

# Submission

to the

## Joint Committee of Public Accounts and Audit Review of Australia's Quarantine Function The Appropriate Level of Protection

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Tatura Milk Industries  
Warrnambool Cheese and Butter Factory

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# 1 Summary and Recommendation

The “Appropriate Level of Protection” (ALOP) standard that guides decisions whether to impose a quarantine import barrier should take account of the economic impact of quarantine barriers on Australian community as a whole and on Australian export industries in particular.

The current IRA procedures, by focusing only on the benefits of a phytosanitary protection measure to the protected industry, do not result in a full accounting of the full costs and benefits of quarantine. The costs of some quarantine measures outweigh the benefits and reduce, rather than add to, Australia’s economic welfare.

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## Recommendation

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The Australian Government should urgently develop a more formal and complete ALOP that takes account of the broader economic impacts of quarantine and should implement procedures for assessing these impacts before it imposes a quarantine measure.

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# 2 Who we are

This submission is made on behalf of

Bonlac Foods  
Murray Goulburn Cooperative  
Tatura Milk Industries  
Warrnambool Cheese and Butter Factory

Our companies – all farmer-owned manufacturing cooperatives – account for more than 70 percent of the milk processed in Australia and more than 70 percent of Australia’s dairy exports.

Dairy is the largest processed food export industry in Australia. Last year, we sold more than \$3.25 billion worth of Australian products in South and North East Asia, the Americas, Middle East, Africa and Europe. It is a major value-adding industry with turnover exceeding \$8.3 billion in 1999–2000: significantly larger than any other food or beverage manufacturing industry. Dairy farming and dairy food manufacturing together are one of Australia’s largest rural and regional employers.

We and our farmer shareholders have a huge stake in the Australian export economy. We are very conscious that the competitiveness of the Australian economy and our continued access to foreign markets depends crucially on maintaining an open market at home.

Quarantine barriers which restrict or ban imports from Australia's trading partners must be given very careful consideration not only for their benefits but also for their costs.

### **3 What is an 'appropriate level of protection'**

The 'appropriate level of protection' (ALOP) – also known as the 'appropriate level of risk' – is a concept found in the World Trade Organization's "Agreement on Sanitary and Phytosanitary Measures" (SPS Agreement). Its function is to allow each Member of WTO to determine for itself what measures it will take in response to risks to human, animal or plant life or health.

WTO rules limit the scope of the quarantine measures that may be taken to achieve whatever ALOP a government may adopt in particular circumstances. These limits are very broad: no measure may be discriminatory (as between the exports of other WTO members) and no measure should be more restrictive than necessary to achieve the ALOP.<sup>1</sup>

#### **3.1 What role does the ALOP play in a quarantine decision?**

The decision to impose a quarantine restriction on imports takes into account both an Import Risk Assessment (IRA) provided by AQIS and the policy guidance contained in the ALOP.

**The IRA** is a scientific evaluation of the probability of damage from an imported pest or disease

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<sup>1</sup>The use of the concept in Article 5 of the SPS Agreement indicates that the ALOP may be different for different risks and circumstances within any country. Article 5.5 of the Agreement provides that Governments must seek to achieve "consistency across different applications of the ALOP and must "avoid arbitrary or unjustified distinctions" in the level of ALOP considered appropriate in different circumstances "if such distinctions result in discrimination or a disguised restriction on international trade".

**The ALOP** is a policy that determines the nature and ‘severity’ of the measures that are appropriate to offset the risk

The ALOP is a constant point of reference in the documentation on AQIS import risk assessments. In the *AQIS Import Risk Assessment Handbook* AQIS says:

**[Draft IRA stage]**

AQIS circulates to stakeholders, for comment within 60 days, the draft IRA paper covering technical issues on disease and pest risk, risk management options and a preliminary view on which option would achieve Australia’s appropriate level of protection.

