Australian Government

Department of Agriculture, Fisheries and Forestry

Attachment A

Amendment of Administrative Arrangements for EU High-Quality Beef Quota

Amendment of Administrative Arrangements for EU High Quality Beef Quota

Summary

This Regulation Impact Statement (RIS) has been prepared by the Department of Agriculture, Fisheries and Forestry (DAFF) to assist the Australian Government to make decisions regarding options to improve the management arrangements for Australian high quality beef tariff rate quotas (TRQs) set by the European Union (EU).

The regulations governing these quota arrangements have been in place for a number of years. DAFF established an independent review of the management system for the EU High Quality Beef (HQB) quota in May 2011. The independent reviewer consulted widely with industry and government agencies, and has recommended changes to maximise the value of the HQB access for the benefit of the beef industry. The reviewer's recommendations and DAFF's response to the recommendations were distributed to Australian HQB exporters and posted on DAFF's web site for comment on 14 December 2011.

Following a seven week consultation period with industry and government agencies, the EU HQB 2011 review was finalised on 8 February 2012. The primary conclusion of DAFF is that the independent consultant's recommendations, including the adoption of a new TRQ allocation model for new entrants, constitutes a more appropriate framework for the effective administering of the EU HQB TRQs than the existing arrangements.

This RIS has been prepared in accordance with *Australian Government Best Practice Regulation Guidelines* issued by the Office of Best Practice Regulation (OBPR).

The key determinants for an appropriate EU HQB quota management system centre on rewarding market development in a transparent manner. Based on industry consultations and the impact analysis undertaken in the RIS, the proposed EU HQB Option 3 (accept most of the review's recommendations) would provide a fairer, more effective and more efficient way of administering this highly sought after quota relative to the status quo (Option 1).

Implementation of Option 3 will not change quota availability (amount) to exporters, revenue received by the government or the administrative process with regard to the receival, processing and issuing of the quota certificates.

Option 3 is expected to have marginal impacts on government costs of running the scheme but some costs and benefits to the industry are expected.

The preferred option in the RIS will modify existing rules or apply new administrative rules to managing the current quota arrangements. These modifications aim to improve the usage rate of the quota, particularly in relation to returning unused quota in sufficient time to allow for reallocation to those exporters who have the capacity to ship additional quota. The modifications also seek to optimise the quota rent for exporters by encouraging business behaviour that focuses on exporting quota product rather than on quota trading as a principal business objective.

While the RIS has not been able to quantify the costs and benefits of the proposed arrangements in particular detail, the consultation process and impact analysis undertaken suggests that the proposed quota arrangements are expected to deliver a more efficient and effective management of EU HQB quota by optimising the commercial value and use of the tariff rate quota, minimising barriers to exporting and reward market development in the export industry, including for new entrants.

Contents

Abbreviations

ABARES	Australian Bureau of Agriculture and Resource Economics and Sciences
AMIC	Australian Meat Industry Council
DAFF	Department of Agriculture, Fisheries and Forestry
EU	European Union
FCFS	First Come First Served
GATT	General Agreement on Tariffs and Trade
HQB	High Quality Beef
NE	New Entrant
NPE	Non-Packer Exporter (3rd Party Trader)
NSQ	Non-Standard Quota
OBPR	Office of Best Practice Regulation
RIS	Regulation Impact Statement
RMAC	Red Meat Advisory Council
SQ	Standard Quota
TRQ	Tariff Rate Quota
USA	United States of America

REGULATION IMPACT STATEMENT

(Office of Best Practice Regulation ID No 13016)

1.0 Background

The EU has restricted beef imports into the Union since 1968 through the use of tariffs. Concessionary quotas were introduced under the General Agreement on Tariffs and Trade (GATT) and Australia currently has a fixed quota allocation of 7 150 tonnes per financial year for HQB. This HQB quota attracts a 20 per cent tariff compared to product shipped out of quota that is subject to flat rates calculated on a per kilogram basis that equates to an ad valorem tariff of 60 to 90 per cent.

The Australian Government administers the EU HQB scheme on behalf of industry under the *Australian Meat and Live-stock (Quotas) Regulations 2000* and the *Australian Meat and Live-stock Industry Regulations 1998* to ensure fair and equitable allocation of quota. The administrative arrangements for the EU HQB quota scheme are underpinned by the *Australian Meat and Live-stock Industry (High Quality Beef Export to the European Union) Orders* (the Orders).

The EU requires all consignments exported under the EU HQB quota to be accompanied by a certificate of authenticity which are issued by the Quota Administration & Statistics Unit (quota unit), DAFF.

The quota unit administers six different types of quotas (see Table 1) on a cost recovery basis. Any surpluses or deficits are managed through adjusting the quota fees.

Table 1: Meat and dairy quotas administered by the quota unit

	Quota amount (tonnes)
EU HQB	7 150
EU sheep/goat meat	19 186
EU cheese for processing	500
EU bulk cheese	3 711
US beef	408 214
US cheese	4 383.60

1.1 The current EU HQB Allocation System

The current EU HQB quota allocation arrangements were established after an independent review in 2005.

The EU HQB access is managed through an allocation system that distributes the quota either as standard quota (SQ) for established exporters or non-standard quota (NSQ) for new entrants. The system is funded on a cost recovery basis.

The SQ EU HQB quota entitlement for individual eligible exporters is calculated by a formula where individual exporters' entitlement to quota is the sum of their exports to the EU as a proportion of all exports to the EU during the previous shipping year.

NSQ for new entrants is calculated by a formula where the individual exporters' entitlement to quota is the total entitlement (500 tonnes) divided by the number of applicants.

Eligible exporters are advised of their quota entitlement by the issue of a second notice under Section 6 of the Quotas Act, which confirms the amount of the allocation and the conditions under which it is granted, including rights of appeal and the fee payable for the quota

Other key features of the current system are:

- eligibility for SQ is open to any licensed exporter with EU export performance
- eligibility for NSQ is restricted by a cumulative threshold of 150 tonnes of NSQ and a time limit of five years
- the department re-claims unused quota in early March which is redistributed to eligible exports on a first come first serve (FCFS) basis.

A key recommendation of the 2005 review was to increase the NSQ from 400 to 500 tonnes so as to provide additional access to new entrants. The recommendation was implemented and to ensure that this additional access had not had a negative impact on SQ holders and that the NSQ was being fairly allocated, the effectiveness and suitability the NSQ was part of the 2011 Terms of Reference for the EU HQB review (refer to Appendix A).

In 2010-11, there were 35 SQ and 19 NSQ holders compared with 12 and 6 respectively in 2005-06. The increase in holders has been in companies without processing facilities and half of the SQ holders accessed the NSQ pool in 2010-11.

The allocation process changes initiated after the 2005 review required that after five years a formal review is again undertaken. This was extended by six in 2011 with the agreement of the Australian Meat Industry Council (AMIC).

In March 2011 the department met with the AMIC and confirmed that industry still supported a review of the EU HQB quota allocation arrangements with a focus on the new entrant provisions. The reviewer's terms of reference are at Appendix A.

The independent review of EU HQB quota arrangements commenced in May 2011 and the final report is attached (see Appendix C). Any changes to quota administration process resulting from the review will come into effect for the 2012-13 quota year.

The EU HQB review concluded that industry broadly supported the current arrangements including the need to allocate quota and provide for new entrants. Improvements suggested included:

- smoothing allocation fluctuations and rewarding consistency in performance
- tightening eligibility criteria
- limiting third party trading of quota
- more effective recall of unused quota
- introducing penalties for hoarding
- ensuring the commercial viability of small allocations.

Following a seven week consultation period with industry and government agencies, the EU HQB 2011 review was finalised on 8 February 2012 and was considered by Senator the Hon. Joe Ludwig, Minister for Agriculture, Fisheries and Forestry. Pending the Minister's approval, the final EU HQB quota administration guidelines will be published on DAFF's website

(www.daff.gov.au/agriculture-food/meat-wool-dairy/quota/eu-beef-quota-review)

after this RIS has been assessed by the OBPR.

2.0 Problems or issues that give rise to the need for action

While current quota arrangements are operating reasonably well, there is scope for greater improvement which may provide a more efficient system in optimising the commercial value and use of the tariff rate quota while allowing a fairer and more certain business environment for domestic exporters.

As discussed above, the current EU HQB quota arrangements are based on the recommendations of the 2005 independent review. It included agreement that a formal review would be undertaken after five years of operation in particular provisions for new entrants. Industry supported a review of the EU HQB quota allocation arrangements with a focus on the new entrant provisions.

The terms of reference for the 2011 independent review sought to examine the effectiveness and efficiency of the current quota arrangements and identify where improvements to the existing quota management arrangements could be made (Appendix A). The 2011 independent review, which also benefited from industry feedback, identified a number of key areas where changes would improve the current quota management. These are briefly discussed below.

i) Export performance to determine standard quota (SQ) allocation

Currently SQ allocations are based on the exporter's previous financial year's export data. This can result, particularly during periods of economic uncertainty, in large fluctuations in exports by the individual exporter. A system is required to smooth out trade fluctuations so as to provide greater stability in market development.

ii) Management of the non standard quota (NSQ) set aside and the treatment of new entrants

The current system allocates the NSQ (500 tonnes) by dividing it equally amongst the applicants irrespective of whether they can use the quota or not and in some years this can be more than the quota received by established exporters who could also utilise the quota. Furthermore, in a year where there are few applicants, the new entrants can potentially end up receiving more quota that the SQ holder who has an established market.

iii) Eligibility for new entrant (NE) allocations

Under the current system, exporters who export less than 150 tonnes of EU HQB can remain in the NSQ pool for up to five years. The system does not encourage market development and can potentially make it more difficult for 'newer entrants' to develop a market presence.

iv) Penalty for un-used quota

The current system does not penalise exporters who hoard quota, that is, do not hand back quota that they will not be using. To help develop trade the hoarding of quotas by exporters needs to be addressed.

v) Modified first-come-first-serve (FCFS) system to distribute unused quota

It takes six to eight weeks for a shipment to reach the EU and the current system of reclaiming unused quota in late March and then re-allocating it means that there is only a very small window of opportunity for exporters to use this quota. That is, land the HQB consignment(s) in the EU by 30 June.

vi) Third party trading

The value of the quota rent on HQB sales is a critical factor in optimising the economic value of the access as there is a 20 per cent tariff for in quota products compared to an ad valorem tariff of 60 to 90 per cent for products shipped out of quota. The monetary benefit of in quota tariff rent can be dissipated by unnecessary costs for exporters through the strategic behaviour of brokers.

A loss of value in the quota rent reduces the monetary benefit for producers, exporters and the regional communities where they operate. It is important to minimise these costs in order to optimise the economic value of the rents.

Addressing the above key areas would improve any changes to future quota management and therefore the efficiency of the current EU HQB quota arrangements.

3.0 The desired objective

The government is keen to make sure that management of EU HQB quota is operating against the six principles of quota management developed from the Council of Australian Governments' principles of good regulatory practice. The principles are to:

- optimise the commercial value and use of the TRQ
- minimise regulatory intervention
- provide consistent, transparent and efficient administration
- minimise barriers to exporting
- consider commercial arrangements
- reward market development.

These principles also provided the framework in developing in 2009 the new model for EU and United States of America (USA) dairy quota management systems administered by the quota unit.

The government considers these principles constitute an appropriate framework for evaluating different options regarding the administration of the EU HQB quota allocation arrangements.

4.0 Options to achieve the desired objective

The review evaluated a number of options in the context of the six principles of quota management (refer to section 3 above), industry perspectives and policy directions. Based on the review's recommendations and extensive industry consultations, the EU HQB quota allocation management options considered by the government for the next five years included:

1. Continuation of current arrangements
2. Ending quota allocations and switching to a FCFS system
3. Accept majority of the 2011 independent review's recommendations (i.e. modifications of the current arrangements

Industry management of the quota was not considered a feasible option as the EU currently requires government certified certificates to accompany all imports of Australian HQB.

The three options are discussed in greater detail below.

4.1 Option 1 - Continuation of current arrangements

As detailed in Chapter 1.1 above, the current EU HQB quota allocation regime is a simple system based on a proportional distribution of the SQ of 6 650 tonnes and NSQ of 500 tonnes.

Essentially:

- SQ quota entitlement for individual eligible exporters is calculated by a formula where individual exporters' entitlement to quota is the sum of their exports to the EU as a proportion of all exports to the EU during the previous shipping year and
- NSQ for new entrants is calculated by a formula where the individual exporters' entitlement to quota is the total entitlement (500 tonnes) divided by the number of applicants.

4.2 Option 2 - Ending quota allocations and switching to a FCFS system

Under this option, new exporters have to compete on equal terms with established exporters. Exports would continue until the quota is exhausted with subsequent consignments being subject to the out-of-quota tariff. Key features of this system would be:

- No restrictions on access to TRQ pool or on the amounts accessed
- TRQ certificates provided on a per shipment basis
- Mechanism required to inform all potential exporters in a timely manner when the TRQ is open
- DAFF continue managing the TRQ on a cost recovery basis.

4.3 Option 3 – Accept most of the review's recommendations (i.e. modifications of the current arrangements)

Under this option, the majority of the 2011 EU HQB independent review's recommendations would be accepted, which would modify the current quota arrangements. This option would impact on government costs of running the scheme. It will also impact (costs and benefits) on local exporters.

The recommendations and the impacts on business from the 2011 EU HQB independent review are examined in Section 5 (Impact Analysis). The review identified the following key issues related to the effectiveness and efficiency of the current quota arrangements:

- NSQ eligibility is only restricted by a cumulative threshold of 150 tonnes of NSQ and a time limit of five years
- NSQ is fully allocated to eligible exporters. In a year where there are only a few eligible exporters they can receive more quota than SQ holders
- SQ allocations are based on EU HQB export performance in the previous year

- NSQ holders are eligible for SQ based on performance so SQ quota allocation is declining as SQ holder numbers increase
- Effective quota re-claim provisions are essential to ensure there is an opportunity for un-used allocations to be utilised by year end. Ineffective re-claim provisions can affect TRQ fill rates
- Discretionary penalties in the allocation process will increase the administration burden for DAFF
- There are concerns about strategic ad hoc sales of beef through the GATT global quotas to enhance performance
- An allocation to non packer exporters or third party holders (NPEs) with no commitment to market development was seen to be detrimental to optimising the value of the TRQ
- Quota transfers are an efficient and effective way to maximise quota fill rates. However, stakeholders are concerned about trading in market access rights as a speculative activity.

The full list of recommendations including sub-recommendations suggested by the independent reviewer can be viewed in Chapter 5 of the review report (pages 36 – 53), Appendix C.

5.0 Impact Analysis

This section discusses the costs and benefits of the proposed options. The main costs and benefits from the two alternative options considered relative to the status quo are attributed to business. However, there are potentially additional costs for Government in administrating the quota arrangements.

5.1 Government management of the current scheme

Before analysing the costs and benefits in greater detail, this sub-section provides a summary of how the department currently manages the quota arrangements. A fee-based, cost-recovery system is used, where an exporter's access to an allocation is subject to payment of the prescribed fees. The fee amount charged by the department does not take into consideration the exporter's cost of production, supply chain development or profit margin; information that the department does not have nor considers relevant to the current fee-based cost-recovery system.

Under current arrangements the fee is charged on the initial allocation and is paid once only for the initial allocation. The fees are set under *Australian Meat and Live-stock (Quotas) Regulations 2000.*

As the quota unit operates on a cost recovery basis, any surpluses or deficits are managed through adjusting the quota fees.

The quota unit is managed by two full time staff equivalents whose functions include:

- receiving and assessing applications for annual allocations of Australia Free Trade Agreement and World Trade Organisation (WTO) dairy quotas
- calculating and allocating six different quota types including EU HQB
- obtaining preferred importer details from WTO dairy quota holders and advising the US Department of Agriculture of designated importers
- issuing approvals and certificates for most meat and dairy quotas
- monitoring usage of all allocated meat and dairy quotas
- recalling and reallocating quota entitlements
- assisting in resolving bilateral quota management issues in consultation with other Australian and foreign government agencies
- reporting weekly to the Directorate General for Agriculture (European Commission) and the Australian Embassy in Brussels on quota fill and certificates issued for both EU beef and sheep meat quotas.

The quota unit issues approximately 13 000 certificates annually; 464 EU HQB certificates were issued in the financial year 2010-11.

The budget for running the quota unit is formulated each year and follows the department's cost allocation policy. These costs include both direct and indirect costs. Direct costs include employee expenses, supplier costs (e.g. travel, IT, consultants, contractors, legal) and depreciation. Indirect costs represent functions provided to support program functions which include corporate costs (e.g. finance, HR, property, governance), executive cost (e.g. cost of internal divisional/branch executives) and business overheads (e.g. stationary). The unit does not pay for policy or parliamentary servicing functions and funds for these are allocated in the budget.

For 2010-11, the total expenditure for the running of the quota unit was $816,915.00. Labour and IT costs were the major components of this expenditure; representing 35 and 12 per cent respectively. Refer to Appendix B for full breakdown of revenue and expenditure in managing the quota unit.

The fee for exporting EU HQB quota products under the EU TRQs is prescribed in the Regulations and access to quota entitlement is subject to the payment of fees. Currently, all meat quota fees are calculated on the entitlement amount at 0.20 of a cent a kg ($2.00 per tonne).

The rate of quota access fees are reviewed annually and the Cost Recovery Impact Statement (August, 2011) determined that fee charges for EU and USA Meat TRQs be increased from the current rate of 0.20 cents per kilogram to 0.26 cents per kilogram. The EU HQB fee increase will come into effect for the 2012-13 financial year.

Based on historical data (quota fully utilised) the quota unit should receive $18,590 per financial year from EU HQB quota fees; effective from 2012-13 financial year.

5.2 Option 1 – Continuation of current arrangements

As this option is the status quo – continuation of existing arrangements – there would be no expected changes in behavioural or monetary terms (costs or benefits to exporters, brokers and the department).

Using this option, the method of allocating quotas based on historical precedent has the advantage that it reinforces the maintenance and strengthening of trading relationships previously established - a relevant consideration for products where marketing and advertising are important. A potential disadvantage of an allocated system based on historical trade is its discriminatory nature of preventing other potential exporters from competing and accessing quotas on an equal footing. However, this issue is addressed in the EU HQB quota system as 500 tonnes is set aside for new entrants. To date this NSQ quota (500 tonnes) has been underutilised.

It is considered that the current arrangements are not the ideal regulatory arrangements. This was often raised as an issue by business during consultations. The 2011 independent review identified that based on the current quota allocation model, where NSQ exporters receive an allocation based on the number of applicants, those NSQ exporters graduating to a SQ allocation could be worse off than companies still receiving only NSQ. The unduly favouring of NSQ exporters and the fact that SQ exporters may experience a fall in their total allocation despite performance growth is disruptive for market development. Indeed, the size of annual quota allocations - both SQ and NSQ – and year-to-year fluctuations in the allocations are common issues raised by stakeholders. And thus it could be argued that the current arrangements do not meet the Council of Australian Governments' principles of good regulatory practice.

During stakeholder consultations, industry broadly supported the need to allocate quota, provide for new entrants and have in place a quota allocation system that would better reflect export performance.

5.3 Option 2 – Ending quota allocations and switching to a FCFS system

The advantages of this method include its simplicity and potentially non-discriminatory nature. The latter allows new exporters to compete on equal terms with established exporters. Exports would continue until the quota is exhausted with subsequent consignments being subject to the out-of-quota tariff.

The HQB quota is small (7150 tonnes per annum) and in most years fully utilised. Historical export data of HQB and anecdotal evidence from industry suggest demand for quota will remain strong (see Table 2). Indeed, at the half-way point in the 2011-12 quota year, the EU HQB quota is already 63 per cent filled.

