Retirement Scheme* and a *Compensatory Allowance Scheme*. The CAP Plan is a central plank of the Government's strategic approach to agriculture, food and rural development announced in 1999.

***The Special Beef Premium Scheme:*** This scheme with payments in excess of IP200 million annually ($A400 million) is directed at premium livestock development.

***Beef Processing Development:*** IP120 million ($A250 million) is earmarked for the beef processing industry to modernise equipment and enhance international competitiveness.

Source: Official Media Releases

Over and above assistance to particular sectors of agriculture (e.g. beef, sheep) the OECD measures general assistance to agriculture through its GSSE indicator. This covers assistance which is provided communally and which cannot be allocated to any particular sector individually.

For Australia the 1999 provisional GSSE is $A802 million, mainly comprising $A578 million in Research and Development, $A161 million in infrastructure and $A37 million in Inspection services. Only $A10 million is provided for marketing and promotion.

It should also be noted that the inspection services amount is a net figure i.e. it represents the cost of the service net of any fees recouped. According to OECD analysts this figure is supposed to represent the gross transfers from the Budget net of any fees recovered. It seems difficult to reconcile this estimate, which would suggest Australian farmers are receiving net assistance to the extent of $A37 million with the 100 per cent cost recovery practices of AQIS as discussed above.

By way of comparison, the GSSE for the United States is $US21.579 billion, with marketing and promotion comprising $US16.8 billion, Research and Development $US2.3 billion and inspection services comprising $US648 million. New Zealand's GSSE is a paltry $NZ190 million, with research and development being $NZ113 million and inspection services $NZ49 million.

By definition, the GSSE does not indicate the sums of assistance gained by individual industries in the form of promotion, research and development or other generally-available assistance mechanisms. In Australia, it is a relatively easy matter to identify the sums of such general assistance obtained by the sheep and beef industries. For example, Meat and Livestock Australia , which is responsible for managing Government-matched funds for meat and livestock industry R&D under an arrangement with the federal Government, received $A20.6 million in such assistance in 1999-2000. By contrast, it is much more difficult to identify how much the United States beef and sheepmeat industries received in the form of generally available assistance. Estimates of such assistance using latest available data are included in Appendix B.

Whilst the PSE is supposed to include assistance provided by all levels of Government, the reality is that its coverage of assistance provided at the State and Local levels (sub national government) is limited. Essentially the OECD relies on National Governments to report on the amounts of assistance provided at all other levels of Government, and the OCED lacks the resources to monitor and measure State assistance itself. It is understood that the USA authorities have reported around $US 2 billion in State and Local government assistance being provided to agriculture out of a total of $US54 billion in 1999.

However, it is not possible to ascertain the accuracy of this figure. The OECD is currently engaged in a research project on this issue, and it may produce more details in due course. What is clear is that a substantial number of States and local governments provide assistance to farmers, including livestock producers in the USA. Many States for example provide tax discounts or rebates on fuel or property taxes (the main forms of revenue for the State budgets) to those operating farm machinery as the Box below indicates for one State.

*Box 10*

**State Tax Credits and Exemptions for Livestock Producers**

"There a few tax credits and exemptions that farmers can receive. Fuel used for farming purposes in –non-licensed machinery is exempt from highway tax. In 1999 this was 19 cents per gallon and could be taken as a credit against income tax when the tax return was filled... There are also tax credits or refunds on property tax, cow-calf operations, capital gains on the sale of certain business assets, and sales tax on utilities and depreciable farm machinery. Some of these like the farm family property tax credit and the cow-calf refund are proportioned out to farmers based on applications and money appropriated by the legislature"
*Personal communication, 9 November 2000*

An illustration of the types of assistance for which agricultural producers may be eligible in the USA is provided in respect of the Illinois Programs identified in Appendix C.

As far as Australia is concerned, there are State and Local Government assistance measures provided to farmers too. But as in the case of the USA,

the OECD in assessing the amount of such assistance relies on the Federal Government to provide estimates thereof and include it in the total assistance reported to the international body. The Productivity Commission in 1996 undertook a very large study of *State, Territory and Local Government Assistance to Industry*. This concluded that around $A682 million of such assistance was provided to agriculture in 1994-95, amounting to 3% of farm gate production value. (This was higher than the $A656 million total amount of assistance to agriculture provided by the Commonwealth in that year.) State assistance to beef was $A134 million and sheepmeat $A41 million (IC 1996).

In Australia's case the systematic research and annual publication of assistance measurements by the Productivity Commission, suggests that OECD and WTO published measures for Australia probably capture sub-national government assistance at least as well as other countries. Clearly estimating all these State (or sub-national government) measures internationally constitutes a daunting task which, because of its difficulty, not even the OECD and the WTO have yet adequately resolved.

Another measure of assistance to farmers is provided by the World Trade Organisation in the form of the Aggregate Measure of Support (AMS). This measure differs in important respects from the PSE, mainly in that:

- Only certain benefits considered to be "trade distorting domestic policies" are included (non-trade distorting measures are included in the WTO so-called Green-box of allowable subsidies);
- The AMS calculates market price support and deficiency payments byway of fixed reference prices (e.g. intervention prices in the EU) rather than using market prices as the PSE does
- The AMS includes some policy benefits or government outlays not in the PSE, including direct payments made to processors.