Table 2: EU HQB Quota Fill Rate

EU HQB (financial year quota)	Quota amount (tonne)	Amount shipped (tonne)	% shipped
2011-12 (as at 30/12/11)	7 150	4 486	63.0%
2010-11	7 150	6 435	90.0%
2009-10	7 150	7 133	99.7%
2008-09	7 150	7 121	99.6%
2007-08	7 150	7 149	100%
2006-07	7 075	6 346	89.7%

The disadvantages of a FCFS system for the EU HQB quota system are in the practical difficulties in operating the system as well as potential manipulation by a small group of exporters/brokers that would dilute the value of the quota rents.

As this is a small and fully utilised quota, there would be a frantic rush to import as soon as the TRQ is opened, contributing to import surges, market disruptions, and probably increased storage costs. Industry would need to consider whether FCFS is on landed shipment or on quota allocation. If on quota allocation, exporters are likely to seek all of the quota and then export against or trade quota limiting opportunities for other exporters. From the standpoint of the EU with several customs posts, it would also require a good information system so that the EU customs authorities would know when exactly the quotas have been filled.

Thus a FCFS system for this fully utilised quota is likely to attract speculators and encourage a secondary parallel market that will dilute the value of quota rents. Hence there is little support, if any, by industry and the department for shifting to a FCFS management system as stakeholders are concerned about the threat of disorderly trade and quota manipulation. Quota holders with significant investments in EU accreditation require long term commercial certainty for maintaining/developing their EU HQB market.

The administrative process with regard to the receival, processing and issuing of the quota certificates (resources and time) will remain the same as for the current system. No change to the IT system will be required. So a change to a FCFS system will not result in an increase in fees charged by the department. However, as noted above, this option will attract speculators and encourage a parallel market that will dilute the value of quota rents as well as disrupt market development for exporters; unpredictable access to quota. Thus adoption of a FCFS system is likely to result in an increase in costs to exporters relative to existing arrangements (Option 1).

5.4 Option 3 – Accept most of the review's recommendations (i.e. modifications of the current arrangements)

Implementation of Option 3 will not change quota availability (amount) to exporters, revenue received by the quota unit or the administrative process with regard to the receival, processing and issuing of the quota certificates.

However, there will be a one-off IT cost to the department in implementing this option as quota allocation calculators within the existing IT program (SARA) will need to be upgraded. This one-off programming change will cost the department $38 400 which will be capitalised against the IT asset (SARA) and amortised on a straight line basis for a period of five years; in line with departmental policy regarding internally developed software. This means that $38 400 per annum will need to be recovered over a five year period.

The one-off IT programming cost of $38 400 will not impact on the meat quota fee for the financial year 2012-13. There is no other cost with Option 3 from the government perspective relative to the status quo (Option 1).

The rest of the analysis under this option focuses on the costs and benefits to business arising from the government's response to the recommendations of the 2011 independent review.

The review identified areas where changes may be appropriate in the TRQ management system. They are presented in the context of the operational aspects of the administration system. Most of the recommended changes are modifications to the existing operational aspects of the quota administration system. These modifications aim to improve the usage rate of the quota, particularly in relation to returning unused quota in sufficient time to allow for reallocation to those exporters who have the capacity to ship additional quota. The modifications also seek to optimise the quota rent for exporters by encouraging business behaviour that focuses on exporting quota product rather than on quota trading as a principle business objective.

A summary of the modifications recommended by the review to the existing arrangements and the department's response to the respective recommendations is listed below. Qualitative impacts are discussed as well in order to illustrate the potential costs and benefits on business under this option relative to Option 1 (status quo).

5.4.1 Department's Response to Review

The recommendations fall into four main categories, those that:

a) Make no changes to existing administrative rules:

   i. Recommendation 1 – the EU HQB access remains an allocated quota.

   ii Recommendation 12 – performance share calculations remain based on HQB exports.

   iii Recommendation 15 – 1 tonne minimum allocation threshold.

   iv Recommendation 16 – restrictions on transfers.

b) Modify existing rules:

   i Recommendation 2 – an application process be introduced at the start of the quota year.

   ii Recommendation 3 – performance for SQ allocations are based on a three year moving average of HQB exports to the EU.

   iii Recommendation 4 – supplementary allocation.

   iv Recommendation 5 &10 – modified FCFS system.

   v Recommendation 6 – modify existing 500 tonnes NSQ set aside.

   vi Recommendation 9 – activate quota re-claim provisions one month earlier.

c) Apply new administrative rules:

   i Recommendation 7 – introduce a time limit and annual eligibility threshold for SQ holders to access NSQ.

   ii Recommendation 8 – introduce provisions against frivolous NE applications.

   iii Recommendation 11 – penalty provision.

   iv Recommendations 2, 4, 5, 9, 10 and 13 – various subsections on forfeitures.

   v Recommendation 16 - restrictions to volume of transfers.

d) Rejected some recommendations:

   i Recommendation 13 – eligibility for allocations is limited to owners of EU accredited property.

   ii Recommendation 14 – third party exporter's eligibility assessment criteria.

5.4.2 Make No Changes to Existing Administrative Rules

Recommendation 1: The EU HQB access remains an allocated quota.

Recommendation 12: Performance share calculations will remain based on HQB quota exports, out-of-quota HQB trade and sales of cuts from HQB carcasses under the EU GATT global quotas – grain fed exports under the new EU global quota are excluded.

Recommendation 15: The 1 tonne minimum SQ allocation remains unchanged – if an initial SQ calculation falls below this threshold the exporter is excluded from the SQ allocation process.

Recommendation 16: SQ allocations and distributions of re-claimed quota are transferable and NSQ allocations are non-transferable.

DAFF's response: Agreed. As the above recommendations are consistent with current arrangements, they will not have an impact on market participants or government. Thus, it will be business as usual.

The access amount remains at 7 150 tonnes (which is a World Trade Organisation agreement). Industry has indicated a preference for the quota to continue to be fully allocated, for it to be based on the existing record of shipment formula and that the 1 tonne limit remain, as this amount is considered is to be the minimum for a commercially viable shipment.

Exporters make commercial decisions about whether they ship to EU or non-EU markets, fully aware of which components will be taken into account for future quota allocations.

Transfering quota between holders is a long standing practice. The option for exporters to transfer (or trade) quota recognises commercial realities and facilitates an efficient and effective way to maximise quota usage.

NSQ allocations will remain non-transferable to continue to support the original intent of restricting exporters from applying to simply trade in quota.

> *Benefit:* Business certainty and allocation fairness (continuation of current practice).
>
> *Cost:* No costs to industry, it is business as usual (continuation of current practice).

5.4.3 Modify Existing Rules

Recommendation 2: An application process be introduced at the start of the quota year to improve the effectiveness of the allocation process and support a mechanism to handle situations of weak demand for quota.

Recommendation 3: Performance for SQ allocations are based on a three year moving average of HQB exports to the EU.

Recommendation 4: If necessary a supplementary SQ allocation will be made at the end of July to share the pool of any unallocated quota.

Recommendation 5: A modified FCFS system is used to distribute any unallocated quota that remains after the supplementary SQ allocation.

Recommendation 6: The 500 tonne NSQ set aside remains in place and the treatment of NEs in accessing set aside is modified to provide a preferential pathway to participation in the HQB quota trade.

Recommendation 9: Activate quota re-claim provisions one month earlier and introduce penalties for non-use of quota to sharpen the commercial focus on timely quota use and discourage the inclination to 'sit' on quota.

Recommendation 10: A modified FCFS system is used to distribute any un-used quota recovered though the quota re-claim provisions.

DAFF's response: Agreed. Industry indicated the current arrangements were generally acceptable. However, they wanted some modifications to improve the allocation process and access to non-standard, unallocated and uncommitted quota. There may be some costs to some business, but not for the vast majority. Benefits to industry will be greater business *certainty and a capacity to plan for growth. These modifications will not result in an increase in government cost-recovery charges.*

Recommendation 2: Application Arrangements

Current application arrangements only require an expression of interest (EOI) for standard and non-standard quota from exporters. The EOI registers the exporter for a potential allocation and the allocation process then gives them an amount, regardless of whether that amount is appropriate to their business needs for that year.

The modified arrangements will take into account exporters' assessment of the amount of quota they believe they can use in a quota year based on market conditions and contractual arrangements. This assessment will be known as the 'request amount'. This way quota that is not required is redistributed early in the allocation process to those who believe they can ship more than the three year average they are entitled to.

> *Benefits:*
>
> Exporters can be more certain of how much quota they will have for the year and make business plans accordingly earlier in the year. The request amount arrangement also provides greater flexibility to handle situations where there may be weak demand for quota, leaving excess quota to become available to those who can use it.
>
> *Cost:*
>
> Some businesses may get a lower allocation under the proposed arrangements than what they receive under the current arrangements. However, for many individual businesses this is not a monetary or business planning cost, as they would not be receiving more quota than required. The unrequired quota would become available for wider redistribution.

Recommendation 3: Three Year Moving Average

Current allocations are based on the previous year's record of shipment. Exporters have different strategies and business performance that can fluctuate over time. Reward for performance is a key principle for the SQ allocation mechanism and a time dimension is considered appropriate for this criteria.

> *Benefit:*
>
> A three year criteria will smooth out spikes in performance that is not possible when using a single year on which to base quota entitlement. Effectively, a three year moving average of past performance will reward a growth trend and have the opposite effect for a declining sales trend.
>
> *Cost:*
>
> It is difficult to analyse the costs involved under this proposal. While those businesses that are active market participants will benefit from the proposed regulation, it is possible that exporters with declining sales trend will be worse off, at least initially, by having less SQ allocated than under the current arrangements.

Recommendation 4: Supplementary allocation

Current administrative arrangement includes an interim and a final allocation process and does not take into account periods of weak demand for quota. Under the modified arrangements a single allocation will be made. After the single allocation process, a supplementary allocation process may take place in the rare event when quota is in weak demand and exporters have received the quota they want but there is still some quota remaining. Generally, this proposal is aimed at strengthening the operation and efficiency of the existing arrangements.

> *Benefit:*
>
> The single allocation in normal market conditions will provide more certainty to exporters on the amount of quota they are entitled to. Other benefits could arise at the margin when the quota is unutilised due to unexpected events such as floods or other disruptions to business.
>
> *Cost:*
>
> There are no expectations of any notable costs associated with this proposal. It is expected to be business as usual for the overwhelming majority of exporters.

Recommendations 5 and 10: Modified FCFS

Current arrangements include provision for a FCFS process, including a time limited restriction on trade in FCFS quota. The restrictions are in place to prevent speculation in quota prices. However, the process focuses solely on uncommitted quota as the quota year draws to a close.

The modified FCFS will be activated twice a year. Once in relation to forfeitures on non-payment of fees, and then again later in the quota year, but earlier than is currently is the case, for reclaimed quota.

> *Benefit:*
>
> The benefit will be access to additional entitlement earlier in the quota year to optimise access to uncommitted quota. European buyers and Australian exporters are fully aware that the value of quota diminishes towards the end of the quota year. Therefore, earlier access to FCFS will allow exporters to negotiate contracts which are more beneficial to them. The department cannot quantify theses commercial-in-confidence arrangements but can make a reasonable assumption that commercial behaviour would be based on the economic fundamentals of supply, demand, and in the quota environment: time.
>
> *Cost:*
>
> There are no costs associated with this modification, including to third parties. Third parties will have a one month window in which to trade FCFS quota, after which such trade will not be permitted. This time restriction on FCFS trade is a current condition that will remain under the new arrangements.

Recommendation 6: 500 tonne NSQ

There are some unintended anomalies in the way the current NSQ allocation process operates. They arise from requiring the set aside to be fully allocated on an even share basis. The system is cumbersome, it can lead to fluctuating allocations that are disruptive to market development, and there is no reward for performance.

The intention of the NSQ is to provide trade opportunities for new entrants. But currently it is primarily operating as a 'top-up' for small operators. This can crowd out the opportunities for new entrants, particularly when small operators consistently apply for NSQ without competing in the standard quota pool. This practice then reduces the amount of NSQ available for genuine new entrants.

Current rules for NSQ mean that if a new entrant is eligible, it can get quota whether it specifies an amount or not. Standard quota holders cannot access NSQ because NSQ cannot be traded. This arrangement effectively quarantines a significant amount of quota from standard quota holders who have long standing trade arrangements in the European Union meat market.

The current NSQ system reached the end of its operating timeline in 2010, but it was extended by one year until a review into its effectiveness was finalised in 2011. From 2006 to 2010 on average about 18 businesses received entitlement each year under NSQ. In the additional year of 2011 it was seven. The numbers each year fluctuated. Some businesses had reached the maximum amount they were allowed to receive under existing rules; some were no longer in business and others moved in and out of the NSQ as market conditions dictated.

Under the new rules many old NSQ holders will be eligible to access quota from the SQ pool. Some who have not operated in the market for some time will be eligible to apply for NSQ again. Six of the seven 2011 NSQ holders will still be eligible to apply for NSQ for 2012-2013. The overall net effect is that those who had access to quota in the past can still access it in 2012, subject to entitlement calculations based on record of shipment. It is unknown how many will apply, however, based on some previous year's applications it can be up to 30 businesses.

> *Benefits:*
>
> The modified arrangements aim to provide better trade opportunities for new entrants as well as free up unallocated NSQ to SQ holders, thus ensuring optimum more efficient allocation and use of all quota.
>
> *Costs:*
>
> Costs are expected to be negligible as the vast majority of businesses will have access to some form of quota.

Recommendation 9: Reclaim of Uncommitted Quota

Stakeholders believe the current process is not working effectively as it does not encourage early return of uncommitted quota. Ineffective re-claim provisions can affect the quota fill rate. The pressure to use quota before year end can lead to weak selling and some of the value of the quota rent can be lost. These outcomes can be amplified by 'trade inertia' from business pressures. Some exporters may not give enough attention to the use of their quota early in the year. The risk of this is higher with small operators and in periods of weak demand for access.

Users of re-claimed quota need time to make commercial arrangements and there is a six week shipping lag. By the time un-used quota is distributed there is at best 2.5 months to make use of the access.

Specific records of those who retain uncommitted quota beyond the point where it can be used by others are not kept by the department. The department also does not have access to commercial-in-confidence business plans or dealings. In practice, in March each year, the department requests businesses to advise it about uncommitted quota. It may take several weeks to determine the uncommitted status of the remaining quota, which means it may be May before the department can re-claim quota or the business voluntarily hands it back. The quota year ends on 30 June.

The modified arrangements include an earlier requirement for exporters to assess their remaining quota use. These arrangements do not prevent an exporter who handed back quota from applying for more later under FCFS should their contractual circumstances change.

Benefits:

Quota is returned earlier, giving other exporters time in which to access, ship and land additional quota product before the quota year lapses. Overall, the proposed reclaim is expected to lead to a more efficient use of the current quota arrangements.

Costs:

The department does not have access to commercial-in-confidence data about company costs in relation to possible penalties for retaining uncommitted quota (see Recommendation 11). Neither can the cost of waiting for uncommitted quota be quantified. However, basic economic fundamentals would operate. An exporter needs to ensure supply of EU specification cattle, and any uncertainty in relation to this factor may cause the producer to sell elsewhere. An exporter needs to ensure he has a buyer, and any uncertainty in being able to supply the buyer could lead to the buyer going elsewhere and not necessarily to another Australian exporter. The aim of the proposed modification is to give certainty to both the supply and demand factors.

5.4.4 Apply New Administrative Rules

Recommendation 7: Introduce a time limit and annual eligibility threshold for SQ holders to access the set aside in conjunction with a maximum NSQ allocation.

Recommendation 8: Introduce provisions to act as a disincentive for frivolous NE applications for NSQ allocations from the set aside.

Recommendation 11: Penalty provisions for non-use of quota should be applied using a 3 step approach to quota allocation determinations to ensure the deterrence effect of a 1 for 1 reduction in allocations is effective.

Recommendation 16: SQ allocations distributions of re-claimed quota are transferable and NSQ allocations are non-transferable.

DAFF's response: Agreed. Adoption of these new administrative rules will help to improve the allocation process and reward exporters trying to develop their EU market. Impacts on businesses will be nil or negligible except for those exporters penalised through reduced quota allocation (refer to discussion below).

Recommendation 7: Access to NSQ

Current arrangements allow new entrants to access NSQ for several years, restricted mainly by the 150 tonne maximum entitlement. This arrangement encourages opportunism and ties up quota by those not in a solid position to export. Opportunism is contrary to the intention of facilitating business behaviour that would grow a company's European Union beef market. The modified arrangements still provide a pathway to the market for genuine new entrants. The aim is to help the new entrant establish themselves in the market. Opportunists will have difficulty in meeting eligibility requirements, thus freeing NSQ quota for genuine market players with long term business goals. As access to NSQ is not a perpetual right, new entrants are expected to 'graduate' to the standard quota pool after three years in NSQ. When they graduate they will still be supported as a SQ holder but only through limited access to NSQ quota for a further three years, after which they will be treated as normal standard quota holders. If there are no new entrant allocations in a given year, the entire NSQ will be put into the SQ pool.

Benefits:

New entrants are given short-term support as standard quota holders to help them continue to grow their business.

Costs:

Previous NSQ holders may not be eligible for NSQ under the modified arrangements. However, they can access quota from the standard pool, which has the effect of minimising their costs.

Recommendation 8: Frivolous Applications

Current arrangements allow for NSQ to be allocated to new entrants simply on a supply and demand basis.

The intention of the new NSQ provisions is to encourage NEs and small operators to work harder on market development. Needs-based allocations will sharpen the focus on market development. It shifts the balance away from ad hoc, speculative sales that can reduce the value of the TRQ.

Speculation can result in cases where new entrants receive more quota than some long standing standard quota holders. This occurrence is particularly vexatious to standard holders, who would have to wait almost 11 months to see if they can access uncommitted NSQ; almost too late in the quota year. Information on the number of SQ holders that received less than NSQ holders over the last five years is detailed below:

2006-07

5 out of 13 SQ holders received less than an NSQ holder

Record of uncommitted quota not available.

2007-08

3 out of 16 SQ holders received less than an NSQ holder

12 SQ holders requested over 896 tonnes of additional quota and waited almost 11 months for access to 470 tonnes of uncommitted quota to become available.

2008-09

2 out of 20 SQ holders received less than an NSQ holder

12 SQ holders requested over 256 tonnes of additional quota and waited almost 11 months for 226 tonnes of uncommitted quota to become available.

2009-10

2 out of 22 SQ holders received less than an NSQ holder

7 SQ holders requested over 80 tonnes of additional quota and waited almost 11 months for 52 tonnes of uncommitted quota to become available.

2010-11

15 out of 35 SQ holders received less than an NSQ holder

7 SQ holders requested unspecified quota (any amount will do was the phrase used). No one handed back quota. However, in 2010-11 only 90% of the total quota was used, whereas in previous years the usage rate was 99-100%.

> *Benefits:*
>
> The modified arrangements ensure new entrants have access to commercial quantities of quota or to conditional self-assessed request amounts, leaving the remaining NSQ to be distributed amongst SQ holders at the beginning of the allocation process.
>
> *Costs:*
>
> There are no costs involved, as the new entrants will be allocated amounts that they can use.

Recommendation 11: Penalties

Currently there are no penalty provisions and thus no incentive to move or return uncommitted quota.

The new arrangements make provision for circumstances where an exporter fails to arrange for in-quota shipments by a certain date and has to show cause why their next year's allocation should not be penalised. A number of checks will occur before the penalty is imposed and the right to appeal is available to ensure exporters are not inadvertently penalised.

Penalties will be imposed through a three step process. The first step would be to calculate the performance based share of the 7 150 tonne quota. Step two would be the adjustment of the preliminary determinations to reflect 'quota requests' with any residual quota allocated to the remaining applicants. The third step would be to deduct penalties from the preliminary determinations including the active 'quota requests'. The penalty amounts would then be distributed among the remaining non-penalised applicants. The penalty will be applied on a kilogram to kilogram basis and will affect the company's next years' allocation amount.