The AMS for Australia reported for 1998, the most recent year, was $A119 million, and this did not include any trade-distorting support for beef and sheep producers. The AMS for the USA for 1997 was $US6,238 million, which included no specific support for beef or sheep producers, and for New Zealand the AMS for 1998 was zero. There were no direct payments recorded subsidies to beef or sheep processing any of these countries.

The AMS suffers from similar difficulties as the PSE in measuring State and Local level assistance, and the WTO is also conducting research into this issue. It would appear that the issue of State and Local government assistance will acquire increased importance in international trade policy in the future.

Assistance to Processors

Assistance to meat processors internationally is not measured by the PSE and the AMS has recorded no such assistance. The Subsidies Agreement under the WTO theoretically provides a basis for measuring manufacturing subsidies but contains no data on assistance to meat processors.

It is apparent however, that meat processors internationally do receive assistance by way of Federal and/or State Government programs. In the case of Ireland, Box 9 above makes reference to one such program. Furthermore, it is apparent that selective assistance by way of business assistance programs is a feature of many countries' meat industries.

A USDA report found that "...Over 60 percent of rural manufacturing establishments benefited from government business assistance programs (State and local tax breaks, training and technical assistance, loans and industrial parks/enterprise zones) and 28 per cent found these programs to be very important over the last 3 years" *Greenberg and Reeder 1998, page 1.* Although no data is available on the amount of funds provided under these Federal, State and local government programs in the USA it is clear that they are comprehensive in scope as the USDA reports (Box 11).

**Box 11**

**Business Assistance Programs**

***Loan Programs***. Direct loans are loans that government makes directly to businesses. Guaranteed or insured loans are made by intermediaries (usually banks), where government agencies guarantee all or some portion of the loan in case of default. Government-assisted revolving loan funds (RLF's) are at least partially capitalized by government, and are often operated by nongovernmental entities, such as nonprofits. Most Federal business loan assistance comes from the Small Business

Administration, which guarantees loans to small businesses and provides direct loans to firms affected by natural disasters, and from several smaller programs, including the USDA's Business and Industry (B & I) program. Several Federal programs provide funding to capitalize RLF's, which typically make loans to risky ventures or microloans to very small firms. In addition, a growing number of States have established venture or seed capital programs that offer direct loans and other types of financial assistance to new and smaller firms (USDA/ERS, 1995, pp.77-85). Some States have direct loan programs, used mainly to retain or attract firms.

***State and Local Tax Breaks.*** State and local government tax breaks include such things as local property tax abatement and reductions in State sales and corporate income taxes.

***Industrial Parks and Enterprise Zones.*** Industrial parts and enterprise zones assist firms located in a specific industrial site or zone. Industrial parks are tracts of land that government (usually local government) develops and subdivides for groups of compatible businesses, which benefit from the park's convenient access to transportation, utilities, labor, and other inputs. Funding comes from many sources, including private banks and investors and Federal development programs, such as highway, water, and sewer programs. Enterprise zones (EZ's) are local areas with high levels of socioeconomic distress (unemployment, poverty, etc) that receive special government assistance to encourage their development. Most State EZ programs use State tax incentives to encourage firms to invest or add jobs in the zones. The Federal Empowerment Zone/Enterprise Community (EZ/EC) program, like some State programs, includes both tax incentives for firms and grants for development organizations.

***Worker Training and Technology Assistance.*** Technology programs may involve developing new technologies for clusters of firms or providing technical assistance to specific firms. Many training and technology programs are run by States, through their university and community college systems, with the help of Federal funding. Federal programs, such as the Manufacturing Extension Partnership, provide technical assistance. Local schools and local development organizations also help in preparing and training the workforce and providing technical assistance.

Source: USDA/ERS *Agriculture Information Bulletin* Number 736-04, September 1998.

In assessing the significance of State and local government assistance in the United States it is important to recognise that (unlike Australia) most State governments levy income tax. Hence the tax concessions they can provide to business for new projects and location are significant.

It is also relevant that "tax competition" between States for new investment projects is vigorous in the United States, and according to personal communications, beef processors and feedlot operators do take up these concessions. Negotiations and arrangements made are generally on a case-by-case basis between State and Local governments and the companies concerned, are confidential and sometimes include contra investment and public infrastructure provision (e.g. the provision of school facilities, etc).

An example of the "tax competition" between States for new investment is provided by the Illinois' EDGE program (Box 12) which includes agricultural processing projects. It should be stressed this is only one of numerous State and local government assistance programs available for which commercial feedlotting and meat processing operations are eligible.

**Box 12**

***The Illinois EDGE Program***

"The Illinois EDGE program is intended to help level the playing field between Illinois and its neighboring Midwestern states when competing for the location of job creation projects."
Source: Department of Commerce and Community Affairs, Illinois; Media Release

"A new income tax credit is available for tax years beginning on or after January 1, 1999. The Economic Development for a Growing Economy (EDGE) Tax Credit is available to taxpayers who have entered into an agreement with the Department of Commerce and Community Affairs (DCCA) under the Economic Development for a Growing Economy Tax Credit Act. The credit is available to businesses located within Illinois or businesses planning to locate within Illinois."