There is no potential government revenue increases. The management of the quota is done on a cost recovery basis whereby exporters are charged a fee of $2.60 a tonne for every tonne they are allocated.

> *Benefits:*
>
> The existence of a penalty provision should focus market participants on better business planning and facilitate timely use of the quota. The department is not able to quantify the overall monetary benefit as this type of information is commercial-in-confidence and not available to the department.
>
> *Costs:*
>
> Cost will apply only to those who are penalised through reduced quota allocation for the next quota year. The monetary value is unknown. It is difficult to estimate the extent to which the proposed penalty provisions will act as a deterrent because of the number of variable factors. These factors include the number of companies involved, who are not necessarily the same companies each year, the amount of quota involved, and the timing of quota usage each year.

Recommendations 2, 4, 5, 9, 10 and 13: various sub-recommendations on forfeitures

Currently there are no forfeiture provisions. The new rules introduce forfeiture to discourage inclinations to 'sit' on quota. Forfeiture of an entitlement can occur when the prescribed fee is not paid within 30 days of the date of invoice, if less than 1 tonne is used by a given date, if less than 33 per cent of an allocation has been used by a given date and if no response has been received to the department's request about the exporter's proposed use for his uncommitted quota. The forfeited quota is placed in a FCFS pool and distributed accordingly.

Benefits:

Forfeited quota releases access to additional quota earlier in the quota year.

Costs:

Costs will only apply to those companies that forfeit entitlement. The cost would be to the value of the quota, which would be in accordance with potential contractual arrangements.

Recommendation 16: restrictions to volume of transfers

Under current arrangements an exporter can gain additional quota through trade/transfer with another quota holder. The department is not party to these transactions and is not aware of the commercial value of transfers. The department only keeps a record of how much quota was transferred between parties. Allocated quota is accessed by exporters through a $2.60 a tonne cost recovery fee paid to the government. However, anecdotal evidence indicates that quota entitlement through transfer/trade can change hands for a significantly higher amount.

Currently trade/transfer can take place with non-standard quota and re-claimed/first-come first-served allocations, subject to time-based restrictions.

The intention of the modification is to apply the same principles as is current but now includes additional rules about how much quota can be traded. The volume allowable (50% or 33% depending on the period) is stipulated in the reviewer's report at Appendix C.

Benefits:

Reduced quota costs to exporters with genuine shipments by limiting speculative trading.

Cost:

The cost will fall on those businesses whose principle objective is trading in quota. However, the modifications will not prevent these businesses from trading altogether and it is not clear to what extent their trading margins or profits will be reduced.

5.4.5 Rejected Some Recommendations

Recommendation 13: Eligibility for allocations is limited to owners of EU accredited HQB cattle, owner-operators of EU accredited processing plant and beef processors operating through an EU accredited plant – NPEs are excluded from quota allocations with the exception of those that satisfy an assessment test on quota use.

Recommendation 14: Third party exporters (NPEs) marketing HQB allocations on behalf of quota holders are subject to the eligibility assessment criteria for quota allocations faced by quota holders.

DAFF's response: Not Agreed.

Currently the quota administration system recognises active quota participants as either a "processor" or an "agent". Processors are known as packers and agents as NPEs (non-packer exporters) or traders.

Some processors were seeking to exclude NPEs on the grounds that NPEs do not have the same infrastructure/capital investment in the EU beef market as they have. This view fails to recognise that many NPEs have established business relationships with customers needing high quality beef and have an incentive to maximise returns on quota sales and invest in market development.

DAFF noted the processor request but does not support it. The department does not have the capacity to distinguish between NPE business structures. To develop such a capacity or seek external advice would add significantly to the cost of assessing eligibility, which would need to be cost-recovered from industry.

Benefits:

NPEs will continue to operate in the quota system as previously and provide specialist integrated marketing services for producers and smaller processors that have no capacity to engage in export market development.

Costs:

Cost would be to those exporters who purchase quota through trade/transfer. However, these costs would be limited by the proposed restrictions to that trade under Recommendation 16.

6.0 Consultation statement

The independent review of EU HQB quota arrangements commenced in May 2011 and stakeholders from the beef industry were widely consulted from May to July 2011. The objective of this consultation process was to seek comments from interested parties on the effectiveness and efficiency of current EU HQB quota arrangements, and any changes that they propose to improve the existing arrangements.

Submissions for the review were sought in May 2011 through notification on DAFF website (www.daff.gov.au/quota) and by contacting all registered beef exporters. DAFF also invited stakeholders to meet the consultant face-to-face or through teleconference. DAFF also sought assistance from the Red Meat Advisory Council (RMAC) and the AMIC to encourage stakeholders to provide input into the review. In addition to the teleconferences, face-to-face meetings were held in Brisbane, Sydney, Melbourne and Canberra. RMAC and AMIC did not provide written submissions, however provided input during the face-to-face meetings.

The review and draft departmental response were published on the DAFF website

(http://www.daff.gov.au/agriculture-food/meat-wool-dairy/quota/eu-beef-quota-review)

and sent to all EU HQB exporters for comment on 14 December 2011. One comment, from a broker, was received during the seven week feedback period that closed on 7 February 2012 (see Appendix D).

The broker was basically supportive of the proposed changes but had strong views regarding quota transfer rules. The department recognises that quota trading is a legitimate commercial activity but needs to ensure that any quota system adopted meets the government's principle regarding optimising the commercial value and use of the TRQ. The department is also aware that trading in quota as a principle business objective is particularly vexatious to those exporters who have to compete for quota with those who do not have significant capital investment in the EU market. The implementing of a system adopting most of the review's recommendations including restricting trade in quota will meet government policy regarding optimising the commercial value and use of the TRQ, and at the same time recognising the commercial reality by allowing for some trade in quota.

Following a seven week consultation period with industry and government agencies, the EU HQB 2011 review was finalised on 8 February 2012. The primary conclusion of DAFF is that the independent consultant's recommendations, including the adoption of a new TRQ allocation model for new entrants, constitutes a more appropriate framework for the effective administering of the EU HQB TRQs than the existing arrangements.

7.0 Conclusion and recommended option

The key determinants for an appropriate EU HQB quota management system centre on rewarding market development in a transparent manner. Based on industry consultations and the impact analysis undertaken in the RIS, the proposed EU HQB Option 3 (accept most of the review's recommendations) would provide a fairer, more effective and more efficient way of administering this highly sought after quota relative to the status quo (Option 1).

Implementation of Option 3 will not change quota availability (amount) to exporters, revenue received by the government or the administrative process with regard to the receival, processing and issuing of the quota certificates.

However, Option 3 is expected to impact on government costs of running the scheme, and it will also impact (costs and benefits) on local exporters.

The cost to government of implementing Option 3 is marginal. The only anticipated implementation issue that will need to be resolved is the modifications to the EU HQB quota allocation computer system SARA. This IT cost is anticipated to be under $50 000 but as the quota unit operates under the department's cost recovery model, this cost may have to be passed on to exporters from the financial year 2013-14 onwards.

Overall, Option 3 will modify existing rules or apply new administrative rules to managing the current quota arrangements. These modifications aim to improve the usage rate of the quota, particularly in relation to returning unused quota in sufficient time to allow for reallocation to those exporters who have the capacity to ship additional quota. The modifications also seek to optimise the quota rent for exporters by encouraging business behaviour that focuses on exporting quota product rather than on quota trading as a principle business objective.

This RIS has not been able to quantify the costs and benefits of the proposed arrangements in particular detail. However, the consultation process and impact analysis undertaken suggests that the proposed quota arrangements are expected to deliver a more efficient and effective management of EU HQB quota by optimising the commercial value and use of the tariff rate quota, minimising barriers to exporting and reward market development in the export industry, including for new entrants.

With respect to modifications of existing arrangements, the main benefits are in terms of improving the allocation process and access to non-standard, unallocated and uncommitted quota as well as greater business certainty and a capacity to plan for growth. There are expected to be minor costs to some businesses. However, the vast majority of businesses will be able to access quota using alternative arrangements. Others may get a lower allocation under the proposed arrangements than what they receive under the current arrangements. This reduced allocation would be related to the calculations around the exporter's "request amount" and record of shipment.

Adoption of the proposed new administrative rules will help to improve the allocation process and reward exporters trying to develop their EU market. Impacts on businesses will be nil or negligible except for those exporters penalised through reduced quota allocation. It is expected that the impact on these businesses will be minimal.

8.0 Strategy to implement and review the preferred option

The preferred option (Option 3) including the OBPR assessed RIS will be considered by the department before recommended changes to the administration arrangements for EU HQB quota will be implemented by amending the *Australian Meat and Live-stock Industry (High quality Beef Export to the European Union) Order*. The Senator the Hon. Joe Ludwig, Minister for Agriculture, Fisheries and Forestry will be advised of any changes to the administration arrangements for EU HQB quota.

The quota unit is working towards the proposed EU HQB quota arrangements (Option 3) in place for the 2012/2013 financial year.

Any quota administration methodology will be established within a framework of regular review. Therefore, if market conditions change over time, new suppliers emerge or unintended consequences become apparent, industry can be assured that these factors can be addressed during the next review. If accepted, the Orders and the new model will be reviewed after five years in line with government best practice regulatory review cycles.

To ensure transparency and that on-going fees and charges are set at appropriate rates, DAFF will prepare a short annual statement each year detailing revenue, expenditure and forward cost estimates of managing the beef TRQs on a cost recovery basis.

Deputy Secretary
Australian Government Department of Agriculture, Fisheries and Forestry

May 2012

Appendix A

Terms of Reference - European Union High Quality Beef Quota 2011 review

Background

A review of the European Union (EU) high quality beef quota arrangements was conducted in 2005. Subsequent to the review and consultation between DAFF and industry, the former Minister for Agriculture, Fisheries and Forestry agreed to the current quota administrative regime for the management of Australian high quality beef (HQB) exports to the EU. A review of EH HQB arrangements is due to be undertaken.

Terms of Reference

The consultant will examine and report on:

- The effectiveness and efficiency of the current quota arrangements, with an emphasis on use, by new entrants, of non-standard quota. This part of the review will cover:
- the definition of 'new entrant';
- use of non-standard and standard quota by new entrants;
- the ongoing suitability of the total annual new entrant entitlement of 500 tonnes; and
- any other area the consultant considers is relevant.
- Identify where improvements to the existing quota management arrangements could be made, including in the areas of:
- allocation of quota to exporters, including options for the allocation of standard and non-standard quota entitlements when demand for quota is either low or high;
- minimum allocations, having regard to commercial practices;
- quota transfer arrangements;
- measures to deal with unused quota – including incentives and/or penalties and the date of return of unused quota – to ensure maximum utilisation of Australia's in-quota access to the EU beef market; and
- any other area the consultant considers is relevant.

Considerations and timing

In undertaking the review, the consultant should have regard to recent quota fill outcomes, costs of quota administration and commercial requirements of individual quota holders. Where appropriate, the consultant should use scenario mapping to demonstrate any suggested improvements to the allocation system.

The consultant should also take into account the outcomes of the 2005 review and the views of industry representatives and individual exporters and processors.

The consultant will present a draft report to DAFF by 24 June 2011.

Appendix B

A full breakdown in revenue and costs for the meat and dairy quotas are illustrated in Tables 1 and 2.

Table 1: Meat quota revenue and expenses

Meat Quota	**2009-2010 Actual**	**2010-2011 Actual**		**2011-2012 Revised Budget**
Opening balance (Quota Appropriation Account)	**418,831**	**32,925**	**	
Opening balance (Quota Operating Account)	**15,178**	**146,951**		**2,220**
Revenue				
Gov. Process Appropriation	–	46,654		45,629
Gov. Appropriation	–	152,179	*	
Revenue from fees	131,770	178,801		217,883
Total Revenue	**565,779**	**557,510**		**263,512**
Employee Expenses	**199,171**	**206,420**		**185,716**
Supplier Expenses	**154,821**	**66,931**		**107,047**
Consultants	*–*	*18*		
Information Technology	*109,109*	*63,210*		*100,807*
Office Services	*–*	*149*		
Legal Services	*5,126*	*2,908*		*2,910*
Publications	*285*	*404*		*336*
General Office Supplies	*2,086*	*364*		*1,594*
Other Administrative	*122*	*-122*		*400*
Temporary and Contract Staff	*8,146*	*–*		
Depreciation and Amortisation	**29,718**	**38,117**		**36,533**
Interest expense	–	**337**		**11**
Write Down of Assets	**–**	**-1,297**		
HR Services	**229**	–		
Corporate Overheads	**31,914**	**144,922**		**112,829**
Government Process Overheads	–	**99,860**		**96,691**
Government Process Expenses	–	*41,820*		
Branch Executive Overheads	–	*40,116*		
Divisional Executive Overheads	–	*17,924*		
Total Expenses	**385,906**	**555,290**		**538,817**
NET SURPLUS / DEFICIT	179,873	2,220		**-275,305**
Closing balance (Operating Account)	**146,951**	**2,220**		
Closing balance (Gov. Appropriation Account)	**32,925**	–	**	

*This is a one-off government supplementation for corporate costs pending the transition to full cost recovery.
**In 2010-2011 the surplus meat quota fees collected in 2003 were fully expended. From 2011-2012 and in subsequent years the Quota Unit will not receive any funds from the Government appropriation account.

Table 2: Dairy quota revenue and expenses

Dairy Quota	2009-2010 Actual	2010-2011 Actual		2011-2012 Revised Budget
Opening balance(Quota Operating Account)	**146,489**	**129,921**		**60,093**
Gov. Process Appropriation	-	15,600		6,364
Gov. Appropriation	-	46,997	*	
Revenue from fees	190,437	129,200		146,498
Total Revenue	**336,926**	**321,718**	**	**152,853**
Employee Expenses	**60,247**	**78,632**		**29,906**
Supplier Expenses	**99,776**	**38,978**		**59,862**
Information Technology	*40,361*	*38,469*		*57,254*
Travel	-	*204*		
Legal Services	*728*	-		
Publications	*285*	*305*		*336*
General Office Supplies	*1,070*	-		
Temporary and Contract Staff	*5,744*	-		
Depreciation & Amortisation	**51,588**	**51,588**		**52,190**
Corporate Overheads	**46,982**	**58,576**		**30,242**
Government Process Overheads	**-**	**33,851**		**13,452**
Government Process Expenses	-	*14,176*		
Branch Executive Overheads	-	*13,598*		
Divisional Executive Overheads	-	*6,076*		
Total Expenses	**207,005**	**261,625**		**185,652**
Closing Balance	**129,921**	**60,093**		**-32,799**

*This is a one-off government supplementation for corporate costs pending the transition to full cost recovery.

**$50 000 less than forecast in 2009

Appendix C

Review of administration arrangements for the
tariff-quota on
EU high quality beef

Report to the Australian

Department of Agriculture, Fisheries and Forestry

by

David Harris

D. N. Harris & Associates

September 2011

Acknowledgements

This review could not have been completed with the cooperation of staff from the Animal Welfare and Livestock Industries Branch of the *Department of Agriculture, Fisheries and Forestry*. They provided secretariat services for industry consultations and information on the HQB quota administration. The data and advice provided by Ms Elizabeth Phillips from the Quota Management Unit was greatly appreciated. The assistance of Dr Vani Srungaram, Mr Mark Whitechurch and Ms Susan Wishart from the Meat and Livestock Section was also greatly appreciated.

Contents

Tables

Abbreviations

ABARES	Australian Bureau of Agriculture and Resource Economics and Sciences
AMIC	Australian Meat Industry Council
COAG	Council of Australian Governments
DAFF	Department of Agriculture Fisheries and Forestry
EUCAS	EU Cattle Accreditation Scheme
FCFS	First Come First Serve quota allocation system
GATT	General Agreement on Tariffs and Trade
GFC	Global Financial Crisis
HGP	Hormone Growth Promotion
HQB	High Quality Beef
HQGFB	High Quality Grain Fed Beef
MLA	Meat and Livestock Australia
NE	New Entrant
NLIS	National Livestock Identification Scheme
NPE	Non-Packer Exporter
NSQ	Non-Standard Quota
RMAC	Red Meat Advisory Council
SQ	Standard Quota
TOR	Terms of Reference
TRQ	Tariff-Rate Quota
WTO	World Trade Organisation
ytd	year-to-date

Executive summary

The *Department of Agriculture, Fisheries and Forestry* (DAFF) has initiated a review of the management system for the EU High Quality Beef (HQB) quota. The review requires an examination of the effectiveness and efficiency of the TRQ administration. Identifying ways to improve the management system was a further requirement.

The aim of the administration arrangements is to maximise the value of the HQB access for the benefit of the beef industry. It is not intended to be a mechanism for creating a property right or to encourage quota trading. To guide the review a set of principles were developed and a stakeholder consultation process was undertaken in July 2011.

Quota usage and management rules

The HQB quota is fixed at 7,150 tonnes with a 20% in-quota tariff. The quota trade is characterised by high valued, chilled cuts and sea freight is the most common method of shipment. The EU has imposed product specifications and there are costs associated with accreditation requirements for Australian producers and beef processors.

In 2009 the EU established a new global import quota for grain fed beef. Management rights have been retained by the EU and access is allocated to EU importers. The quota is fixed at 20,000 tonnes and there is no in-quota tariff. Australia is a designated supplier and was an active user of the quota in 2010-11.

The HQB access is managed through an allocation system that distributes two types of quota – standard quota (SQ) and non-standard quota (NSQ). It has been fully utilised until the most recent year. Year–to-date exports show under-fill of around 9% in 2010-11. Key features of the current system are:

- SQ allocations are based on EU HQB exports in the previous year;
- eligibility for SQ is open to any licensed exporter with EU export performance;
- a 500 tonne set aside for NSQ with allocations based on an equal share;
- eligibility for NSQ is restricted by a cumulative threshold of 150 tonnes of NSQ and a time limit of 5 years;
- a mechanism to re-claim unused quota in early March with re-distributions to eligible exporters on a first-come-first serve (FCFS) basis.

Quota allocations and management issues

The number of quota participants has increased over the past 5 years. There are currently 35 SQ holders compared with 12 in 2005-06. The increase has been in companies without processing facilities. Almost three quarters of participants had a total allocation of less than 100 tonnes in 2010-11.

NSQ allocations increased to 23 in 2009-10 and the growth in quota participants reduced the size of NSQ allocations. New entrants (NEs) increased to 11 in 2008-09 but declined to 2 companies in 2010-11. The NSQ set aside is largely being used as a quota 'top-up' for small operators with about half of the SQ holders receiving NSQ allocations.

The review has identified some areas where changes would improve quota management. The main recommendations for change relate to the following issues:

- export performance to determine SQ allocations;
- management of the NSQ set aside and the treatment of new entrants;
- eligibility for allocations; and
- the quota re-claim provisions.

Management of NSQ is an area of concern for stakeholders. Allocation outcomes are not especially transparent and the management system can lead to unintended consequences. When combined with the SQ allocation process, NSQ distributions generate inequities in the treatment of small operators. It can lead to fluctuations in total annual allocations that are inconsistent with the principle of reward for performance.

Distortions arise because SQ allocations use performance and NSQ allocations do not. The NSQ allocated to exporters inside the eligibility threshold was 78 tonnes in 2011-12. In the previous three years it was around 25 tonnes. SQ allocations are affected by NSQ allocations in the previous year. Exporters graduating after a small NSQ allocation could be worse off than companies still receiving NSQ.

More generally, some exporters may experience a fall in their total allocation despite performance growth. This is disruptive for market development efforts. There is no reward for performance and failure to fully use an NSQ allocation has no effect on subsequent NSQ allocations. This may encourage an ad hoc approach to sales.