Source: Illinois Department of Revenue Schedule 1299-A

Another form of assistance relates to environmental regulation, whereby extended periods for compliance with environmental regulations are provided, resulting in a cost saving for the processor. This takes place on a case-by-case basis in the USA. USA processors are also able to use the Foreign Sales Corporations tax provisions that allow a portion of a US taxpaying firm's foreign-source income to be exempt from US income tax, although the extent to which use has been made of these provisions by processors is unknown. These provisions, it must be said, were created to enable a level playing field with European tax systems, which allow rebates on value added taxes for exports.

For Australia and New Zealand, the assistance programs available to processors are relatively limited. Apart from Federal Government export grant assistance provided by Austrade (which totaled under $A2 million in 1998/99 – *source; personal communication*), there are some State Government programs for industry rationalisation, technology and training assistance for which processors can be eligible. In the case of training, these can amount to a substantial offset to a company's training costs. Processors are also able to negotiate payroll tax concessions and other assistance, but the sums involved are relatively small. It is also relevant that some State and Territory governments have provided assistance for live cattle export facilities in recent years.

In New South Wales assistance to the meat processing industry by the Department of State and Regional Development (DSRD) over the period 1990 through to 1999 is detailed in the following table.

**TABLE 7 Assistance to the New South Wales Meat Processing Industry 1990-1999**

| | Approved $ | Taken Up $ |
|---|---|---|
| Payroll Tax Concessions | 5127891 | 2129474 |
| Establishment & Expansion Grants | 625000 | 489860 |
| Skills Training | 388800 | 249070 |
| Stamp Duty | 300155 | 300155 |
| Business Diagnostic & Planning | 260360 | 104163 |
| Infrastructure Contributions | 115000 | 35112 |
| Other | 323183 | 112588 |

Source: Hassall & Associates 1999

Recently the NSW Government also announced a $12 million assistance package to help stabilize the meat industry following a string of abattoir closures in recent years (*Australian Financial Review, 21 November 2000*). The Queensland government funds the Queensland Meat Processing Development Initiative, an initiative that aims to assist meat processing businesses to undertake structural changes necessary for longer term viability, to create and retain secure jobs and to encourage downstream processing, development and continuous improvement. The program provides $20 million over 3 years.

In total, assistance provided to meat processing (excluding poultry) in Australia by all levels of government is estimated by the ABS at $4.2 million in 1997-98 and $6.9 million in 1998-99 (Source ABS Consultancy Stats). No data was identified in New Zealand suggesting government assistance to meat processing although processors are able to negotiate concessions in respect of environmental compliance in that country.

Overall, and having regard to the previously cited estimate of USDA/ERS of $2 billion for annual State and Local government assistance to agriculture it seems reasonable to conclude that this form of assistance by government to the meat industries in the United States would exceed that of Australia and New Zealand. Clearly more light will be shed on this subject if and when the WTO and OECD succeed in their aim of collecting data on sub-national government assistance in member countries but no firm conclusions can be drawn on the amount of sub-national government assistance provided to the beef and sheepmeat industries in the three countries studied in this Report.

The important finding is that sub-national assistance to agriculture does appear to be significant, and it is not adequately captured by any of the recognised OECD and WTO measures. It is also relevant that, presumably because of the degree of difficulty of estimation referred to in its 1996 Report, the Productivity Commission does not regularly report State and Local assistance to agriculture (including the beef and sheepmeat industries) in its annual Trade and Assistance Reports (PC 1999a, p117).

Clearly the mammoth research task of improving the scope and coverage of OECD, WTO and Productivity Commission measures of assistance to capture adequately sub-national assistance should be supported by the Australian meat and livestock industries.

# 5. STRATEGIC ANALYSIS AND RECOMMENDATIONS

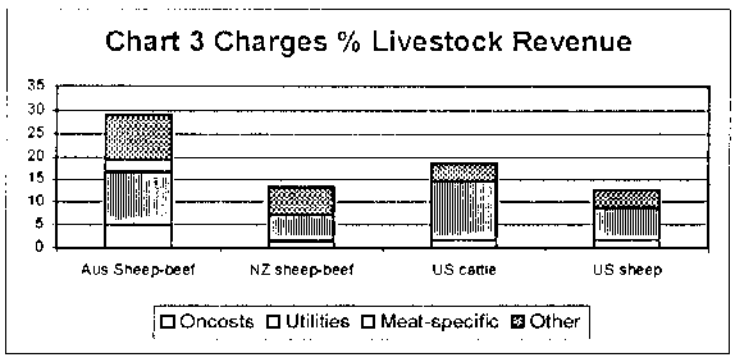
## 5.1 Strategic Cost/Charges Analysis

The starting point for constructing arguments for possible future use by the Australian industry in seeking modification by Government on imposts imposed on the Australian industry or assistance provided is to analyse strategically where the major cost/charges disabilities lie relative to our international competitors.

Livestock

Using the public data gathered for the average sheep-beef farm in Australia and New Zealand and the sheep and cattle farms in the USA, it can be seen in Chart 3 that the Australian farm had disadvantages in all the categories indicated areas relative to New Zealand farms.

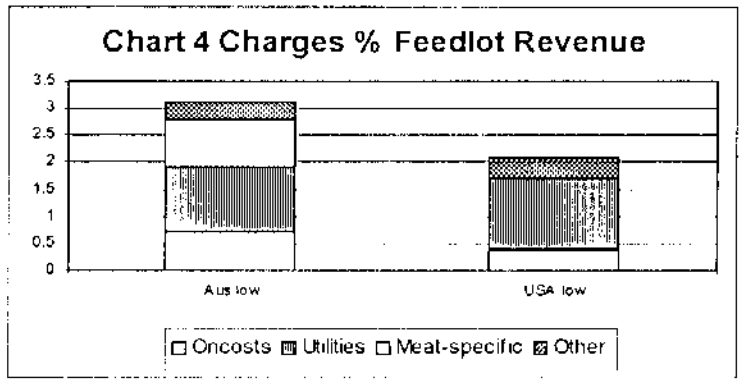
Relative to both the USA cattle and sheep farms the Australian total government influenced costs/charges percentage of revenue (excluding wool) was higher. However Australian utilities cost/charges were slightly lower as a percentage of revenue relative to the USA cattle farm.




Based on this analysis, the livestock sector should focus its strategies in seeking reduction in Government-influenced costs/charges on the major cost categories identified - oncosts; other costs (mainly rates); and utilities and fuel.

Feedlots

In the absence of comparative public data for the USA and Australia, private data indicating the lowest total percentage cost/charges operations are used in Chart 4. This indicates that the major areas of relative disadvantage for Australia are in respect of oncosts and meat-specific charges (cattle and grain levies). There is little disadvantage in other costs and a slight advantage relative to utilities and fuel (reflecting a similar feature in relation to utilities/fuel in the US cattle farm data).



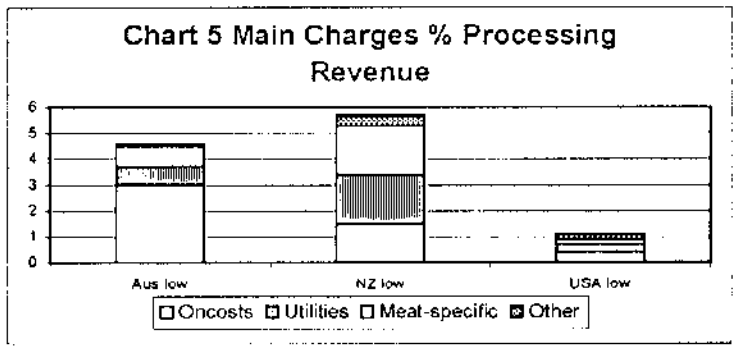

Based on this analysis, the feedlot sector should focus its strategies in seeking reduction in Government-influences costs/charges on the categories of oncosts and meat-specific charges (levies). Additionally, the wide variation in environmental costs for different feedlots (included in the "other" category above) suggests that more intensive analysis should be done of this area before assessing its relative strategic priority.

Processing

Based on private data indicating the lowest total percentage cost/charges operations (Chart 5), the key challenge for the processing sector to address the far lower proportion of costs/charges in the United States.

The Australian low cost processor has major disadvantages over its New Zealand counterpart in respect of the oncosts. However these are more than offset by advantages in respect of the other categories.

However in relation to the USA case, the Australian processor sector has across all categories of government influenced costs and charges serious disadvantages, and needs to develop strategies, across all categories.




## 5.2 Government Assistance Analysis

Evaluation of government assistance must necessarily rely on the extensive data collection, research and methodology which has been published over many years by the OECD and WTO, and in Australia's case by the Productivity Commission and other agencies such as ABARE.

Taking the widely accepted OECD measure of the PSE for agriculture Australia ranks higher than New Zealand, but below the United States in regard to government assistance enjoyed by its beef and sheepmeat industries.

| | *PSE: Beef* | *PSE: Sheepmeat* |
|---|---|---|
| New Zealand | 1.0 | 0.4 |
| Australia | 2.7 | 2.5 |
| United States | 3.5 | 12.8 |

An important finding of this Study, however, is that the internationally accepted measures of government assistance do not adequately capture State and Local (or sub-national) government assistance. In the United States (and of course in the EU and in many other countries) this appears to be large. In Australia's case it is also significant.

Progress on resolving the sub-national government assistance measurement problem can clearly best be progressed in a trade policy context.

### 5.3 Strategic Recommendations

Basic Principles

1. The Australian meat and livestock industry (livestock, feedlotting and processing) must ***give greater weight and attention in its dealings with Government*** to reducing the adverse impact of Government-influenced costs and charges on its international competitiveness.

2. The industry should not seek to redress the fact that it pays more in cost/charges and receives less assistance by simply seeking more assistance. The focus should be on improving the industry's efficiency and hence its international competitiveness. This should be achieved by ***getting Government cost/charges down so as to enhance economic efficiency*** rather than retard it.

Focus on Key Charges/Costs Categories

3. A priority for the industry is to address the impact of oncosts. The major focus for this should be developing ***a campaign aimed at State Governments that are responsible for excessive payroll tax and workers compensation costs***.

4. Another priority for the industry is to ensure that utilities and fuel costs reflect the need for efficiency in the industry. The industry should assess the extent to which it should ***become involved in representations to the Commonwealth and State utility regulatory bodies that ultimately influence utility pricing***.

5. Regarding meat-specific costs/charges, and consistent with recommendation 2, the industry should ***aim for meat inspection charges to reflect orthodox economic efficiency pricing principles – that is marginal cost pricing.*** The present full cost recovery regime based on accountancy principles should be terminated. Inspection charges should be reduced substantially as a result, potentially saving the industry at the least around $A15 million.