The 5 year eligibility period and lack of specific provisions for a new entrant can lead to other anomalies in NSQ allocations. A larger number of applicants will limit the initial trade opportunities for NEs. In certain circumstances the time limit on eligibility could unintentionally favour one small operator over another.

There is no case for unduly favouring small operators over other exporters by granting quota top-ups that are not based on performance. A preferable approach is to limit NSQ eligibility and treat all exporters equally by using performance to share the total access. Exporters just beyond the set aside eligibility threshold should not be disadvantaged in comparison to those inside the threshold. This would suggest an NSQ management system that:

- limits maximum NSQ allocations to an eligibility threshold; and
- facilitates the distribution of un-allocated NSQ to other exporters that were excluded from the set aside.

Recommendations for HQB quota management

The recommendations for HQB quota management are presented in chapter 5 – there are 16 recommendations with associated sub-recommendations. A summary of the major changes is presented in table 1 and most are modifications to existing arrangements.

The HQB access should remain an allocated quota. An application for a quota allocation should be introduced with a obligation to specify a ‘quota request’ in tonnes. No response will mean exclusion from all allocations. A simultaneous call for NE applications should require the submission of information on intended quota use for an eligibility assessment. A fee should be levied to cover assessment costs.

The existing approach of dividing the HQB access between SQ and a set aside for NSQ should continue. Key changes to the SQ allocation process are:

- allocations to be based a 3 year moving average of HQB trade to the EU;
- performance data to use year-to-date shipments for the most recent year (t-1) and will be ‘locked’ for the duration of the quota year;
- if necessary, a supplementary allocation at the end of July to share any quota that becomes available from forfeits, rejected allocations and the NSQ set aside;
- supplementary allocations limited to SQ holders that were ineligible for NSQ with allocations based on a 3 year moving average of HQB trade to the EU.

The recommended changes will ensure the HQB access is fully distributed at the start of the quota year unless the demand for quota is weak. In the unlikely event this situation arises it is recommended that:

- a modified FCFS system is used to distribute any remaining unallocated quota;
- quota holders get first preference – quota requests are accepted for short period;
- if total requests exceed the available quota, it is shared evenly;
- if they are less than the available quota, applicants receive their quota request;
- any residual access is available on an ‘as-needs’ FCFS basis to any exporter;
- per unit quota fees apply to all distributions and the FCFS pool remains open until the quota re-claim provisions are activated.

The set aside for NSQ should not be managed as a quota within a quota. It will be defined as a maximum amount of access available for NEs and eligible SQ holders. An eligibility threshold for SQ holders and a maximum NSQ allocation will be established. NEs will get first preference in use of the set aside with a minimum annual allocation of 12 tonnes.

NEs will be restricted to NSQ allocations for a 3 year probation period before graduating to SQ allocations. An eligibility threshold of 36 tonnes will be imposed for SQ holders to access the set aside. Access to the set aside will be limited to a maximum of 2 years. The maximum NSQ allocation will be the difference between an initial SQ allocation and the eligibility threshold – SQ plus NSQ cannot exceed 36 tonnes.

1. Recommended changes in HQB quota administration

SQ management

1. Application for allocation with 'quota request' in tonnes - exclusion from allocations if no response.
2. Initial allocations based on 3 year moving average of HQB exports to EU.
   - year-to-date exports used for most recent performance year.
   - allocations not to exceed 'quota requests' & adjusted for quota administration penalties.
3. If necessary, supplementary allocation at end of July to share any unallocated quota.
   - composed of forfeits, rejections of initial allocations & residual access from NSQ set aside.
   - restricted to SQ holders not eligible for NSQ.
   - allocations based on 3 year moving average of HQB exports to EU.
4. If quota remains unallocated, further distributions made through modified FCFS system.
   - first preference for allocations to quota holders based on 'quota request' or equal share.
   - residual available on FCFS basis to any beef exporter.

Management of NSQ set aside

1. NE defined as exporter with no HQB allocation for 3 years - assessment of intended quota use.
2. NEs participate in NSQ allocations for a 3 year probation period.
   - 12 tonne minimum annual allocation & excluded from SQ allocations for 3 years.
   - graduate to SQ allocations after 3 years subject to assessment of quota use in probation period.
3. Eligibility threshold for SQ holders is initial SQ allocation of < 36 tonnes.
   - 2 year limit on access to NSQ set aside.
4. Allocations of remaining set aside based on 3 year moving average of HQB exports to EU.
   - NEs & eligible SQ holders participate with set aside remaining fixed at 500 tonnes.
   - maximum NSQ is difference between SQ & eligibility threshold (SQ+NSQ not to exceed 36 tonnes).
   - residual set aside transferred to pool of access for secondary allocation of SQ.

Re-claim provisions for un-used allocations

1. Provisions activated 1 month earlier - automatic forfeit if no response to DAFF inquiry by 1 February.
   - automatic forfeit if quota use by 1 February is < 25% of total allocation.
2. Penalties apply to retained or re-distributed quota that is un-used by year end.
   - next HQB allocation of SQ or NSQ is reduced on a 1 for 1 basis.
3. Modified FCFS system to distribute re-claimed quota.
   - first preference for distributions to quota holders based on 'quota request' or equal share.
   - residual available on FCFS basis to any beef exporter.

General provisions on eligibility for allocations and quota trading

1. NE eligibility assessment for quota allocation from information on intended quota use.
   - one-off application fee to cover cost of NE eligibility assessment.
   - exclusion of NPEs is default position with exceptions based on NPE assessment test.
2. NE information on quota use at end probation period to confirm graduation to SQ allocations.
3. Eligibility requirements for third party exporters of allocations held by other parties.
4. Exclusion from allocations for 3 years if sales of SQ or re-claimed quota > 50%.
   - exclusion from allocations for 3 years if 2 year moving average of quota sales > 33% of quota rights.

NSQ allocations will be based on a 3 year moving average of export performance with calculations aligned with the SQ allocation process. This will involve calculating a set of performance shares that exclude SQ holders who are ineligible for NSQ. Any residual set aside will transfer to the pool of access available for supplementary SQ allocations.

This approach provides a preferential pathway for NEs to participate in the HQB quota. It is also a more equitable way to treat NSQ allocations. The set aside can remain at 500 tonnes provided the maximum NSQ allocation threshold is introduced and performance is used to determine allocations. Recommended changes to treatment of NEs are:

- NEs are exporters with no SQ allocations in the 3 years before their application;
- eligibility for NSQ requires NEs to satisfy an assessment of intended quota use;
- NEs apply for NSQ in each probation year and specify a ‘quota request’ – they are excluded from SQ allocations during the probation period;
- after establishing NE minimum allocations the remaining set aside is available for allocation to all exporters eligible for NSQ – NEs participate in this process and receive extra access on top of their minimum initial allocation;
- NEs graduate to SQ allocations if they satisfy an assessment of their quota use during the probation period;
- conditions are imposed to discourage frivolous NE applications – see chapter 5.

The quota re-claim provisions need to be modified to encourage timely quota use and discourage quota hoarding. Recommended changes to the re-claim process are:

- it is activated one month earlier – automatic forfeits occur on February 1 if there’s no response to DAFF inquiries or evidence of intended use is insufficient;
- automatic forfeits occur if an allocation is unused or if less than 25% of a total allocation has been used by February 1;
- penalties will apply to quota retained after February 1 but remains unused by year end – penalties will also apply to distributions of re-claimed quota;
- penalties will be a 1 for 1 reduction in SQ or NSQ at the next opportunity;
- penalties are not transferable between commercially related companies and do not transfer to companies that are ineligible for quota allocations;
- the treatment of penalties for export performance is set out in chapter 5.

Distribution of re-claimed quota will be based on a modified FCFS system. Quota holders get first preference if a ‘quota request’ is submitted. If requests exceed the available quota, the access is shared evenly. If requests are less than the available quota, applicants receive their ‘quota request’. Any residual quota is made available on an ‘as-needs’ FCFS basis to any exporter. Per unit quota fees apply to all distributions under this system.

The methodology for calculating export performance is appropriate and should remain unchanged. Gain fed exports under the new EU global quota should be excluded. Out-of-quota HQB sales and trade in HQB cuts under the GATT quotas should be included.

Eligibility for quota allocations is a major issue for stakeholders. Allocations to NPEs with no commitment to market development is detrimental to maximising the value of the quota. The recommended default position is to exclude NPEs from allocations unless it can be shown the business model and intended quota use is appropriate.

NE applicants must satisfy basic eligibility requirements including an assessment of intended quota use. NPE applicants will face a higher level of scrutiny through a NPE assessment test developed in consultation with industry – see chapter 5:

- when the 3 year probation period ends NEs supply information on actual quota use to assess eligibility for graduation to SQ allocations – NEs found to be ineligible are excluded from all allocations for 3 years;
- DAFF may use independent advice in all NE eligibility assessments.

There are concerns about the use of access by some current quota holders. Some NPEs may not pass the new eligibility test that is developed. If necessary the NPE assessment test could be applied to selected, current quota holders as a transitional measure to confirm eligibility for quota allocations. DAFF should discuss the need for this transitional measure with the relevant industry organisations.

Some HQB is being shipped by a third party under the trading name of the quota holder. This activity is not detrimental to maximising the value of the quota as long as the third party meets the NE eligibility assessment for NSQ allocations. Shipping approval forms should be adjusted to confirm the eligibility status of third party exporters. Requests should be rejected if a third party has not been assessed as eligible for allocations.

Some extra provisions should be introduced to improve the effectiveness of the eligibility conditions for quota allocations. DAFF may initiate an ad hoc review of eligibility based on the NPE assessment test if there are concerns about quota use. Quota holders found to be ineligible will be excluded from all allocations for 3 years.

The current minimum allocation rule should remain unchanged. Rules on quota trading should be adjusted. Market based transfers are an efficient way to maximise the fill rate but buying and selling of allocation rights for financial gain is not appropriate. Therefore SQ rights will remain transferable and NSQ rights will be non-transferable:

- SQ holders eligible for NSQ can trade in SQ without affecting the eligibility to access the set aside – if quota sales exceed their SQ allocation they are excluded from all quota allocations for 3 years;
- exporters selling 50% or more of their SQ allocation or distribution of re-claimed quota are excluded from all quota allocations for 3 years; and
- if a 2 year moving average of quota sales is 33% or more of total quota rights the exporter is excluded for quota allocations for 3 years.

1. Review terms of reference

In April 2011 the *Department of Agriculture, Fisheries and Forestry* (DAFF) announced a review of management arrangements for the EU high quality beef (HQB) quota. The current arrangements were established following a review conducted in 2005.

The review terms of reference (TOR) are set out in appendix A. It requires an assessment of the effectiveness and efficiency of the quota management arrangements and to identify areas for improvement in administration.

The current arrangements include provision for a fixed amount of quota to be set aside for new entrants (NEs). It is called non-standard quota (NSQ). The remaining access is referred to as standard quota (SQ). Management of NSQ is a key focus of the review as the TOR requires an examination of:

- the definition of a new entrant;
- the use of NSQ and SQ by new entrants; and
- the ongoing suitability of the fixed annual allocation to NSQ.

The review will also consider possible improvements in other aspects of the management arrangements with due regard to recent quota fill outcomes, the cost of administration and the commercial requirements of quota holders. Areas to be examined include:

- changes in market conditions and the need for quota allocation;
- quota allocation mechanisms;
- quota transfers;
- minimum allocation levels in the context of commercial practises;
- provisions for managing un-used quota and their implications for maximising the value of the quota access (i.e. quota fill rates and quota rents).

The review has been undertaken by an independent consultant, Mr David Harris. DAFF provided secretariat services and contributed information as required. Mr Harris is an agricultural economist with considerable expertise in trade policy analysis, strategic economic advice and econometric modelling. He is currently the managing director of an economic consulting business, *D. N. Harris and Associates*.

Mr Harris was a member of the DAFF panel that reviewed administrative arrangements for Australia's dairy quotas to the EU and the United States in 2008. He was involved in developing policy measures for deregulating the Australian dairy market in July 2000 and has prepared numerous economic studies on agricultural trade policy issues. His professional background includes a strong focus on market access issues for Australian livestock products. He has a detailed understanding of TRQ administration arrangements for livestock products in Australia and overseas markets.

Mr Harris has a commercial background in the beef export industry from a family owned processing company with associated farming interests. For several years he held a senior advisory position with Bonlac Foods Ltd, a major Australian dairy cooperative based in Victoria. His professional background includes senior positions at the *OECD Secretariat* in Paris, the *Centre for International Economics* and the *Australian Bureau of Agriculture and Resource Economics and Sciences* (ABARES).

The review commenced on the 16th of May 2011. Stakeholders were invited to lodge submissions or meet with the reviewer. The closing date for written submissions was the 17th of June 2011.

The public was advised of the Review through the usual communication processes. DAFF provided information on their website and contacted all registered beef exporters. They sought assistance from the *Red Meat Advisory Council* (RMAC) and the *Australian Meat Industry Council* (AMIC) in circulating notices about the Review.

Initial interest in the Review was limited. A small number of stakeholders requested face-to-face meetings with the reviewer. The AMIC and the RMAC did not lodge written submissions but participated in separate consultation meetings. To ensure adequate consultation, the reviewer contacted a number quota holders to confirm they did not wish to participate in the review. Some expressed an interest and were subsequently included in the consultation process.

The reviewer travelled to Brisbane, Sydney, Canberra and Melbourne to facilitate the face-to-face consultation meetings. Some stakeholders were unable to meet with the reviewer. Phone conference calls were arranged for these stakeholders.

The reviewer consulted a range of information sources during the course of the review. Information on recent market conditions prepared by ABARES and *Meat and Livestock Australia* (MLA) were reviewed. The 2005 report on administrative arrangements for the EU HQB quota was reviewed. The TRQ management arrangements for other livestock products were reviewed. Briefings on specific issues were obtained from the DAFF Quota Administration Unit.

2. Principles of TRQ management

The EU HQB quota was established through market access negotiations to provide trade opportunities in a highly protected market. There are 'quota rents' associated with the access which is the extra income earned on beef sales under the TRQ. They exist because of the higher prices in the EU in comparison to prices received for the same product in other markets. The quota rents mostly flow to Australia because the EU passed the TRQ management rights to Australia.

HQB access rights provide monetary benefits for the beef industry and their associated regional communities. The aim of TRQ administration is to maximise the commercial return (i.e. quota rents) on product traded through the quota. It is not intended to be a mechanism for creating a property right and to encourage trading in quota rights.

TRQ management should be consistent with accepted public policy principles that guide the development of the Australian economy. This requires the access to be used by commercial entities with an incentive to maximise quota utilisation and the associated quota rents. Over the course of a year the strength of this incentive will vary with changes in market conditions and the application of quota administration rules.

The *Council of Australian Governments* (COAG) has developed a set of principles for good regulatory practice. It provides guidance on the economic efficiency of regulations. The COAG principles for developing regulatory arrangements include:

- minimising the restrictive effect on competition;
- predictability of clearly defined outcomes;
- not act as a restriction on international trade;
- flexibility to ensure the regulations adapt to changing circumstances; and
- standardise the exercise of bureaucratic discretion.

Quota management principles for the review

The COAG principles on good regulatory practice were used to define a set of principles to guide the review. The provide a reference point for assessing the effectiveness and efficiency of the TRQ administration. They also provide a basis for identifying changes that could improve the management system.

Principle 1: Optimise the commercial value and use of the TRQ

Optimising the value of the HQB quota is related to considerations of the TRQ fill rate and the rents from using the access. TRQ administration should not seek to promote full use of the quota access if it is contrary to market signals and could reduce the value of Australian beef exports. Quota use should be based on commercial considerations.

Management arrangements should not encourage exports at discounted prices in order to enhance future allocations. At the same time they should not constrain opportunities for using the quota access:

- future opportunities to negotiate increased access to the EU beef market will be influenced by historical fill rates for the HQB quota;
- but maximising the fill rate should not be achieved at the expense of earning higher returns from sales in other markets.

The value of the quota rent on HQB sales is a critical factor in optimising the economic value of the access. The size of the rent is reduced by the in-quota tariff. It can also be dissipated by unnecessary costs and strategic behaviour by exporters. Compliance costs to meet access conditions, DAFF quota administration costs and sub-optimal use of the access by exporters are other factors that can reduce the value of quota rents.

A loss of value in the quota rent reduces the monetary benefit for producers, exporters and the regional communities where they operate. It is important to minimise these costs in order to optimise the economic value of the access.

At particular times quota management arrangements can affect the bargaining position of exporters. EU importers will capture more of the rent if an Australian exporter is inclined to accept discounted prices. This situation may arise near the end of the quota year as EU importers are aware of the closing date for quota usage. It can be exacerbated if exporters engage in strategic behaviour to influence future quota allocations.

TRQ management arrangements can distort commercial behaviour. Optimal economic outcomes are more likely to be achieved if commercial decisions focus on maximising returns across all export markets rather than:

- speculative sales in a market with expectations of windfall gains from quota rents;
- strategic trading in access rights encouraged by TRQ management rules;
- engaging in speculative hoarding of quota; and
- establishing business arrangements to enhance quota trading opportunities.

Principal 2: Minimise regulatory intervention

The TRQ will be effectively and efficiently utilised when market forces operate to the greatest extent possible. It requires minimal regulatory intervention. This principle is related to considerations about the need for an allocation process. It can be contrasted with a ‘first-come-first-served’ (FCFS) system with access used as required.

The views of the importing country have to be considered in applying this principle – the EU may not accept an unmanaged FCFS system. Other considerations include the size of quota, changes in market conditions during the quota year and the capacity for individual exporters to manipulate quota usage.

When an unallocated TRQ is expected to be filled it creates an incentive for strategic behaviour which accelerates quota usage. If the TRQ is small this creates commercial uncertainties for exporters trying to service their established customers. The distortion effect on decision making can be detrimental to the effective use of the quota.

The HQB quota is small. It should be allocated if the demand for access exceeds the total quota. This will optimise the commercial value of the TRQ. If an FCFS scheme was in place there may be an incentive for price discounting to maximise quota utilisation.

There may be situations where the initial demand for access is limited and expected usage is uncertain. An assessment of the need for quota management needs to consider the costs and benefits for stakeholders. If an allocation scheme is applied the regulated approach may not optimise the value of the quota because of:

- unnecessary administration costs;
- possible distortions from discounted sales to maintain future allocations, and
- unnecessary constraints on commercial market development.

If these circumstances could potentially arise there needs to be some flexibility in quota management to facilitate maximum quota usage. It requires provision for re-claiming unused quota and switching to a less regulated management system.

Principle 3: Consistent, transparent and efficient administration

A TRQ administration system should be efficient, transparent and aim for consistency in applying management rules. This principle is related to considerations of administration costs and clarity in quota management for business planning purposes.

Complex TRQ management systems can lead to higher administration costs which are passed on to industry through cost recovery charges. Simple, definitive management rules improves compliance and administration efficiency. Transparency is important for stakeholder acceptance of the system and effective public policy outcomes.

Consistency in applying quota management rules is important for the integrity of the system. As far as possible the use of subjective assessments and arbitrary determinations should be avoided. More generally, consistency in TRQ management for different types of products will improve public policy outcomes and administration efficiency.

Principle 4: Minimise barriers to exporting

Quota management should aim to minimise the barriers to market participation. This principle relates to considerations about the design of quota rules and conditions that can affect the cost of market entry. The commercial value of the TRQ will be enhanced if there is a competitive and innovative group of exporters focused on market development in the EU.