6. The industry should make ***a strategic assessment as to whether it should seek to negotiate directly with Government to achieve recommendation 2 or whether it should seek the introduction of a Regulator-General into the inspection system*** (in common with the situation in utility regulation). Current potential changes to the inspection system that might see AQIS inspection outsourced could affect the strategic choices to be made in this regard.

7. The industry should undertake a ***review of State Government licensing charges*** to assess whether they are being determined in accordance with economic principles that encourage efficiency.

8. The industry should ***undertake more research into the area of comparing environmental charges and systems internationally*** to deepen its understanding of the extent to which the Australian industry is being over-regulated or over-charged relative to its international competition.

Trade Policy

9. The industry should ***focus Australian trade policy on increasing the scope and accuracy of information on assistance provide by State and Local (or sub-national) Governments internationally*** to ensure that international trade negotiations to reduce subsidies can properly and accurately take such assistance into account. The industry should urge the Federal Government to ensure that organisations such as the OECD and the WTO have sufficient financial and research resources to accomplish this aim. (The pay-off for the Australian meat industries – and more broadly for all Australian rural based industries – would be substantial if the apparently huge amounts of sub-national subsidies provided by other countries was quantified and exposed by the WTO and OECD.)

Further Initiatives

10. The industry should build upon the foundation of this research project and ***continue to update and monitor the government influenced charges/costs situation***. Such further research should aim to deepen the analysis and discover how the situation has changed (has it improved/deteriorated?) over an appropriate period of time.

11. The industry should encourage ***the improved collection of financial data of government influenced costs/charges by the management of Australian farms, feedlots and processors*** that can be used to identify and track the various costs/charges, and hence feed in to the updating and monitoring process recommended above and provide a permanent data base for lobbying Commonwealth and State governments and for industry strategy development. This could be facilitated by appropriately designed interactive electronic data information collection from industry stakeholders.

# APPENDIX A

## AUSTRALIAN GOVERNMENT LICENCE AND PERMIT FEES

| | *Licence/Permit Type* | *Cost* |
|---|---|---|
| ***Commonwealth*** | | |
| ***ASIC*** | Registration of an Australian company | Name registration $36<br>Company with share capital $720, not having share capital $300.<br>Annual return fee $900 public company, $200 proprietary company. |
| ***IP Australia*** | Registration of a trade mark | Application $150, registration $300 |
| ***ATO*** | Superannuation Guarantee | Refer section: Superannuation |
| ***AQIS*** | Licence to export livestock | $500 |
| | Licence to export meat, meat products & edible offal | $500 |
| | Export establishment registration | full cost recovery, inspection fees apply |
| | Export permit | time based fee |
| ***Import/export management branch*** | Export controls | Varies |
| ***AQIS*** | Licence to export animals & reproductive material | Varies up to $1280 for >5001 cattle |
| ***Queensland*** | | |
| ***Animal & plant health services*** | Permit to travel stock | None for single journey, $16.85 multiple movement |
| ***Dept. Transport*** | Registration of a motor vehicle | >4.5tonnes gross vehicle mass registration costs based on weight of vehicle, number of axles, configuration & are national registration charges. |
| ***DNR*** | Watercourse licence | $75 |
| ***Forestry*** | Stock grazing permit | variable depending on pasture, bid process & beast price $3.02-$52.28/beast/year for standard fees. |

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|---|---|---|
| *QMLA* | Application for accreditation for meat processing | varies with cattle units<br>application fee $259-$776<br>accreditation fee $215-$10,343 |
| *QLMA* | Accreditation of transportation | <1tonne $97 application fee, $108 accreditation fee<br>>1 tonne $97 application fee, $162 accreditation fee |
| *EPA* | Environmental authority to carry out an environmentally relevant activity | application fee (level 1 or 2 activity) $200, annual licence fee |
| *Animal & plant health services* | Registration of cattle earmark<br>Registration of a symbol brand<br>Registration of sheep brand &/or earmark | $59.25<br>$171.65<br>$59.25 (letter or number fire or paint brand, or earmark) $64.35 symbol fire or paint brand |
| *New South Wales Fair Trading* | Registration of business name | $114 application fee, $88 renewal fee |
| *Meat Industry Auth.* | Animal food processing plant licence | (1-5 staff) $125 application fee, $250 licence fee<br>(6-50 staff) $250 " ", $500 " "<br>(>50 staff) $1000 " ", $2000 |
| | Meat van licence | Licence & application fee 50% of renewal fee, renewal fee $150 |
| | Animal food van licence | Licence fee $150, renewal fee $150, application fee 50% of renewal fee |
| | Meat processing plant licence | (1-5 staff) $125 application fee, $250 licence fee<br>(6-50 staff) $250 " ", $500 " "<br>(>50 staff) $1000 " ", $2000 " " |
| | Abattoir licence | Application fee 50% of renewal fee<br>licence & renewal<br>(1-5 staff) $250<br>(6-50 staff) $500<br>(>50 staff) $2,000 |
| | Register brand or earmark (sheep/cattle) | $25 application fee per brand/earmark |