TRQ rules should discourage commercial behaviour that undermines the value of the access. But they should not unduly restrict the opportunities for market participation. Rules that may influence the capacity of exporters to use the HQB quota include:

- eligibility criteria for TRQ participation and provisions for new entrants;
- allocation formula and minimum allocations;
- definitions of performance for allocation decisions;
- the tradability of quota allocations; and
- the process and timing for reclaiming and distributing unused quota;

No exporter has a permanent right to a specified share of the HQB access. Effective and efficient use of a managed TRQ requires an initial allocation process to facilitate business planning. Quota holders retain the access rights for a specified period. At an appropriate time unused access rights should be returned to facilitate quota usage before the end of the quota year.

Quota re-claim provisions are critical for optimising the value of the HQB quota. It reduces barriers to trade and EU market development. If it is an effective process it will prevent 'quota hoarding' and reduce the prospects for sub-optimal pricing behaviour.

Tradability of access rights is important for optimising the commercial value of the quota. Access rights should be free to move to the businesses that can maximise the value of the quota. During the quota year it is more efficient for transfers to be determined by market forces – formal administration imposes unnecessary costs.

However, TRQ management should not encourage trading in access rights for financial gain. There needs to be adequate protection to discourage this behaviour. Quota trading can dissipate the value of quota rents and reduce the benefits for exporters engaged in EU market development.

Principle 5: Consideration of commercial arrangements

TRQ management arrangements need to consider existing commercial relationships and past investments in developing a capacity for market participation. This is important if administrative changes are being considered. It is important to recognise past efforts to establish, maintain and grow a profitable market presence:

- EU access requirements involves accreditation for producers and processors;
- there are investment and maintenance costs associated with gaining and maintaining EU accreditation.

TRQ management should aim to reward exporters that are actively engaged in EU market development. Commercial relationships and market conditions can change. But these businesses are more likely to engage in market behaviour that optimises the value of the quota. Speculative, ad hoc trading will diminish the value of the quota rents.

New entrants should be given an opportunity to develop a market presence. But NEs should not be unduly favoured over established operators. Similarly, small operators should not be unduly favoured at the expense of large quota holders.

There is no reason to assume NEs or small operators will be any better or worse than established or large operators in maximising the value of the HQB quota. The risk of failure or loss of value of the quota rents may be higher for NEs and small operators. But this is not a sufficient reason for limiting the opportunities for these operators:

- an appropriate balance is required between rewarding sustainable performance and providing an opportunity for new commercial relationships to develop.

Principle 6: Reward for market development

The HQB access is a small quota for specialised, high valued product. To optimise the value of the access the TRQ management should reward market development. Active market participants with commercial strategies to develop customer relationships are more likely to maximise the value of the quota rents.

Allocations based on reward for performance should apply universally to exporters of all sizes across different quota components. It facilitates business planning and EU market development. Provided adequate provision is made for new entrants, it is an appropriate and equitable way to allocate the access:

- as far as possible the concept of reward for market performance over a period of time should be used as the basis for all quota allocation decisions;
- even distributions of fixed amounts of quota does not reward performance and it can lead to fluctuations in annual allocations which may be detrimental to market development efforts.

3. Utilisation of the EU HQB tariff-quota

The HQB trade under the quota is characterised by high value cuts and, in some cases, branded product. The trade is mostly composed of chilled beef for retail outlets and the food service trade. Sea freight is the common method of shipment. There is a six week shipping lag which limits the shelf life of the landed product.

The EU imposes particular production specifications for the HQB quota and there are accreditation requirements for Australian producers and processors. There are costs associated with accreditation and limits on the supply of EU eligible cattle that meet the HQB specifications. Participation in the HQB quota trade is challenging. It requires a sustained commitment to meet the access requirements.

History of beef quota access to the EU

The HQB quota was established in 1968 as a concession for the introduction of EU beef support policies. The access was split between historical exporters to the EU and quota management rights were given to exporting countries. An ad valorem import duty of 20% is imposed on HQB quota shipments. Australia has a fixed portion of the HQB quota and the TRQ is administered by the Australian Government.

Two other quotas were established at the same time – the *GATT Frozen Boneless Beef* quota and the *Frozen Beef for Processing* quota. Management rights for both quotas were retained by the EU. Australia has no quota management role and access is allocated to importers by the EU. These quotas are restricted to frozen product and have a 20% in-quota tariff. Australian exporters compete with other supplying countries such as Brazil and Argentina for the use of this access.

The HQB quota operates on a financial year basis. It was a fixed amount of 7,000 tonnes until 2006-07 when it was increased to 7,150 tonnes – there was a transition year in 2005-06 when the quota was set at 7,075 tonnes. HQB trade outside the quota is limited. In general, out-of-quota duties make it prohibitive for Australian exporters to supply beef to the EU market outside of the concessionary access arrangements.

In August 2009 the EU established a new global import quota for grain fed beef. Quota management rights have been retained by the EU. Australia became one of the designated supplier countries in January 2010. The quota operates on a financial year basis and there is no in-quota tariff:

- global access is currently fixed at 20,000 tonnes – the quota is likely to expand if the Doha WTO trade negotiations are completed;
- Australian sales of 262 tonnes in 2009-10 and 3,874 tonnes in 2010-11 have been achieved under this quota.

2. Major destinations for Australian beef exports to the EU

	2006	2007	2008	2009	2010	2011 *
	tonnes					
Belgium	196	199	127	272	99	354
Denmark	0	0	1 707	2 464	1 956	924
France	32	48	65	291	41	0
Germany	100	111	1 107	1 191	460	297
Italy	46	218	803	1 826	1 409	2 045
Netherlands	60	685	1 899	844	1 230	1 314
Spain	0	0	15	95	31	68
Sweden	4	75	57	57	0	0
United Kingdom	4 895	5 021	4 679	5 339	3 982	4 376
Other destinations	1 480	1 614	31	376	0	19
Total exports	6 813	7 970	10 491	12 756	9 210	9 397

 # Year ended June 30. *Source: DAFF private comm.*

Australia has a significant beef trade with the EU under the assortment of concessionary access arrangements (table 2). The trade is dominated by shipments to the UK. But in recent times there has been growth in shipments to the Netherlands, Italy and Denmark. HQB quota shipments account for sizeable portion of the trade and the access is highly valued be Australian exporters.

HQB quota requirements

The EU specification for beef supplied by Australia under the HQB quota is set out in EU Commission Regulations. It allows access for bone-in or boneless cuts of fresh, chilled or frozen beef obtained from cattle which:

- do not have more than four permanent incisor teeth;
- weigh no more than 327 kilograms (dressed weight); and
- have a compact carcass appearance with a good eye of meat, light and uniform colour and with adequate but not excessive fat cover.

In 2006 the EU agreed to changes in the specification of HQB. The specifications were aligned with AUS-MEAT carcass classifications with references to beef colour, fat colour and fat depth. Veal is excluded from the specification.

Australian exporters must have an in-house carcass assessment program to ensure compliance with HQB specifications. The beef must come from cattle raised on properties where all cattle are individually identified and proven to be HGP free.

The HQB quota has been largely composed of grass-fed beef. It is possible for grain-fed beef to be shipped under the HQB quota. Additional specifications have to be met if the product is to be marketed as grain fed beef. There have been very few shipments of grain fed product under the HQB quota since the new global quota for grain fed beef was established.

The quota for high quality grain fed beef (HQGFB) has product specifications similar to the HQB quota. It allows access for bone-in or boneless cuts of fresh, chilled or frozen beef obtained from cattle which:

- are less than 30 months of age;
- fed a diet for the last 100 days before slaughter of more than 62% concentrates and/or feed grain co-products that meet a specified energy content; and
- have an average daily feeding rate (dry matter basis) of not less than 1.4% of live body weight.

The close alignment of product specifications has created a new source of demand for EU accredited cattle that yield high quality beef. The purchase of feeder stock for HQGFB quota sales reduces the supply of cattle for HQB quota sales. The pool of eligible cattle is limited and the supply of finished grass fed cattle for the HQB quota is seasonal. This may have implications for future utilisation of the HQB quota.

Increased competition for EU accredited stock strengthens the flow through effects of the quota rents on cattle prices. Financial gains from quota sales flow back to producers when there is strong competition for stock. The emergence of Coles as a buyer for HGP free cattle has added to the competitive pressures for EU accredited cattle.

The HQB quota is likely to remain a largely grass fed trade for the foreseeable future. In the short term it may be more challenging for exporters to secure the stock they need to fully utilise their allocations. A larger portion of the quota may be un-used when the 'use-it-or-lose-it' provisions are activated. This may affect the TRQ fill rate:

- an effective mechanism for re-claiming and re-distributing unused HQB quota at an appropriate time is essential;
- it is important the HQB quota allocation mechanism does not favour gain-fed operators at the expense of operators that focus on grass fed sales – it is the main concessionary access point for grass fed HQB.

Despite the increased competition for EU eligible cattle the underlying demand for HQB access has remained strong. Sizeable quota rents are still achievable because of the price differential between the EU and Australian beef markets. This situation is expected to continue over the medium term. There is no indication of a supply constraint in eligible cattle and a producer supply response will occur if a constraint were to emerge:

- ABARES and MLA beef market projections support this perspective.

The cost of EU accreditation for cattle properties is a possible constraint on growth in the supply of cattle. The *EU Cattle Accreditation Scheme* (EUCAS) was developed to meet EU cattle sourcing rules. It establishes proof of identification and traceability to verify the HGP status. But the cost can be a deterrent to maintaining accreditation.

This issue has been less of a concern since the *National Livestock Identification Scheme* (NLIS) was established in 2005. Most properties need to meet NLIS requirements and the disincentive to invest in EU accreditation has been reduced. HGP free cattle are also in demand for other markets – Coles has moved to promoting HGP-free beef.

EUCAS and other quota access requirements add downstream costs in processing and transport. Processing plants have to meet EU accreditation requirements. Companies have made investments to gain accreditation and there are costs in maintaining accreditation. Steel cattle pens and electronic tag readers are required and carcass weights have to be verified by an AQIS inspector.

A further element of processing cattle for the EU HQB market is that boning rooms have to be cleaned and cleared of meat processed for other markets. This adds further costs to the preparation of a HQB shipment for the EU market. The collective effect of meeting the EU requirements is the per unit cost of processing an animal is higher:

- recognition of the accreditation costs and higher processing costs is an important consideration for HQB quota eligibility and allocations.

Quota usage and management rules

Exporters aim to maximise the value of TRQ shipments because of the cost of meeting the access conditions. Per unit processing costs are lower for heavier stock and higher quality cuts generate higher rents. Chilled beef generates higher rents than frozen beef. EU importers supplying retail outlets prefer product with these characteristics.

For these reasons the quota trade has focused on chilled high valued primal cuts. Full and half carcasses can be shipped under the TRQ but there is no commercial incentive for this type of trade. Much of the trade is in a limited range of high valued cuts – cube rolls, strip loins, outsides, insides, knuckles, tenderloins and rumps are common. The nature of the trade means a sizeable portion of the EU accredited carcass is sold in other markets:

- the remainder of the carcase is lower valued forequarter cuts – finding profitable markets for this residual HQB product can be challenging;
- some of this product may be sold in the EU market through the other quota access arrangements if it is commercially viable.

TRQ fill rates have varied over the past 10 years due to commercial factors and quota management rules. Quota administration were altered in 2006-07. This affected TRQ allocations, quota utilisation and company efforts to optimise the value of the access.

3. EU HQB quota performance

		2006	2007	2008	2009	2010	2011 *
HQB quota	*tonnes*	7 075	7 150	7 150	7 150	7 150	7 150
Quota approvals	*tonnes*	6 344	7 149	7 121	7 142	7 133	6 523
Quota shipments	*tonnes*	6 331	7 149	7 149	7 139	7 133	6 513
- fill rate	%	*89.5*	*100.0*	*100.0*	*99.9*	*99.8*	*91.1*
Unused quota	*tonnes*	744	1	1	11	17	637
Non-quota exports **	*tonnes*	62	45	0	688	1 203	787
Grain-fed quota exports ***	*tonnes*	..	..	..	..	262	3 874
Other beef exports	*tonnes*	421	777	3 342	4 928	612	..
Total exports	*tonnes*	6 813	7 970	10 491	12 756	9 210	..
- HQB quota contribution ****	%	*92.9*	*89.7*	*68.1*	*56.0*	*77.5*	..

 # Year ended June 30. *Source: DAFF private comm.*

** Provisional data for period up to the end of June 2011.*

*** Includes out-of-quota HQB shipments and shipments under EU global quotas - used to determine performance in HQB quota allocations. Excludes grain fed exports under the EU global quota.*

**** Grain fed exports under the EU global quota commenced in January 2010.*

***** Contribution of HQB quota shipments in total beef exports to the EU as recorded by the ABS.*

Since 2007 there have been 27 member states in the EU - in 2006 there were 26 member states.

The TRQ was filled in 2000-01 but was under-filled in the following three years by 13%, 20% and 14% respectively. In 2004/05 the TRQ was marginally short of filling and in 2005-06 the quota was under filled by 744 tonnes – about 10%. The degree of under fill is surprising given the favourable price differentials that typically exist.

In the period since the TRQ management arrangements were changed the fill rate has improved (table 3). The quota has been essentially filled until the most recent year. The year–to-date shipment results are showing under-fill of around 9% in 2010-11.

For the past five years the TRQ has remained an allocated quota. A number of changes were made to quota administration after an independent review in 2005-06. Key features of the current system for allocating SQ are:

- allocations are based on exports of HQB product to the EU in the previous year;
- HQB product is defined as TRQ shipments, out-of-quota HQB sales and HQB exports under the EU global quotas – it excludes shipments under the recently established EU global quota for grain fed beef;
- a minimum allocation of 1 tonne – previously there was a 12 tonne minimum which is equivalent to a standard sized sea freight container;
- allocations are calculated to the nearest kilogram – allocations of less than 1 tonne are excluded; and

- eligibility is open to any exporters with HQB quota shipments – previously allocations were limited to owners of EU accredited processing plant.

Eligibility for SQ allocations is an important issue. Under the previous arrangements owners of cattle with no processing capacity were ineligible. Producers were unable to enter the market in their own name through the use of contract processing and marketing services. The revised eligibility criteria removed that restriction.

A further consideration is the eligibility of non-packer exporters (NPEs). These operators (i.e. meat traders or consignment sellers) do not own livestock or carcasses – they trade in boxed beef. Under current arrangements NPEs are eligible for SQ allocations as long as they have shipped HQB quota product under their own name.

The business model of most NPEs is cost minimised commodity trading which is not compatible with selling chilled HQB with a restricted shelf-life. They do not engage in market development and tend to be weak sellers as pricing reflects the need for turnover. Opportunistic, ad hoc sales are characteristic of their trading activities. The NPEs play an important role in the beef industry but this approach is not appropriate for maximising the value of the HQB quota access:

- the HQB access should be used for chilled high quality cuts;
- shipping frozen lower quality cuts would reduce the value of the access;
- quota rents that flow back to beef producers will be higher when export sales are directed to importers servicing end-users requiring high quality cuts.

However, some NPEs specialise in providing integrated marketing services for producers and processors that have no capacity to engage in export market development. They have established business relationships with customers needing high quality beef. These NPEs have an incentive to maximise returns on quota sales and invest in market development. This business model is consistent with optimising the value of the HQB access:

- a number of NPEs participate in the HQB trade under negotiated arrangements with owners of meat and/or cattle;
- the quota shipments involve a combination of exports in their own name and exports in the name of another quota holder.

The participation of NPEs in the HQB quota is not dependant on an SQ allocation. Under the current eligibility criteria any NPE can potentially participate. It includes those with a business model that is not consistent with maximising the value of the access. There is no assessment of quota usage by NPEs to confirm it is being used appropriately.

Current arrangements have increased the prospects that some allocations are inconsistent with the principle of optimising the value of the TRQ. Distinguishing between different types of NPEs for quota allocation purposes is difficult. But the current approach is too lenient and is not compatible with a key principle of quota management.

There is an elevated risk of dissipating the value of the HQB quota access because of the potential widespread participation of NPEs – both producers and meat traders. A revised more definitive approach to eligibility for quota allocations would be appropriate. It is worth noting New Zealand's eligibility criteria for HQB quota allocations:

- NZ exporters must be the owner of HQB product at the time of slaughter (i.e. when the carcass is weighed);
- this criteria allows for contract killing/boning of carcasses but it excludes NPEs that are trading in boxed beef.

Distribution of NSQ is more complicated. NSQ was originally established as a set aside to help NEs get a start in the HQB trade. But it primarily acts as a quota 'top-up' facility for small operators. Key features of the current NSQ allocation system are:

- a set aside of 500 tonnes with allocations based on an equal share of the set aside up to a maximum of 149 tonnes – previously the set aside was 400 tonnes;
- a minimum allocation of 1 tonne;
- allocations are calculated to the nearest kilogram;
- access to NSQ is restricted to 5 years unless a cumulative maximum of 150 tonnes of NSQ or an annual allocation of SQ and NSQ of 150 tonnes is reached first – previously access was limited to 1 year and a maximum allocation of 144 tonnes;
- a new entrant is implicitly defined as an exporter without an SQ allocation;
- eligibility for NSQ is also open to exporters with an SQ allocation of less than 150 tonnes – previously eligibility was restricted to licensed exporters that owned an EU accredited processing plant with no EU export performance.

In effect there is no eligibility restriction on accessing the NSQ set aside. Exporters with no SQ allocation (i.e. new entrants) can access the set aside. Exporters with small SQ allocations can also receive NSQ for a limited period. There is no performance rule for NSQ allocations and no preference is given to a 'pure' new entrant:

- distributions based on an equal share can lead to fluctuations in annual NSQ allocations – it all depends on the number of eligible applicants;
- it makes commercial planning difficult for exporters receiving NSQ.

The previous eligibility rules were considered to be a barrier to trade. Lack of ownership of an accredited processing plant prevented exporters with small SQ allocations from accessing the set aside. A rule that limited access to un-used allocations to current quota holders was a further restriction. The revised eligibility rules removed these restrictions.

Under the previous rules NPEs were excluded from quota allocations unless they had purchased quota access from a quota holder. Relaxation of the NSQ eligibility criteria opened up the potential for any licensed exporter to participate in the HQB quota trade. Currently EU accredited cattle producers, meat packers operating through EU accredited service works and NPEs can all participate in NSQ allocations.

A different set of rules apply for managing un-used TRQ allocations near the end of the quota year. Key features of the current system for quota re-distributions are:

- quota allocations can be voluntarily returned to DAFF at any time;
- compulsory re-claim of unused quota in early March unless the exporter provides evidence the quota will be used before the end of the year;
- quota holder advice on intended use is required by mid-February;
- evidence of intended use is not clearly specified – DAFF assessment is subjective and may be open to manipulation by quota holders;
- no penalties on retained quota that remains unused – there is a disincentive for quota returns as it gives competitors a chance to improve their next SQ allocation;
- no eligibility restrictions on applying for un-used quota – previously distributions of re-claimed quota were restricted to current quota holders;
- un-used quota is distributed on an FCFS basis – applicants specify an amount and the available access is distributed in order of request;
- DAFF releases FCFS quota upon requests for HQB export approvals; and
- no administration fees are levied on FCFS distributions of un-used quota – a per unit fee is charged on all SQ and NSQ allocations but there is no application fee for a quota allocation.

The FCFS distribution mechanism provides another entry point for NEs without affecting their NSQ eligibility. It's also an opportunity for quota holders to build performance. But a lack of penalties for the non-use of FCFS distributions can encourage applications for export approval regardless of the certainty of the trade opportunity. This can lead to un-used access at the end of the quota year.

Individual quota recipients are not especially concerned about the overall TRQ fill rate. They are focused on their export performance relative to their competitors. There are no negative consequences for non-use of quota and there's a disincentive for voluntary returns if a quota holder considers it will affect subsequent allocations.

HQB quota allocations

Changes in quota administration have led to an increase in the number of participants in the HQB trade (table 4). There are currently 35 SQ holders compared with 12 in 2005-06. Most of the increase has been in companies without processing facilities.