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|---|---|---|
| ***Rural Lands Protection Board*** | Walking stock permit | varies with local board |
| | Grazing permit | varies with local board |
| | Transported stock statement | $1 |
| ***Environmental Protection Authority*** | Authorisation of the emission of pollutants for all abattoirs & feedlots > 1000 head | environmental assessment<br>licence administrative fee = units x$50 (depending on processing capacity & activity type)<br>animal slaughtering<br>0-30000t ~ 5 admin fee units =$250<br>>30000t ~ 15 admin fee units =$750<br><br>rendering or fat extraction<br>0-4000t ~ 5 admin fee units =$250<br>>4000t ~ 15 admin fee units = $750<br>monitor state of odour, dust, noise, surface & ground water quality level of land degradation |
| ***Victoria DNRE - Victorian Meat Authority*** | Licence to operate further processing including poultry meat | Application fee / Licence fee<br><250 t $274 / $494<br>up to 500 t $318 / $573<br>501-1500t $477 / $860<br>1501-2500t $636 / $1,147<br>2501-5000t $795 / $1,434<br>>5000t $954 / $1,721 |
| | Licence for a cold storage freezer | $636 |
| | Meat transport vehicle licence | $75pa |
| ***Environmental Protection Authority*** | EPA works approval | application fee varies with value of works to be undertaken<br>value <$10000 fee $480<br>$10000-50000 fee $960<br>$50000-250000 fee $2000<br>$250000-1million fee $3369<br>up to maximum fee of $36000 for works > $100 million. |
| | EPA licencing of abattoirs, non-edible fat rendering works, livestock saleyards. | Annual licence fee varies with operation type, volume, quality of discharge |

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|---|---|---|
| ***Local Government (licences that may be relevant)*** | Flammable & combustible liquids storage licence<br>Environmentally relevant activity licence<br>Trade waste permit<br>Development permit | Varies with council<br><br>$200 application fee, annual licence fee varies with quality & quantity of discharge |

Sources: Business Licence Information Service NSW, Business Information Branch, Qld Department of State Development. Business Licence Information Service, Vic, EPA NSW, EPA Vic, RTA NSW

# APPENDIX B

## USA FEDERAL BEEF AND SHEEPMEAT PROMOTION AND RESEARCH ASSISTANCE PROGRAMS

US promotion and research programs for agricultural products marketing are known as 'check-off programs' due to the way they are funded. Producers and or other industry members contribute an amount from the sales revenues of their products.

The beef industry is covered by the Cattlemen's Beef Promotion and Research Board. All cattle producers and importers of cattle and beef contribute $1 per head of cattle sold.

The USDA, through the Agricultural Marketing Service (AMS) develops regulations to implement the check-off program and ensures compliance with the authorizing legislation (GAO 1995). The importance of market development programs is likely to increase as WTO agreements to reduce trade barriers have the effect over time of reducing other assistance measures.

Federal export assistance programs aim to increase US agricultural exports. The export subsidies and market promotion programs also aim to directly counter competitor agricultural export assistance. The US Meat Export Federation is funded by industry and government funds (under the Market Access Program) and promotes all US meat exports.

The following table highlights generally available government promotion and research assistance programs for which sheep and beef industries may have been eligible over recent years.

In addition to these Federal programs, there are a number of programs provided by State governments that assist promotion activities in the beef and sheepmeat industries.

| *EXPORT ASSISTANCE* | *Type* | *Funding (US$ million)* |
|---|---|---|
| *USDA*<br>*Export credit program* | Offers short & intermediate term loan guarantees to lower the cost of borrowing for importing countries to purchase US agricultural exports | |
| *Export promotion programs*<br>- *Foreign market development program*<br>- *Market access program (MAP)* | Provides funding for advertising, other overseas market promotion for products including meat and processed goods | 1996/97 MAP funding for:<br>US Meat Export Federation $US9.9m<br><br>American Sheep Industry Association $US0.17m |
| *Food aid programs* | Provides US agricultural commodities to developing countries through concessional loans or grants for market development. | |
| *USDA*<br>*Foreign agricultural service* | Operational cost of managing USDA's agricultural export assistance programs | $US118m (1994/95) |
| *RESEARCH, EDUCATION, EXTENSION* | | |
| *USDA* | Research, Education, Extension | Total $US2 billion (1993/94) |
| *AGRICULTURAL RESEARCH*<br>*-Federal Government*<br>*USDA's*<br>*Agricultural Research Service* | Develop knowledge for solving technical agricultural problems | ~$US1.6 billion (25% of total) |
| *Cooperative state research, education & extension service (CSREES)* | Distributes funds for research, education, extension to state agricultural experiment stations and other institutions. | |

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|---|---|---|
| *-State Governments through Land Grant Universities* | | ~$US0.9 billion (15% of total) (1991/92 data) |
| *AGRICULTURAL EXTENSION*<br>*USDA* | Disseminate research results to public | $US419m |
| *Land Grant Universities and county extension offices* | | ~$US1 billion (1993/94) |
| *AGRICULTURAL EDUCATION*<br>*USDA* | *Generally nonfederal function*<br>*Responsible for strengthening higher education through programs to enhance university teaching programs* | $US12.8m (1993/94) |
| *Land Grant Universities* | | |

Source: GAO 1995, GAO 1997, GAO 1999, FSIS 2000b

# APPENDIX C EXAMPLE OF STATE ASSISTANCE PROGRAMS

## Illinois Assistance Programs

| *Agency* | *Program* |
|---|---|
| **Illinois Department of Agriculture** | |
| Illinois Agricultural Products Promotion Program | Program promotes Illinois agricultural products and is available to any Illinois company marketing those products. Benefits include participation in food shows, retail grocery store promotions, mall promotions, displays (including the Illinois State Fair), and seminars. |
| State Export Promotion Coordinating Program | International marketing/promotional program available to any Illinois company that exports Illinois food and agricultural products to foreign countries or promotes the international export of Illinois food and agricultural products. Benefit from market promotional activities organized by the Department, and exploit resources established in foreign market offices (including access to computerized trade leads, opportunities to participate in trade missions, trade shows, and grocery store promotions (in foreign countries), participation in seminars, and be listed in food and agribusiness guides). |
| **Illinois Department of Commerce and Community Affairs** | |
| Development Corporation Grant Program | Provides qualified investments, loans, or grants to public or private development corporation, financial intermediaries or other entities whose purpose it is to enhance local or regional economic development. Provides funding for development corporations for organizational set-up costs and lending activities for businesses. Grant funds are available only for the establishment of Revolving Loan Funds to lend to for-profit businesses in the development corporation's service area. Up to 10% of the grant (maximum $5000) may be used for actual organizational set-up (not operating) costs of a new development corporation. Applicants may receive the grant only once. Grants remain in effect for 2 years. |
| Development Corporation Participation Loan Program | Program helps small businesses receive loans in order to create or retain substantial employment in Illinois or to modernize or improve the competitiveness of the borrower. Money can be used for acquisition of land and building; construction, renovation, or leasehold improvements, purchase and installation of machinery and equipment; inventory and working capital. |
| Enterprise Zone Programs: Tax Exemptions, Credits, Deductions | Businesses operating in Enterprise Zones are eligible for tax exemptions, credits and deductions by qualifying with DCCA.<br>**Tax Exemptions** Sales Tax Exemption: Retailers located in an Enterprise Zone may offer a point of sale 6.25% state sales tax exemption on building materials to be used in the Enterprise Zone. Materials must be purchased from a business located in the municipality or county which has established the Enterprise Zone. Machinery & Equipment / Pollution Control Facilities Sales Tax Exemption: A 6.25% state sales tax exemption is available on purchases of tangible personal property to be used or consumed in the manufacturing or assembly process, or in the operation of a pollution control facility within an Enterprise Zone. DCCA determines the term of the exemption, but it may not be longer than the term of the certified Enterprise Zone. Utility Tax Exemption - A State utility tax exemption on gas, electricity, and the Illinois Commerce Commission's administrative charge and telecommunications excise tax on originating calls, is available to businesses located in Enterprise Zones. DCCA determines the term of the exemption, not to exceed twenty years, and the percentage of the exemption. Local units of government may further exempt their public utility taxes on gas, electricity and water for eligible businesses.<br>**Tax Credits** Investment Tax Credit: Investments in qualified property (machinery, |

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|---|---|
| High Impact Business Program | equipment, buildings) in an Enterprise Zone may receive a State investment tax credit of .5%. The credit may be carried forward up to 5 years. This credit is in addition to the regular .5% investment tax credit, available throughout the State, as well as a .5% credit for businesses increasing their employment in Illinois by 1% over the preceding year. Jobs Tax Credit: Businesses may receive a $500 Illinois Income Tax credit for each job created in an Enterprise Zone for which a certified dislocated worker or economically disadvantaged individual is hired. The credit may be carried forward for up to 5 years. **Income Tax Deductions:** Dividend Income Deduction: Individuals, corporations, trusts and estates may not be taxed on dividend income from corporations that do substantially all their business in an Enterprise Zone. Interest Deduction: Financial Institutions are not taxed on the interest received on loans for development within an Enterprise Zone. Contribution Deduction: Businesses may deduct from taxable income, an amount equal to double the value of a cash or in-kind contribution to an approved project of a designated zone organization. |
| Industrial Training Program | The Illinois Enterprise Zone Act authorizes DCCA to designate qualified businesses as "High Impact Businesses"*. The program allows DCCA to assist in the encouragement, development, growth and expansion of large, private-sector businesses. A "High Impact Business" located in a designated location in Illinois is eligible for a building materials sales tax exemption, investment tax credit, state utility tax exemption and a state sales tax exemption on manufacturing repair and equipment repair and replacement parts. "High Impact Businesses" located in foreign trade zones or sub-zones are eligible for additional incentives: jobs tax credit, dividend income deduction, interest income deduction, exemption from telecommunications excise taxes on originating calls. Businesses may receive this exemption for up to 20 years at the designated location. |
| International Trade Centers; NAFTA Opportunity Centers | State-funded program to assist employers with training, retraining or skills upgrading of their work force. ITP grants are awarded to individual employers and multi-company employee training projects sponsored by intermediary organizations (business or employer associations, institutions of higher education, etc.). Program can provide up to 50% reimbursement of an applicant's training costs. Employers may select the employees to participate in the training, as well as the training provider(s). |
| International Trade Shows / Missions; Catalog Shows | The purpose of this program is to enhance business development in Illinois by identifying and assisting small and medium-sized businesses through educational and training efforts in exporting their products or services to international markets. Provide outreach to potential Illinois exporters by assessing readiness, arranging educational programs and providing counseling to potential exporters. Some types of services are documentation, market analysis and planning, pricing, letter of credits, etc. |
| North Central Area Small Business Development Centers | Trade Shows / Missions: Each year the International Business Division (IBD) identifies international trade shows and missions that develop foreign sales and best serve Illinois export strategy. IBD provides Illinois exporters participating in trade shows and missions with a wide range of services including: Pre-show briefing and publicity, counseling and coordination of follow-up activities; contacting buyers and distributors in host countries in advance of events; researching key distribution channels; arranging in-country appointments with potential customers; handling trade show exhibit logistics such as space rental, stand assembly, furniture rental and lighting. In planning trade missions, the IBD arranges individual appointments for participating Illinois businesses with potential agents, distributors and high-level government officials according to the needs of the business and the nature of the marketplace. |
| Small Business Environmental Assistance Program | Catalog Shows: Catalog shows highlight the products of targeted Illinois companies via proxy catalog representation by International Business Division staff to potential international buyers. CCA and the IBD co-sponsor conferences and seminars annually on export-related topics. |