NSQ allocations increased to 23 in 2009-10 and the larger number of applicants reduced the size of the allocations. The number of NEs peaked at 11 in 2008-09 and then declined to just 2 companies in 2010-11. Currently about half of the SQ holders are accessing the NSQ set aside and it is largely being used as a quota 'top-up' for small operators:

- there is no performance aspect to NSQ allocations and those with declining or ad hoc sales receive the same allocation as those who with growing sales.

4. HQB quota allocations

		2006	2007	2008	2009	2010	2011
HQB quota	*tonnes*	7 075	7 150	7 150	7 150	7 150	7 150
- companies allocated quota	*no.*	12	18	23	30	37	37
*- processors **	*no.*	10	9	9	9	10	13
*- other businesses ***	*no.*	2	9	14	21	27	24
Standard quota	*tonnes*	7 075	6 650	6 650	6 650	6 650	6 650
- SQ holders	*no.*	12	13	16	19	28	35
- SQ holders with NSQ	*no.*	..	0	5	8	14	17
- SQ < 36 tonnes	*no.*	1	3	3	4	12	20
Non-standard quota	*tonnes*	0	500	500	500	500	500
- NSQ holders	*no.*	..	6	12	19	23	19
- NSQ holders with no SQ	*no.*	..	5	7	11	9	2
- NSQ distribution	*tonnes*	..	83	42	26	22	26
Allocations to small operators							
- quota < 100 tonnes	*no.*	4	9	13	21	26	27
- quota < 48 tonnes	*no.*	1	3	8	14	19	19
- quota < 36 tonnes	*no.*	1	2	1	12	14	12
- quota < 24 tonnes	*no.*	1	2	1	1	13	8
- quota < 12 tonnes	*no.*	0	2	1	0	2	2

 # Year ended June 30. *Source: DAFF private comm.*

** Companies with processing plant & packing facilities*

*** Includes cattle producers doing service kill to market their stock, beef marketing businesses & consignment sellers*

In 2010-11 almost three quarters of the TRQ participants had a total allocation of less than 100 tonnes. Container volumes are a useful way to highlight the scale of allocations and EU market participation by small operators. About a third of quota holders have less than 36 tonnes – equivalent to 3 standard sea freight containers. This is a reasonable reference point that demonstrates the large number of small operators:

- in part it reflects the lack of restrictions on NSQ eligibility – the more applicants the smaller the NSQ allocation.

The constraint on HQB quota usage is that opportunities for allocation growth are limited by the size of the quota. NEs reduce the size of allocations for small operators who have access to the NSQ set aside. Small operators excluded from the NSQ pool have to rely on other ways to increase their allocations. Quota purchases, FCFS distributions of un-used access and out-of-quota export sales are the only way to do this.

Most small operators are likely to remain small exporters over the medium term even if they achieve some performance growth. There is no case for favouring a small operator (e.g. an exporter with less than 36 tonnes of access) at the expense of other operators in the allocation process. But it is important to limit distortions in allocations that can arise from strategic behaviour and quota management rules:

- SQ allocations based on performance in the previous year heightens the incentive for strategic behaviour that can reduce the overall value of the TRQ;
- NSQ allocations based on an even share of the pool does not adequately reward the performance of the eligible small operators;
- it is the primary source of fluctuations in quota allocations for small operators.

Export performance over time is the most appropriate way to allocate access at the start of a quota year. Exporters with an expanding market presence should be rewarded over exporters with a declining market presence. The allocation mechanism should incorporate a time dimension. A moving average of HQB exports would be preferable and as far as possible this principle should be universally applied.

A further constraint on performance growth for small operators is quota hoarding. The tendency to 'sit' on quota for strategic purposes is the primary cause of TRQ under fill when market conditions indicate the trade is profitable. The return and distribution of un-used quota is a key element of effective TRQ management. It needs to occur with enough time for other exporters to take advantage of the un-used access.

Re-distribution of un-used quota access should be a rapid process. It needs to discourage quota hoarding and be confined to genuine market sales. There is an economic loss if un-used access is re-distributed to exporters that have:

- insufficient supply capability;
- exited or a declining interest in the market the market; or
- speculated on ad hoc sales to enhance their future performance.

Some companies are not fully utilising their initial allocations (table 4). It suggests a lot of quota movement after allocations are made. This is not surprising as most companies will take what they are offered and then look for cattle supplies to make use of the quota. In some years there have been instances of no shipments under an NSQ allocation to a new entrant:

- 25 companies shipped less than their allocation in 2009-10 and 11 companies shipped more than their allocation.

Under-utilisation of allocations may be due to difficulties in securing cattle supplies. A further cause may be the difficulties of dealing with residual allocation quantities. Small residual amounts of access do not neatly fit into a standard container. Managing this issue may be challenging for small operators.

5. Utilisation of HQB quota allocations

		2006	2007	2008	2009	2010	2011 *
Companies allocated quota	*no.*	12	18	23	30	37	37
- shipped allocation	*no.*	0	0	0	3	1	2
*- shipped > allocation *****	*no.*	2	5	6	8	11	4
- shipped < allocation	*no.*	10	13	17	19	25	31
- shortfall of < 1 tonne	*no.*	0	2	1	2	2	1
Company under performance * ***							
No shipments	*no.*	1	4	4	3	3	11
- quantity allocated	*tonnes*	63	270	215	89	111	254
Shipping < 1 tonne	*no.*	0	0	5	0	0	13
- quantity allocated	*tonnes*	..	..	256	..	..	369
Shipping < 33% of allocation	*no.*	3	5	8	4	8	19
- quantity allocated	*tonnes*	655	353	499	115	466	859

 # Year ended June 30. *Source: DAFF private comm.*

** Provisional data based on year to date for period ending 21/6/11.*

*** In 2006-07 and 2007-08 one company shipped product but had no initial quota allocation.*

**** Companies that shipped < their initial allocations of SQ or NSQ.*

Large operators with an established customer base and a regular shipping program have a greater capacity to handle residual quantities. They may have more opportunities to mix the content of containers. Commercially there are ways of managing this issue as long as the requirements of EU importers align with the quantities involved:

- quota re-claim provisions that encourage returns of residual quantities to facilitate FCFS distributions in container sized lots may be worth consideration;
- however, commercial strategies and negotiated arrangements among exporters appear to be managing this issue.

In 2010-11 provisional performance data shows 11 companies made no shipments against their allocations. In previous years 3 to 4 companies made no shipments. The amount of access involved was significant (table 5). These allocations were locked-up until the re-claim provisions were initiated and even then the quota may not have been returned.

This is an unavoidable outcome of the current quota allocation process. Market access conditions and the sourcing of cattle to meet EU demands for chilled HQB cuts can be difficult at times. Effective re-claim provisions are important and some form of penalty may be appropriate to minimise business strategies to reserve quota.

Management of the NSQ set aside

There are some unintended consequences arising from management of the NSQ set aside. When combined with the SQ allocation process, NSQ distributions generate inequities in the treatment of small operators. It can lead to fluctuations in total annual allocations that are inconsistent with the principle of reward for performance. Allocation outcomes are not especially transparent and management of the NSQ set aside is not consistent with principles 1, 5 and 6.

Some aspects of the NSQ management provisions are inappropriate. The number of NSQ applicants distorts the size of SQ allocations in the following year because they are based on a performance criteria. In 2011-12 NSQ allocations for exporters inside the 150 tonne maximum was 78 tonnes. In the previous three years allocations were around 25 tonnes:

- SQ allocations that follow these low levels of NSQ are unambiguously lower – it is the luck of when companies are participating in the NSQ pool;
- the potential distortion and inequity is even greater in the year a small operator graduates from the NSQ system;
- companies graduating after a small NSQ allocation could be worse off than companies still receiving NSQ – it depends on the number of NSQ applicants.

Some other unintended consequences can potentially arise. Companies eligible for NSQ may experience a fall in their total annual allocation if there is a large rise in number of NSQ applicants. This is disruptive for market development plans.

A further deficiency if the lack of reward for NSQ performance over time. Exporters that do not use their full NSQ allocation receive the same NSQ in the following year as those that fully use their allocation. This may encourage a more ad hoc approach to export sales which can undermine the value of the HQB quota rent.

The 5 year eligibility period and lack of specific provisions for NEs can lead to anomalies in NSQ allocations. A larger number of applicants will limit the initial trade opportunities for NEs. The combined effect of the eligibility time limit and the 'even share' allocation mechanism may be distorting in other ways:

- if NSQ allocations are small over an extended period, exporters may not reach the 150 tonne maximum inside the 5 year eligibility period;
- if NSQ allocations are large over a short period, exporters will graduate with a more favourable SQ allocation position – they will be unintentionally favoured over exporters receiving smaller NSQ allocations over an extended period.

There is no case for unduly favouring small operators over other exporters by granting a non-performance based quota top-up. A preferable approach is to limit NSQ eligibility and use performance in the allocation process. As much as possible all exporters should be treated equally in using performance to share the total amount of access.

A revised approach should remove the potential inequities that can arise between recent NSQ graduates and exporters that remain accessing the NSQ pool. It is not appropriate for a graduate with an expanding trade to receive a lower total allocation than an NSQ eligible exporter with no performance growth. This would suggest an NSQ management system that:

- limits maximum NSQ allocations to an eligibility threshold; and
- facilitates the distribution of un-allocated NSQ to other exporters that were excluded from the set aside.

4. Industry perspectives on TRQ management

To ensure the reviewer well informed about industry views on management of the TRQ a public consultation process was conducted. DAFF advised all quota holders and other interested parties of the commencement of the review in mid-May. This was done by the usual means and included a notice on the relevant page of the DAFF web site. The review terms of reference were circulated through these advisory notices.

MLA, the RMAC and AMIC were informed about the review and invited to participate. DAFF sought the assistance of AMIC to encourage industry participation in the review. The review began in the week beginning the 6th of June. Stakeholders were invited to lodge written submissions – the closing date was the 17th of June.

Stakeholders were given an opportunity to schedule a face-to-face meeting or a phone teleconference with the reviewer. The reviewer travelled to Brisbane, Sydney, Canberra and Melbourne to facilitate the consultation meetings. The period for verbal submissions closed on the 30th of June after an extension due to unforseen travel difficulties.

Initial interest in the Review was limited. A small number of commercial stakeholders requested consultation meetings. To ensure there was adequate consultation, the reviewer contacted various quota holders to confirm they did not wish to make a submission. Some expressed an interest but were unable to meet with the reviewer. Teleconference calls were arranged for these stakeholders.

In total 17 commercial operators were contacted. Discussions were held with 9 exporters which included both small and large quota holders. AMIC and the RMAC participated in separate consultation meetings – they did not provide a written submission.

A range of issues were raised in the consultations including:

- the need for continued allocation of the TRQ;
- eligibility conditions for participating in allocations;
- effectiveness of the assessment process for NEs;
- annual fluctuations in quota allocations, especially for small operators participating in the NSQ allocation;
- minimum allocations and the commercial viability of very small allocations;
- quota transfer arrangements for NSQ;
- the size of the set aside for NSQ;
- participation of small operators in the NSQ set aside;
- reasons for the likely quota under-fill in the current year (i.e. 2010-11);
- the timing and effectiveness of re-claim provisions for un-used quota;
- the lack of a deterrence for non-use of quota; and
- perceived inappropriate business behaviour in the use of quota.

Quota allocations

In general there was widespread support of the need for continued allocation of the TRQ. The HQB access was considered to have significant value over other export markets despite the cost of compliance with EU access conditions. There was a commonly held view that quota rents will continue to exist in the future and the demand for quota access will remain strong. The likely under-fill in 2010-11 was attributed to unusual supply related issues in Australia and soft demand in Europe due to the GFC.

The new global quota for grain fed beef has provided another avenue for EU access but interest in the HQB quota is expected to remain firm. Concerns were raised about the implications of strategic trading behaviour if the TRQ was unallocated. Marketing plans and meeting the requirements of EU customers is a critical issue. Certainty with initial allocations was seen to be important for continuity in servicing customers.

The size of annual quota allocations – both SQ and NSQ – and year-to-year fluctuations in the allocations were common issues raised by stakeholders. Some small and mid-sized operators inquired about the fairness of allocations. Several operators felt the allocation mechanism was difficult to understand and there was some confusion about how the system operated:

- exporters focus on the total allocation and some felt changes in their allocations did not seem to be aligned with their performance;
- eligibility for accessing the NSQ set aside is a source of confusion.

There was widespread acceptance that EU export performance was the most appropriate basis for allocations. A commitment to market development in the use of quota access was seen to be an essential condition for allocations. Speculative or ad hoc sales were widely seen to be a poor way of maximising the value of the access.

The principle of reward for performance as the basis for quota management is widely supported. Consequently several operators had concerns about the current NSQ allocation mechanism. Issues were raised about the notion of NSQ top-ups for small operators and the associated eligibility conditions.

There was broad support for shifting to a moving average of export performance for the quota allocations. It was generally felt this would smooth business fluctuations and also reward consistency in performance. The potential gain from strategic trading behaviour to enhance future allocations would be diminished.

The issue of performance measurement was raised by some operators. There is a general acceptance that EU trade is the appropriate criteria. It is also generally accepted that trade in grain-fed beef under the new EU global quota should be excluded from performance calculations. It was felt this could distort the TRQ allocations and potentially undermine the value of the HQB quota which is mostly used for grass fed beef.

Some operators raised questions about the inclusion of GATT global quota trade in the performance calculations. One view was that some exporters used this trade to protect future allocations. The alternative view was exporters were finding other ways to market lower valued cuts from a carcass processed for the HQB quota trade. This was seen to be important for supporting the prices paid for HQB cattle and enhancing returns on the investment in EU plant accreditation.

The NSQ set aside

Management of the NSQ set aside was a major issue that emerged in the consultations. Some exporters felt the 500 tonne set aside was too large. There was a view the system was dissipating the value of the access by distributing small quantities to exporters with little commitment to market development. This was considered to be encouraging ad hoc trading that did not maximise the quota rent:

- there were related equity issues raised about the provision for non-performance based top-ups of NSQ over an extended period.

Some stakeholders thought the 500 tonne set aside amount was reasonable. But concerns were raised about the variability in NSQ allocations. All quota holders wanted larger allocations but recognised the limitation of the size of the quota.

A related issue raised by a number of stakeholders was the eligibility conditions for NEs. There were concerns the requirement to demonstrate marketing intentions and effective quota use were not operating as originally intended. Some stakeholders felt the eligibility assessment process could be manipulated and participation in quota allocations was too easily achieved.

Quota allocated to exporters with no realistic marketing plans tied up quota that could be used by exporters committed to market development. Several stakeholders felt the TRQ eligibility rules should be tightened and more effectively enforced. No proposals were offered on how this could be achieved. But it was felt that allocations of small quantities to NPEs was not conducive to optimising the value of the access.

Most stakeholders want effective eligibility rules to exclude meat traders that have no commitment to market development. They should be distinguished from the NPEs that specialise in marketing beef in the EU. They should also be distinguished from owners of cattle operating through contract processing arrangements.

Quota re-claim provisions

There is a widespread view that quota re-claim provisions are not working effectively as the process begins too late in the year. There was strong support for an earlier triggering of quota recovery process. The commercial realities of sourcing cattle in the autumn, shipping lags and the shelf life of chilled beef were cited as the reasons for change.

Another issue raised by almost all exporters was quota hoarding. The lack of penalties for delayed quota returns or un-used quota at the end of the year contributes to quota under-fill and reduced quota rents in some conditions. There was a common view the use-it-or-lose-it provisions were not as effective as they should be:

- there was widespread support for the inclusion of penalties to strengthen the quota recovery provisions;
- there was a general view penalties should also apply to distributions of re-claimed quota to deter strategic behaviour for protecting future allocations.

A number of different views were expressed on the distribution process for re-claimed quota. Some operators felt there should be a performance based allocation and others felt it should operate on an FCFS basis. The issue of eligibility was raised. Some exporters suggested non-quota holders should be excluded from the distribution process. Others were comfortable with allowing non-quota holders to be involved.

Other quota management issues

The issue of quota transfers was a common point of discussion. There was a widespread view that NSQ should be non-tradeable. It is seen to be necessary to prevent speculative trading in quota by new entrants. This perspective was reinforced by the perception that eligibility for an NSQ allocation is easily obtained. Relaxing this rule would encourage frivolous applications and speculative quota trading behaviour.

A related issue that emerged is the informal use of allocations by different commercial entities. Some exporters are shipping product under the name of the owner of the quota allocation. This implicit renting of allocations is negotiated as a commercial arrangement. It has advantages for the shipper and the quota holder:

- most stakeholders do not believe this activity is a cause for concern.

Some stakeholders raised the question of minimum quota allocations. But the commercial difficulties in handling small amounts of quota was not considered to be a major problem. Allocations based on a standard sea freight container of 12 tonnes would be ideal but most exporters indicated they can mix and match container content if necessary.

It is generally accepted that the performance criteria should set the allocations – rounding is not necessary. The prevailing view is that imposing judgements about the commercial viability of a total allocation is unnecessary. However, some stakeholders were concerned about total allocations that were less than a standard sized container. It was felt this was commercially unviable and erodes the value of the TRQ:

- some stakeholders expressed a view that a minimum allocation based on a standard sized container of 12 tonnes would be preferable.

5. Recommendations for TRQ management

Management arrangements for the HQB quota were examined using the principles set out in chapter 2. They provided guidance for assessing the effectiveness and efficiency of the arrangements. Recommended changes are presented in the context of the operational aspects of the management system. Options considered for future management were:

- ending quota allocations and switching to an FCFS system;
- continuation of the current administration system; and
- modifications to the current arrangements of quota allocation.

HQB quota management

The HQB quota is small and focused on high valued chilled product. There is unlikely to be any growth in the quota over the medium term as the Doha WTO trade negotiations are stalled. Any TRQ expansions that emerge from the talks will most likely follow the non-discrimination principle. The prospects for country specific access growth would seem negligible.

The size of the quota makes it vulnerable to strategic behaviour that can dilute the value of the quota rents. Under an FCFS management system the anticipation of quota fill can encourage commercial behaviour that accelerates quota fill. Some exporters may try to maximise their use of the quota through price discounting.

HQB exports in 2010-11 suggests the quota may be under-filled by a small amount. Most stakeholders felt the future demand for quota would remain strong. The likely under-fill was considered to be an outcome of disruptions from the mid-year floods and the effects of the GFC on demand in Europe. Quota management was also cited as a contributing factor, especially in the areas of NSQ allocations and quota re-claim provisions.

There was very little support for shifting to an FCFS management system even if there is some short term uncertainty about fill rates. Stakeholders were concerned about quota manipulation. There was also a need for some certainty in the marketing plans of quota holders with significant investments in EU accreditation.

In the immediate future exporter demand for HQB quota may be a little weaker. But the access will continue to have significant value and there is a high probability the TRQ will be filled or close to filled each year.

The demand for access could also strengthen if the WTO Doha trade negotiations move forward. Market access proposals include reductions in TRQ tariff rates. This would raise the value of the quota rents and increase exporter interest in the access. Therefore the EU HQB access should remain an allocated quota in line with principles 1, 5 and 6.

Recommendation 1: The EU HQB access remains an allocated quota.

A quota management system similar to current arrangements for US beef access is not an effective way to optimise the value of the HQB access. An FCFS system with a safeguard mechanism to trigger allocations would be destabilising for the trade – there would be a high risk of strategic behaviour.

The option of maintaining the current arrangements does not satisfy the review TOR. Several stakeholders raised concerns which related to the effectiveness and efficiency of the arrangements. Some believe the system may constrain fill rates and reduce the value of quota rents in certain circumstances. This would conflict with principle 1.