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| Technology and Modernization Initiatives | The Illinois Small Business Development Center Network (The Network) will provide or arrange for confidential one-on-one business counseling and specialized services. The Network centers offer a unique blend of both in-depth business counseling, specialized business assistance resources and quality training. |
| Community Development Assistance Program | The Small Business Environmental Assistance Program, through the federal Clean Air Act Amendments of 1990, provides small businesses with free and confidential environmental compliance assistance. Services offered to help small businesses through permitting/regulatory process. Technical assistance is provided through information and referral resources. Information regarding compliance requirements, businesses rights, responsibilities, permits, pollution prevention, accidental release detection, process technologies is available to Illinois businesses free. |
| Community Services Block Grant Loan Program | Grants under the Technology Advancement and Development Act (TADA) are used to enhance the commercialization of new technologies and secure federal research and development projects for the state while leveraging private and federal investment. Small grants are also available to clusters of manufactures to help them assess and find solutions to shared technical problems.<br><br>Federally-funded grant program assisting local governments with financing economic development projects. Grant funds may be loaned to businesses for projects to create or retain jobs within the community, or used by the local government for improvements to public infrastructure that directly support economic development. The program is targeted to creating and retaining job opportunities for low/moderate-income persons.<br><br>The Community Service Block Grant (CSBG) Loan Program is administered locally by the 36 community action agencies (CAAs) designated by the state or federal government. The program provides long-term, fixed-rate financing to new or expanding companies in exchange for job creation and employment for low-income individuals. It links federal, state and private financing by using CSBG funds at low interest in combination with bank funds and equity. The program is able to offer below-market interest rates for up to ten-year terms. Any new or expanding business, excluding financial institutions, is eligible for the CSBG Loan Program. There is no limit on the number of times a business may participate in this program as long as all hiring and payment requirements are current. |
| **Illinois Farm Development Authority** | |
| Beginning Farmer Bond Program | A Federal program administered by IFDA. Program aims to allow farmers to use federally tax exempt bond financing to reduce the interest rate for capital purchases. The program may be used between a borrower and lender for a loan to make a direct purchase or between a buyer and seller for a contract purchase. The tax exempt interest income to the lender or contract seller enables him or her to charge a lower interest rate. Loans may be used for purchase of capital assets, including farmland, new or used farm improvements or buildings, new, depreciable equipment or used depreciable equipment when purchased in conjunction with farmland. |
| Specialized Livestock Guarantee Loan Program | The Specialized Livestock Guarantee Loan Program provides an 85% guarantee on loans (by conventional lenders) to certain specialized, family sized livestock operations, including but not limited to swine, dairy and beef cattle operations. The primary purpose of loans under this program is to promote the construction, purchase and/or remodeling of facilities, and also for purchases of necessary equipment and/or breeding livestock. |

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| | A secondary purpose of loans under this program is to enhance the opportunities for farmers to purchase stock in value-added cooperatives that further process their commodities. |
| State Guarantee Program for Restructuring Agricultural Debt | The purpose of this low interest rate loan program is to help farmers consolidate and spread debt over a longer term. The program guarantees 85% of principal and interest for loans up to $500,000, made by local lenders. Loans may be used for refinancing of existing agricultural debt. Real Estate may be amortized up to 30 years. |
| Young Farmer Guarantee Program | The purpose of the Program is to help farm operators finance capital purchases at a reduced interest rate. Loans may be used for purchases of capital assets including farmland, buildings, machinery, equipment, breeding livestock, and soil and water conservation projects. |

## LIST OF TABLES

1 Sheep Farm Government Charges & Costs as % of Revenue 40

2 Top 20% Farm Government Charges & Costs as % of Revenue 42

3 Beef Cattle Farm Government Charges & Costs % of Revenue 43

4 Private and Public Data Comparisons 43

5 Oncosts as % of Revenue 50

6 Producer Support Estimates 1999 66

7 Assistance to the New South Wales Meat Processing Industry 1990-1999 74

## LIST OF CHARTS

1 Charges % Processing Revenue 46

2 Inspection Costs % Processing Revenue 53

3 Charges % Livestock Revenue 76

4 Charges % Feedlot Revenue 77

5 Main Charges % Processing Revenue 78

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