The review has identified some areas where the quota management system should be modified. Allocation methods, access to NSQ, quota re-claim provisions and eligibility criteria are areas where more appropriate rules are required. Changes are recommended based on principles 1, 3, 4 and 6.

The effectiveness of quota re-claim provisions are critical. Exporters need sufficient time to use re-claimed quota. Regulatory controls should be minimised in line with principles 2, 3 and 4. But an appropriate balance is required to ensure there is a sharing of trading opportunities from the re-distribution and that strategic behaviour to improve future performance is minimised.

Applications for TRQ access

As there is always the possibility of weak demand for quota at some point in the future it is important the allocation management system has the flexibility to handle this situation. The system needs to maximise the opportunities for quota use at the start of the year in conjunction with an initial allocation process. This situation is unlikely to arise but quota management should be modified to include a mechanism to handle such circumstances.

The aim of the allocation system is to distribute access to the active market participants. Automatic allocations are not appropriate. It is not an effective or equitable way to use the access. Allocations should not exceed business requirements as this will encourage quota trading. It also increases the risk of under-fill from quota hoarding and erosion of the value of the quota rents.

These principles are important and it requires a signal on quota requirements. This can be achieved through a simple application process to provide an indicator of expected market conditions and the demand for access. Failure to submit an application would indicate a lack of interest in market participation.

Recommendation 2: An application process be introduced at the start of the quota year to improve the effectiveness of the allocation process and support a mechanism to handle situations of weak demand for quota.

Sub-recommendations associated with recommendation 2 are as follows:

Recommendation 2a: The application process require all applicants to specify an amount of HQB access they plan to use – a 'quota request' specified in tonnes.

Recommendation 2b: A firm cut-off date is imposed on applications (e.g. 2-3 weeks) and non-response will mean exclusion from all allocations for the coming year.

Recommendation 2c: The call for applications from existing quota holders occurs simultaneously with a call for NE applications – eligibility for allocations is determined by quota management rules.

Recommendation 2d: NEs are required to submit a specified set of information on intended quota use to assess eligibility – the assessment process is discussed below.

Recommendation 2e: A one-off application fee is levied on NEs to cover the cost of assessment and to discourage frivolous applications.

Recommendation 2f: NEs that fail the eligibility test can re-apply – failure on the second attempt will mean exclusion from the application process for 3 years.

Recommendation 2g: Per unit quota fees apply to all SQ and NSQ allocations.

If possible applicants should be notified of initial allocation outcomes by the 1st of June to facilitate business planning. Invoices for quota fees should be dispatched at the same time. Applicants should be free to accept the offer or ask for a smaller allocation at this point. To facilitate the allocation process additional sub-recommendations are:

Recommendation 2h: Non-payment of quota fees by a specified date will mean automatic forfeit of an allocation and the exporter is excluded from quota allocations for the year.

Recommendation 2i: Any unallocated quota from forfeits for non-payment of fees will form part of a supplementary SQ distribution at the end of July.

Allocation of SQ

The value of the HQB access will be maximised if quota is initially allocated to exporters who will be active market participants. Exporters have different strategies and business performance can fluctuate over time. Reward for performance is a key principle for the SQ allocation mechanism and a time dimension is appropriate for this criteria.

Over time business engagement in the trade may be growing, declining or static. At the same time allocations based on trade in the previous year makes the TRQ vulnerable to strategic behaviour to enhance future allocations. A moving average would be a more appropriate indicator of performance. As the TRQ value will be maximised if it is used for HQB products the performance shares should be based on HQB exports to the EU.

Using trade to non-EU markets in the performance criteria could distort quota allocations. The access distributions could become skewed towards exporters that focus on non-HQB trade at the expense of exporters investing in EU market development.

Recommendation 3: Performance for SQ allocations are based on a 3 year moving average of HQB exports to the EU.

Sub-recommendations associated with recommendation 3 are as follows:

*Recommendation 3a**:*** The moving average is calculated as final shipments for years t-3 and t-2 plus year-to-date (ytd) shipments in t-1.
*Recommendation 3b**:*** Performance data is 'locked' for the duration of the quota year and SQ allocation shares are determined as company shipments divided by the sum of shipments by companies who complete the application process.
*Recommendation 3c**:*** Performance shares are applied to the total amount of SQ to determine initial SQ allocations.
*Recommendation 3d**:*** Allocations cannot exceed a 'quota request' and exporters with an allocation of less than 1 tonne are eliminated.

A 3 year moving average of past performance will reward a growth trend and have the opposite effect for a declining sales trend. Using ytd shipments for t-1 will have little effect on shares as DAFF will use shipment records up to the end of May. There are very few shipments in June because of shipping lags. It eliminates the need for a provisional allocation at the start of the year and reduces administration costs.

Recommendation 4: If necessary a supplementary SQ allocation will be made at the end of July to share the pool of any unallocated quota.

Sub-recommendations associated with recommendation 4 are as follows:

*Recommendation 4a**:*** The pool of quota for supplementary SQ allocations will include voluntary rejections of all or part of any allocation offers – this situation could arise if the demand for quota is weak or an allocation exceeds the capacity to supply.
*Recommendation 4b**:*** The pool of quota for supplementary SQ allocations will include forfeits from non-payment of quota fees.
*Recommendation 4c**:*** The pool of quota for supplementary SQ allocations will include residual access from the NSQ set aside after NSQ allocations to eligible exporters.
*Recommendation 4d**:*** Supplementary allocations are limited to SQ holders that were not eligible for NSQ and have not had their 'quota request' satisfied.
*Recommendation 4e**:*** Supplementary allocations are determined by a 3 year moving average of HQB export performance – allocation shares will be calculated as company shipments divided by

the sum of shipments by companies eligible for supplementary SQ.

Recommendation 4f: Supplementary allocations will take account of individual 'quota requests' – the total SQ allocated cannot exceed a 'quota request'.

Recommendation 4g: Non-payment of fees by a specified date will mean the supplementary SQ allocation is forfeited.

The allocation mechanism will require the calculation of a new set of performance shares. The calculations will be a subset of the performance shares calculated for the initial SQ allocations. It will use the same export data but exclude performance by exporters eligible for NSQ and exporters who have had their 'quota request' satisfied:

- exporters should be notified of their supplementary SQ allocation as soon as possible an invoices for quota fees should be dispatched at the same time.

At the end of this process it is possible that some HQB access remains unallocated. This situation could arise if there are forfeits or voluntary rejections of supplementary SQ allocation offers. It may also be the case that all 'quota requests' have been satisfied.

This would mean the TRQ is not fully allocated and yet there may be unsatisfied demand for access. In the unlikely event this situation arises, a potential under-fill situation could materialise. If possible the TRQ should be fully allocated at the start of the year. A final distribution process that gives preferential treatment to quota holders is the appropriate way to manage this situation.

Recommendation 5: A modified FCFS system is used to distribute any unallocated quota that remains after the supplementary SQ allocation.

Sub-recommendations associated with recommendation 5 are as follows:

Recommendation 5a: First preference for distributions of unallocated quota is given to current SQ and NSQ holders including NEs.

Recommendation 5b: DAFF advise quota holders of the availability of quota without specifying the amount and accept 'quota requests' for short period – a closing date for 'quota requests' of 1-2 weeks will be set.

Recommendation 5c: If the total requests by quota holders exceed the available access, it is shared evenly.

Recommendation 5d: If the total requests are less than the available access, the applicants receive their 'quota request'.

Recommendation 5e: Residual quota is made available on an 'as-needs' FCFS basis to any exporter that meets the EU market access requirements – current quota holders can apply.

Recommendation 5f: FCFS requests are processed in the order they are received and the pool of access remains available until the quota re-claim provisions are activated – DAFF will periodically advise exporters of the availability of FCFS quota.

Recommendation 5g: Per unit quota fees apply to all distributions.

Recommendation 5h: Voluntary returns or forfeits of quota that subsequently arise will be accumulated for distribution when the quota re-claim provisions are activated.

Allocation of NSQ

There are some unintended anomalies in the way the NSQ allocation process operates. They arise from requiring the set aside to be fully allocated on an even share basis. The system is cumbersome. It can lead to fluctuating allocations that are disruptive to market development. There is no reward for performance.

The intention of the set aside is to provide trade opportunities for NEs. But it is primarily operating as a 'top-up' for small operators. This can crowd out the opportunities for NEs in certain circumstances. Allocations depend on the number of applicants. It can lead to small allocations and trade outcomes that diminish the value of the TRQ.

Small operators receiving NSQ should be rewarded for performance in line with principle 6. This is consistent with the approach used for SQ allocations. Some niche exporters are shipping small volumes and their marketing efforts should be rewarded.

At the same time it is not appropriate to unduly favour small operators eligible for NSQ at the expense of those who are ineligible. Economic returns from their trading activities will not necessarily be any better or worse than other operators. Graduates from the NSQ provisions will still be relatively small operators. Those close to the eligibility threshold may be disadvantaged in the total allocations.

NEs should be given preference over small SQ holders in accessing the set aside. Support for an NE to become established in the EU market may need to extend beyond the first year of participation. For this reason it is appropriate for a recent NE to have a limited opportunity for a top-up on their SQ allocation. An appropriate balance is required in providing this opportunity.

The 500 tonne set aside is a relative large amount – 7% of the total quota. In other TRQ management systems the NE set aside is much smaller. For example, Australia's dairy TRQs limit the set aside to 1-2% of the quota – it depends on the size of the TRQ. There is no NE set aside for Australia's EU sheep meat quota to the EU. In New Zealand the EU HQB set aside is limited to 2% of the quota.

It could be argued the set aside is too big and should be reduced. Some stakeholders would like the set aside to be reduced. The large set aside contributes to the anomalies and inequities in allocations that may arise. The requirement to fully allocate the set aside to eligible applicants is another contributing factor.

The set aside is operating as quota within a quota. It should be defined as the maximum amount of access available for NEs and SQ holders eligible for a top-up. For equity reasons there should be a limit on NSQ allocations. The residual set aside should be transferred to the SQ allocation process. This is an effective alternative to altering the size of the set aside.

Recommendation 6: The 500 tonne NSQ set aside remains in place and the treatment of NEs in accessing set aside is modified to provide a preferential pathway to participation in the HQB quota trade.

Sub-recommendations associated with recommendation 6 are as follows:

Recommendation 6a: NE eligibility for an NSQ allocation is defined as no HQB allocations in any of the 3 years before the application and satisfying a DAFF assessment of intended quota use.

Recommendation 6b: NEs deemed eligible for NSQ allocations can access the set aside for a 3 year probation period – NEs are excluded from SQ allocations during this period.

Recommendation 6c: NEs must apply for NSQ in each of the 3 probation years and specify a 'quota request'.

Recommendation 6d: NEs have preferential access to the set aside and receive a minimum allocation of 12 tonnes in each of the 3 years unless it exceeds their 'quota request'.

Recommendation 6e: The remainder of the set aside is shared between exporters eligible for NSQ with allocations determined by a 3 year moving average of HQB export performance – NEs will participate in this sharing process and receive extra NSQ on top of the 12 tonne minimum allocation.

Recommendation 6f: ytd exports are used for the most recent performance year and performance data is 'locked' for the duration of the quota year – performance shares are determined as company shipments divided by the sum of shipments by all companies eligible for NSQ.

The treatment of SQ holders in accessing the NSQ set aside should be modified to correct unintended consequences in the way the set aside is managed in conjunction with the SQ allocation process.

Recommendation 7: Introduce a time limit and annual eligibility threshold for SQ holders to access the set aside in conjunction with a maximum NSQ allocation.

Sub-recommendations associated with recommendation 7 are as follows:

Recommendation 7a: Eligibility for an NSQ allocation from the set aside for SQ holders is an initial SQ allocation of less than 36 tonnes.

Recommendation 7b: For SQ holders the maximum NSQ allocation is the difference between the SQ allocation and the eligibility threshold of 36 tonnes – SQ plus NSQ cannot exceed 36 tonnes and it cannot exceed a 'quota request'.

Recommendation 7c: For NEs the maximum NSQ allocation (including the 12 minimum allocation) is 36 tonnes – the allocation cannot exceed a 'quota request'.

Recommendation 7d: NEs graduate to SQ allocations after 3 years if they pass a DAFF assessment on quota use in the probation period.

Recommendation 7e: SQ holders (i.e. NE graduates) can access the set aside for another 2 years if the meet the eligibility threshold.

Recommendation 7f: SQ holders (i.e. NE graduates) can access the set aside at any time – access will lapse 2 years after the first time an NSQ allocation is received (i.e. the NSQ allocations do not have to occur in consecutive years).

Recommendation 7g: residual set aside is transferred to the supplementary SQ allocation pool.

Recommendation 7h: per unit quota fees apply to all NSQ allocations.

This approach provides a preferential pathway for NEs in accessing the set aside. It is consistent with the intention of a new entrant set aside. A minimum allocation aligned with one standard sized container is a sensible starting point. It recognises commercial reality but does not require the allocation to be used in this way:

- for three years the NE receives 12 tonnes plus a share of the remaining set aside up to a maximum equal to the eligibility threshold for SQ holders.

The eligibility threshold for SQ holders is aligned with 3 standard containers. This is a reasonable reference point for NEs that graduate from the set aside. It allows a small operator to gain an SQ top-up for a limited period. It is an appropriate way to manage the set aside. However, there should be some safeguards against frivolous NE applications.

Recommendation 8: Introduce provisions to act as a disincentive for frivolous NE applications for NSQ allocations from the set aside.

Sub-recommendations associated with recommendation 8 are as follows:

Recommendation 8a: the 3 year probation period for NEs to access the set aside is consecutive from the year of eligibility approval.

Recommendation 8b: NEs that voluntarily reject an NSQ offer before the start of a quota year will remain eligible for NSQ for the remainder of their probation period.

Recommendation 8c: NEs that do not use an NSQ allocation in any of their 3 probation years (i.e. quota exports are less than 1 tonne) are excluded from quota allocations for 3 years.

Recommendation 8d: NEs that fail to apply for NSQ and submit a 'quota request' in any of their 3 probation years are excluded from quota allocations for 3 years.

Recommendation 8e: No transitional arrangements will apply to the management of the NSQ set aside for the 2012-13 quota year.

Transitional arrangements for the changes to the management of the set aside in 2012-13 and not necessary. SQ holders will be treated in accordance with the 36 tonne eligibility threshold and the 2 year limit on access to the set aside. NEs will be treated in line with the 3 year probation period:

- if appropriate, current quota holders will be classified as a first, second or third year NE and receive an NSQ allocation based on the new provisions;
- they are excluded from SQ allocations but past trade performance will be used in calculations for NSQ allocations.

The intention of the new NSQ provisions is to encourage NEs and small operators to work harder on market development. Performance based allocations will sharpen the focus on market development. It shifts the balance away from ad hoc, speculative sales that can reduce the value of the TRQ.

Quota re-claim provisions

Effective quota re-claim provisions are essential to ensure there is an opportunity for un-used allocations to be used by year end. The current 'use-it-or-lose-it' provisions require exporters to satisfy DAFF they will use their remaining allocation. The provisions are activated in mid February. If there is insufficient evidence or no response the quota is automatically forfeited in early March:

- there are no penalties if retained quota is unused by the end of the year.

The process for gathering and distributing unused quota needs to be timely. Stakeholders believe the current process is not working effectively. Users of re-claimed quota need time to make commercial arrangements and there is a six week shipping lag. By the time un-used quota is distributed there is at best 2.5 months to make use of the access.

Ineffective re-claim provisions can affect the TRQ fill rate. The pressure to use quota before year end can lead to weak selling and some of the value of the quota rent can be lost. These outcomes can be amplified by 'trade inertia' from business pressures. Some exporters may not give enough attention to the use of their quota early in the year. The risk of this is higher with small operators and in periods of weak demand for access.

Recommendation 9: Activate quota re-claim provisions one month earlier and introduce penalties for non-use of quota to sharpen the commercial focus on timely quota use and discourage the inclination to 'sit' on quota.

Sub-recommendations associated with recommendation 9 are as follows:

Recommendation 9a: DAFF inquiries on intended quota use will be initiated in mid-January – all unused quota is automatically forfeited on February 1 if there is no response to DAFF inquiries or evidence of intended use is insufficient.

Recommendation 9b: Non-use of an allocation by February 1 (i.e. quota exports of less than 1 tonne) will result in automatic forfeit of the quota allocation – no appeal on intended use is accepted.

Recommendation 9c: If less than 25% of an allocation has been used by February 1 all remaining quota is automatically forfeited – no appeal on intended use is accepted.

Recommendation 9d: Penalties will apply to all quota allocations retained after February 1 that remains unused by year end – penalties will also apply to subsequent distributions of re-claimed quota.

Recommendation 9e: The penalty will be a 1 for 1 reduction in SQ or NSQ the next time the quota holder participates in a HQB allocation process – penalties apply to NEs in their probation period.

Recommendation 9f: Quota use rates of 99.5% or more are deemed to be fully utilised in applying the penalty provisions– this makes an allowance for reconciling shipments down to the last kg.

Recommendation 9g: Penalties are not transferable between commercially related companies – DAFF may transfer a penalty to a related company if there is evidence of avoidance..

Recommendation 9h: Penalties do not transfer with quota transfers to companies that are ineligible for quota allocations – liability remains with the transferring company.

Penalties for non-use will sharpen the focus of exporters on their future intentions. It will encourage exporters to work harder at using their allocation and lessens the reliance on DAFF inquiries on export intentions. Automatic forfeit provisions discourages business inertia by exporters who are not concerned about the effect of penalties on allocations:

- 1 for 1 penalty provisions are used in the management of Australia’s dairy TRQs;
- New Zealand has 2 for 1 penalty provisions for unused HQB quota and applies a 0.5% tolerance level on quota usage rates.

In effect the quota re-claim process will now be enforced nine months after the start of the shipping year which begins in June. Availability of re-claimed quota on the 1st of February will enhance the prospects of filling the TRQ subject to trading conditions.

The re-claim provisions include rules to prevent commercial actions to avoid penalties. Transfers of quota after the 1st of February will include the potential penalty liability if the recipient company is eligible for HQB quota allocations. But the penalty liability does not transfer if the recipient company is ineligible for HQB quota allocations.

Re-claimed quota should be distributed to eligible exporters as soon as possible. It should be an orderly process with an initial preference for current quota holders. A pure FCFS distribution system open to all exporters is not appropriate because of the small quantities involved. Distributions should be based on the demand for quota by individual operators and an equitable sharing of the available access.

NPEs with no interest in market development (i.e. meat traders) should be free to apply for any residual access after quota holder requests are satisfied. Non-quota holders can play a useful role in maximising the fill rate if demand for access is weak. If they gained NE status in the future, the export performance would contribute to the calculation of their NSQ allocation.

Recommendation 10: A modified FCFS system is used to distribute any un-used quota recovered though the quota re-claim provisions.

Sub-recommendations associated with recommendation 10 are as follows:

Recommendation 10a:	First preference for distributions of re-claimed quota is given to SQ and NSQ holders including NEs.
Recommendation 10b:	Applications specifying a ‘quota request' in tonnes will be accepted for a short time in late January – the available access will not be announced and applications will close on February 1.
Recommendation 10c:	If the total requests by quota holders exceed the available access, it is shared evenly.
Recommendation 10d:	If the total requests are less than the available access, the applicants receive their ‘quota request’.
Recommendation 10e:	Residual quota is made available on an ‘as-needs’ FCFS basis to any exporter that meets the EU market access requirements – current quota holders can apply.
Recommendation 10f:	FCFS requests are processed in the order they are received and the pool of FCFS access remains available until the end of the quota year – DAFF will periodically advise exporters of the availability of FCFS quota.
Recommendation 10g:	any voluntary returns or forfeits of quota distributed to quota holders are made available on an FCFS basis to any exporter that meets the EU market access requirements.
Recommendation 10h:	per unit quota fees apply all distributions.

The modified FCFS system will reduce the uncertainty on access availability late in the quota year. This is an important consideration given the limited time for shipments. The distribution process is an equitable way of sharing the re-claimed access with NEs and SQ holders ranked equally. All un-used quota could be re-distributed as a single process which is a more efficient way to manage this issue.

There are also sufficient safeguards to limit strategic behaviour. The penalty provisions and quota fees will discourage frivolous applications and quota hoarding. If there are no applications for a distribution by quota holders an unrestricted FCFS system will operate.

Treatment of penalties in the allocation process

The use of penalties for non-use of quota can be discretionary or automatic. Discretionary rules are subjective, encourage lobbying and increase administration costs. An automatic penalty rule is preferable because it strengthens the compliance incentive and can be incorporated in the allocation calculations.

Penalties should be imposed at the next available opportunity using a 3 step approach. For SQ allocations the first step is to calculate the performance based share of the 6,650 tonnes. In step two the preliminary determinations are adjusted to reflect 'quota requests' with any residual quota allocated to the remaining applicants.

The third step is to deduct penalties from the preliminary determinations including the active 'quota requests'. The penalties amounts are then distributed among the remaining SQ applicants with allocations based on performance – a sub-set of performance shares will need to be calculated that excludes the SQ holders that were penalised.

For NEs the penalties should be applied to their NSQ allocations. Some exporters with SQ may be eligible for an NSQ allocation after the preliminary determinations in step two. Penalties should be applied to their SQ allocation. But the lower, penalty adjusted SQ allocation does not transfer to the set aside eligibility process.

Recommendation 11: Penalty provisions for non-use of quota should be applied using a 3 step approach to quota allocation determinations to ensure the deterrence effect of a 1 for 1 reduction in allocations is effective.

Sub-recommendations associated with recommendation 11 are as follows:

Recommendation 11a: Penalties automatically apply to any quota without an export certificate by 1 June.

Recommendation 11b: Special consideration to cancel a penalty may be given if evidence of a pending export transaction is provided – time limits will apply and the review of a penalty decision will not halt other quota management processes.

Recommendation 11c: eligibility for NSQ allocations will be based on pre-penalty SQ allocations – this is to prevent the penalty deductions from inadvertently triggering NSQ eligibility.

Recommendation 11d: Pre-penalty SQ allocations will be used to determine the maximum NSQ allocation – this is to prevent a reduction in the effect of the penalties.

Recommendation 11e: Penalties will apply once during a quota year.

Penalty adjustments may be necessary if a special consideration appeal is successful after the initial SQ and NSQ allocations are announced. This will occur at the next available opportunity. For example, the adjustment can be treated preferentially in supplementary SQ allocations or distributions of re-claimed quota.

Performance measurement for quota allocations

Export sales of HQB product to the EU is the appropriate way to measure performance. Currently performance measurement includes quota exports, out-of-quota HQB sales and exports of selected cuts from HQB eligible cattle under the EU GATT global quotas. Trade in grain-fed beef under the new EU global quota is excluded. This is appropriate as it could distort allocations away from exporters focused on market development for grass fed product.

Inclusion of HQB cuts under the GATT global quotas recognises market development efforts to utilise lower valued cuts from an HQB accredited carcass. A sizeable portion of the carcass is not used in the HQB quota trade. Including this product creates an incentive for exporters to find ways to sell more of the HQB carcass in the EU:

- it can potentially add value to cattle produced for the HQB trade and encourage a stronger producer/processor commitment to utilising the TRQ.

Concerns about sales of HQB cuts through GATT global quotas to enhance performance are mitigated by shifting to the 3 year rolling average calculation. Exporters utilising the GATT access in this way will have a stronger motivation for market development.

Recommendation 12: Performance share calculations will remain based on HQB quota exports, out-of-quota HQB trade and sales of cuts from HQB carcasses under the EU GATT global quotas – grain fed exports under the new EU global quota are excluded.

Eligibility for allocations

Eligibility for quota allocations was a major issue for stakeholders. Allocations to NPEs with no commitment to market development is detrimental to maximising the value of the limited quota access. The business model of meat trading companies is not compatible with maximising quota rents and returns to HQB cattle producers. As a general principal they should be excluded from the HQB quota allocations.

However, there are some NPEs that specialise in providing export marketing services for producers and processors with no market development capacity. They have relationships with EU customers requiring HQB and EU accredited cattle producers and/or processors. They invest in market development and seek to maximise returns. Allocations to these exporters are not necessarily detrimental to maximising quota rents.

An eligibility rule that excludes NPEs (i.e. operators that don't own the cattle or carcass at the time of boning-out) is a simple, effective approach that can be easily enforced. This should be the default position on eligibility. It will exclude meat trading companies from quota allocations.

An exception may be made for an NPE that can demonstrate their business model and approach to quota usage is consistent with optimising the value of the access. It provides an option for producers and processors that rely on external marketing services. This will require an eligibly assessment process that can distinguish between NPEs.

The key to optimal quota use is how the product is marketed in Europe. Competitive livestock markets in Australia ensure most of the quota rent is passed back to producers. It is the approach to product sales in Europe that largely determines the size of the rent. This should form the basis of eligibility assessments. The critical factors are:

- intended use of the allocation (i.e. what sort of product);
- the business model of the EU customer and their consumer sales channel;
- the approach to EU market development;
- the business model of the exporter; and
- relationships with Australian livestock owners and/or processors.

NE applicants should be assessed against a set of criteria that reflect these factors. An effective assessment process requires DAFF to have the expertise to make judgements on these commercial considerations. Applicants need to provide a set of information on intended quota use that confirms compatibility with maximising the TRQ value.

Recommendation 13: Eligibility for allocations is limited to owners of EU accredited HQB cattle, owner-operators of EU accredited processing plant and beef processors operating through an EU accredited plant – NPEs are excluded from quota allocations with the exception of those that satisfy an assessment test on quota use.

Sub-recommendations associated with recommendation 13 are as follows:

Recommendation 13a: NE applications include a requirement for information on intended quota use and the position of the applicant in the industry (i.e. producer, processor, NPE) – applicants must satisfy the basic requirements for eligibility including an assessment of marketing intentions.

Recommendation 13b: NPE applicants will face a higher level of scrutiny through a specific NPE assessment test developed in consultation with industry – applications will require extra information including a declaration from accredited producers and/or processors that confirm a marketing based relationship.

Recommendation 13c: The default position for NPEs is exclusion from allocations – exceptions to be established by the NPE assessment test.

Recommendation 13d: If there is uncertainty about the eligibility of an applicant after applying the NPE assessment test, DAFF has the option of requesting external independent advice.

Recommendation 13e: NPEs that fail the NPE assessment test are excluded from allocations and exporting HQB allocations on behalf other quota holders (i.e. exports under the trading name of another business).

Recommendation 13f: NPEs that pass the NPE assessment test are eligible for allocations and exporting HQB allocations on behalf of other quota holders.

Recommendation 13g: At the end of the 3 year probation period NEs will submit information on actual quota use to assess their eligibility for graduation to SQ allocations.

Recommendation 13h: DAFF may use external advice in making the decision on NE eligibility for graduation to SQ allocations – RMAC, AMIC, MLA and ABARES are possible sources of advice.

Recommendation 13i: NEs not eligible to graduate to SQ allocations are excluded from quota allocations for 3 years.

Recommendation 13j: DAFF has the option of initiating an ad hoc review of eligibility at any time if there are concerns about quota use.

Recommendation 13k: Quota holders found to be ineligible for allocations after an ad hoc review are excluded from quota allocations for 3 years and forfeit any un-used allocations.

To facilitate the assessment of NE applications from NPEs a set of guidelines should be developed in consultation with industry. The following information may be considered for inclusion in the NPE assessment test:

- business model of the applicant including number of staff focused on marketing;
- recent sales to export markets and the type of product traded;
- non-price marketing activities by the applicant in export markets;
- a 3 year business plan/summary of HQB quota use – cuts, form of product;
- declarations from EU accredited producers and/or processors that confirm a marketing based relationship;
- name and business model of intended/actual EU customers;
- final EU sales outlets for product shipped under the TRQ; and
- reasons for under-utilisation of NSQ allocations (if applicable).

Use of the information to assess eligibility is self-evident. For example, if the business model of the applicant is priced-based meat trading or they do not engage in non-price marketing activities they are excluded from allocations. A score-card system could be developed using the agreed guidelines to establish a suitable NPE assessment test:

- the review of NSQ quota use at the end of the probation period is an opportunity to check quota use intentions in the initial application and confirm eligibility.

There are concerns about the use of access by some current quota holders. Some NPEs may not pass the new eligibility test. It would be inconsistent with the revised quota management system if they remained part of the SQ allocation process.

If necessary the NPE assessment test could be applied to selected, current quota holders as a transitional measure to confirm continued eligibility for allocations:

- DAFF should discuss the need for this transitional measure with the relevant industry organisations;
- if it is considered necessary, the nominated quota holders should be required to supply the information needed for the NPE assessment test;
- DAFF has the option of using external, independent advice if there is uncertainty about eligibility after applying the NPE assessment test.

Currently some HQB is being shipped under the trading name of the quota holder through a third party. These commercial relationships are equivalent to an informal rental of quota allocations. In some cases NPEs have been the third party.

This trading activity is not necessarily detrimental to maximising the value of the quota if the third party is a suitable business entity. But it is not clear if all third party transactions are consistent with this objective. It would be appropriate for third party exporters to meet the same eligibility assessment requirements faced by quota holders.

Recommendation 14: Third party exporters marketing HQB allocations on behalf of quota holders are subject to the eligibility assessment criteria for quota allocations faced by quota holders.

Sub-recommendations associated with recommendation 14 are as follows:

Recommendation 14a: Third party exports of quota allocations on behalf of quota holders can only occur if the third party has passed the NE eligibility assessment for NSQ allocations.

Recommendation 14b: Application forms for ‘approval to ship’ are modified to include a yes/no statement that determines the eligibility status of the third party.

Recommendation 14c: requests for ‘approval to ship’ are rejected if a third party exporter has not been assessed and found to be eligible for quota allocations.

Minimum allocations and quota transfer provisions

It is not appropriate for TRQ management arrangements to make implicit judgements about the commercial viability of an allocation or changes in allocations. Exporters can use their allocations in various ways and unused portions can be voluntarily returned. Micro management of quota use is not efficient or appropriate.

Recommendation 15: The 1 tonne minimum SQ allocation remains unchanged – if an initial SQ calculation falls below this threshold the exporter is excluded from the SQ allocation process.

SQ for all eligible exporters will still be allocated down to the nearest kilogram subject to the minimum allocation rule. An exception is made for NEs who will receive a minimum annual allocation of 12 tonnes in each of their 3 years of probation:

- this is aligned with the capacity of a standard sea freight container to provide a reasonable, practical starting point for NEs – distributing very small quantities is impractical and can erode the value of the TRQ;
- the eligibility threshold for SQ holders to access the set aside and the maximum NSQ allocation are aligned with the capacity of 3 standard sea freight containers for similar practical reasons.

Current transfer provisions prevent trading in NSQ. There was widespread stakeholder support for this restriction to continue. It is seen to be necessary to discourage trading in market access rights as a speculative activity.

Quota trading is also limited by the rule that exporters with NSQ are ineligible for future NSQ allocations if they choose to sell some or all of their SQ allocation. The effect of the restriction is to limit trading in SQ. It may have encouraged more third party shipments of allocations under the trading name of the quota holder.

In principle market based quota transfers are the most efficient way to maximise the fill rate. It is preferable to DAFF management of quota transfers. It facilitates consolidation of small quantities that don't use the full capacity of a standard sea freight container.

However, some restrictions are necessary to discourage inappropriate trading behaviour. Some NEs may plan to trade NSQ for financial gain or speculate on trading opportunities that may arise. Some quota holders may have strategies to use a portion of their allocation and sell the remainder.

The primary concern is buying and selling of quota with no marketing intentions. In the absence of trading restrictions exporters are inclined to accept an offer of quota allocation irrespective of their business plans. It can encourage quota trading or, at the very least, tie up quota until the re-claim provisions are activated. A similar outcome is possible with distributions of re-claimed quota although the penalty provisions for non-use of quota will curtail this behaviour.

NEs should not be allowed to sell quota in the probation period – the non-tradability rule for NSQ should remain in place. The recommended approach to managing the set aside will limit the opportunity for exporters to use NSQ to off-set SQ sales. The eligibility threshold for SQ holders and 2 year time limit on accessing the set aside has reduced need for the rule on SQ trading by NSQ holders.

SQ trading is appropriate to facilitate quota movement for consolidation of small amounts and changes in business conditions. But a pattern of sizeable SQ sales over time or selling a large portion of an allocation is not appropriate. Some extra safeguard provisions are appropriate.

Recommendation 16: SQ allocations and distributions of re-claimed quota are transferable and NSQ allocations are non-transferable.

Sub-recommendations associated with recommendation 16 are as follows:

Recommendation 16a: NEs are free to buy SQ during the 3 year probation period.
Recommendation 16b: SQ holders eligible for NSQ are free to trade SQ without affecting future eligibility to access the set aside.
Recommendation 16c: SQ holders eligible for NSQ are not allowed to sell their NSQ allocation – if quota sales exceed their SQ allocation they are excluded from all quota allocations for 3 years.
Recommendation 16d: Exporters selling 50% or more of an annual SQ allocation or a distribution of re-claimed quota are excluded from all quota allocations for 3 years – the exclusion rule is applied separately to allocations and re-distributions.
Recommendation 16e: If a 2 year moving average of quota sales is 33% or more of total allocation rights (i.e. SQ, NSQ and distributions of re-claimed quota) the exporter is excluded for all quota allocations for 3 years.
Recommendation 16f: DAFF will review quota sales at the end of the shipping year (i.e. early June) to determine if the exclusion rules have been breached – exclusion from allocations will apply in the next quota year.

The transfer provisions allow quota movements for commercial circumstances which will help to maximise the fill rate. There are limits on quota sales to curtail the incentive for accepting allocation offers in excess of expected requirements and trading for financial gain. A pattern of selling 33% or more of allocation rights would suggest a partial trading strategy which is not appropriate for maximising the value of the quota.

Appendix A: Review terms of reference

EUROPEAN UNION HIGH QUALITY BEEF QUOTA REVIEW - 2011

Background

A review of the European Union (EU) high quality beef quota arrangements was conducted in 2005. Subsequent to the review and consultation between the department and industry, the former Minister for Agriculture, Fisheries and Forestry agreed to the current quota administrative regime for the management of Australian high quality beef (HQB) exports to the EU. A review of EH HQB arrangements is due to be undertaken.

Terms of Reference

The consultant will examine and report on:

1. The effectiveness and efficiency of the current quota arrangements, with an emphasis on use, by new entrants, of non-standard quota. This part of the review will cover:
   - the definition of 'new entrant';
   - use of non-standard and standard quota by new entrants;
   - the ongoing suitability of the total annual new entrant entitlement of 500 tonnes; and
   - any other area the consultant considers is relevant.
2. Identify where improvements to the existing quota management arrangements could be made, including in the areas of:
   - allocation of quota to exporters, including options for the allocation of standard and non-standard quota entitlements when demand for quota is either low or high;
   - minimum allocations, having regard to commercial practices;
   - quota transfer arrangements;
   - measures to deal with unused quota – including incentives and/or penalties and the date of return of unused quota – to ensure maximum utilisation of Australia's in-quota access to the EU beef market; and
   - any other area the consultant considers is relevant.

Considerations and timing

In undertaking the review, the consultant should have regard to recent quota fill outcomes, costs of quota administration and commercial requirements of individual quota holders. Where appropriate, the consultant should use scenario mapping to demonstrate any suggested improvements to the allocation system.

The consultant should also take into account the outcomes of the 2005 review and the views of industry representatives and individual exporters and processors. The consultant will present a draft report to the department by 24 June 2011.

References

DAFF (Department of Australian Fisheries and Forestry) 2011, *Export of High Quality Beef to the European Union - Guidelines for the Allocation of Non-Standard Quota Entitlement*, Canberra.

—— 2008, *Australian Meat and Livestock Industry (High Quality Beef Export to the European Union) Order 2011*, Federal Register of Legislative Instruments F2011L00629, Canberra.

McQueen, J., Welsman, S. and Harris, D. N. 2008, *Report of the 2008 Dairy Quota Review Panel on Administrative Arrangements for EU and USA Dairy Quotas managed by Australia*, Report prepared for the Minister for Agriculture, Fisheries and Forestry, Canberra.

Taylor, J., Donald, R. and Welsman, S. 2005, *Report of the 2005 Beef Quota Review Panel on Administrative Arrangements for the EU High Quality Beef Quota*, Report prepared for the Minister for Agriculture, Fisheries and Forestry, Canberra.

Appendix D

EU HQB Industry Feedback

From: *NAME REMOVED TO MAINTAIN CONFIDENTIALITY OF SENDER*
Sent: Monday, 6 February 2012 4:52 PM
To: Meat Export Quota & Admin Unit - AID
Subject: EU HQB QUOTA ADMINISTRATION 2011 REVIEW

Dear Sir/Madam

I refer to the EU HQB Quota Administration 2011 Review – Draft Response. Our Company is a Licensed Non-Packer Meat Exporter (258) and we have been allocated New Entrant & Standard HQB Quota over the past years.

I wish to make comments on the Report and the Recommendations proposed.

- Entitlement to Standard Quota - I feel with the small Allocation of HQB Quota given to Australia and with the changing market conditions particularly in largest HQB market the United Kingdom that a performance period of one year, as per the current scheme, is more appropriate than the suggested three year period. Furthermore it is much easier for DAFF to administer the Scheme where one year performance is involved.

- New Entrants – the 500 tonnes of Non-Standard Quota should be set aside exclusively to New Entrants . It is currently extremely difficult for a New Entrant to establish a market and long term business development with customers when allocation for the Quota year is only 13 tonne or equivalent to one 20' container. In my opinion New Entrants need a minimum of 36 tones allocated to achieve any worthwhile marketing success.

- Trading or the transfer of HQB Quota - since the introduction of Quota's in relation to the export of Australian Meat where it be USA Beef Quota, USA Lamb Quota or EU Sheepmeat Quota trading quota has been a valuable instrument for Exporters. We adamantly oppose restrictions on Quota Trading as proposed. Exporters should not be penalised in anyway where for instance suitable EU approved cattle are temporarily not available in their area or whether their Establishment has been temporarily forced to cease operation through drought , Acts of God (Fire , flood etc) or any other circumstances beyond their control or due to market conditions it is unprofitable or uneconomical to supply this type of Cattle to the EU. Under the current scheme the Exporter involved has the opportunity to trade or transfer his HQB Quota whether it exceeds or not 50% of his initial allocation on what is known in the "Trade" as a "Lends" or "Lease" basis to another Exporter and thus maintain his Quota for future years. Furthermore it is not uncommon for HQB Quota to be transferred between Exporters for no consideration to make certain Australia ships their Quota Allocation. Under the proposed changes Exporters could therefore be grossly disadvantaged. I strongly suggest there is no change to the current HQB Quota transfer Rules.

I have no problems with Fees and Penalty recommendations and I agree with the first-come-first served system being applied earlier in the Quota year.

Finally I cannot see where Exporters apply for a specific Allocation of the HQB Quota for the year before Allocation by DAFF is necessary and furthermore I cannot see this system working in practice. Most Exporters are not totally sure of the factor determined by DAFF in allocating the final release of Quota so what purpose would be served in Exporters guessing their final allocation . In my opinion most Exporters , when in doubt, would apply for a higher grant of Quota than expected in order to be on “the safe side” so in fact I feel this recommendation would be detrimental to the HQB Scheme.

Regards,

NAME AND CONTACT DETAILS HAVE BEEN REMOVED TO MAINTAIN CONFIDENTIALITY