**[Decision making stage]**

“The Executive Director must be satisfied that the IRA has been conducted in accordance with the agreed process, and that the determination on the proposal would maintain Australia’s appropriate level of protection and otherwise accord with Australia’s international rights and obligations under the SPS Agreement.” *AQIS Import Risk Assessment Procedures Handbook* pp 15, 18

### 3.2 Why is this important?

It is very important to be clear about the ‘appropriate level of protection’ policy because it guides decisions that have a potentially big impact on Australia’s export economy.

Many quarantine measures contribute to the viability of Australian food and fiber export industries by ensuring that production processes remain free of diseases and pests.

Quarantine barriers, however, like all other measures of trade protection, have costs as well as benefits. If their economic costs are greater than the benefits that they provide then they can reduce the overall welfare of Australian community. Typically the **domestic costs** include

**Higher prices** due to the import barrier and the restriction of domestic demand to domestic supply

**Reduced demand** as a result of higher prices, which ensures that the scale of (domestic) production will always be less than the competitive scale

**Changes in competitive conditions** as a result of the *relative changes* in the level of assistance to industries

**Inefficiencies in production** as the protected industry absorbs resources that would otherwise be employed in other, higher value uses that are more in line with Australia's comparative advantage

**Resource redistribution** from consumers to the protected industry as a result of higher domestic prices than would be available from alternate (import) sources; from taxpayers to the protected industry to implement and sustain the quarantine protection measures

In addition to these domestic economic impacts there are also **external costs**: when our trading partners lose sales opportunities in the Australian market, we find it harder to sell our exports.

Our trading partners do not accept that the disease and pest risks for Australian producers can be as serious as we claim when Australian authorities ban allegedly diseased imports from the most successful producing countries in the world.

- bananas from the world's fourth biggest banana producer (Philippines)
- exports of chicken meat from the world's largest exporter (Thailand)
- fresh salmon from the number two exporter world-wide (Canada)
- table grapes from the world's third biggest exporter (USA)

With a large 'reserve' of quarantine risk assessments in process or still to be made – almost 200 according to the Auditor General's report '*Managing for Quarantine Effectiveness*' (Audit Report No.47 20002001) – it is essential that the ALOP standard should be appropriate for the whole task of determining what is 'appropriate' in any case, taking into account both the costs and benefits of protection.

## 4 What is Australia's ALOP?

In view of the crucial role of the ALOP, it is surprising how little information there is about Australia's ALOP standard. The policy is not written down and is not open for public inspection or comment.

The Senate Committee on Rural and Regional Affairs, in its inquiry in May 2000 described the ALOP as “**inherently vague and unsubstantiated**” (paragraph 4.55 of its report on ‘*An Appropriate Level of Protection*’, Feb 2001), and a standard whose “**precise nature .. is elusive**” (paragraph 4.23) and “**a recipe for inviting confusion and criticism.**”

The policy appears, in fact, to be nothing more than a **set of inferences** that AQIS officers have drawn from government statements and from what they themselves have done in the past.

“A guide to the ALOP may be found in community and industry acceptance of quarantine policy and practice over the years. It reflects value judgements of the Australian community that take into account the benefits of trade and community access to imported goods and the consequences of pest or disease introductions on industry, the environment and society in general. Australian Governments have consistently adopted a highly conservative approach with respect to the ALOP.”

AQIS submission to the Senate Committee on Rural and Regional Affairs inquiry on ‘*An Appropriate Level of Protection*’ Feb 2000

The inferences lead, **in every case**, to the assumption that Australia’s ALOP should be fully determined by a ‘very conservative’ level of protection from risk.

... importation is only permitted when such risks can be managed in a manner consistent with Australia’s very conservative approach to acceptance of pest and disease risk... *AQIS Import Risk Assessment Procedures Handbook* p 8

In most of AQIS’ documentation it appears that AQIS considers this conservative approach to risk to **be** the ‘appropriate level of protection’. They have illustrated the ALOP using a ‘risk estimation matrix’ as the boundary between *very low* and *low* levels of risk and impact.

#### 4.1 What’s wrong with this picture?

A policy that assess **only the benefits of protection** to the affected industry is not a responsible basis for making a decision to impose a trade barrier. However, this is what the current quarantine process provides.

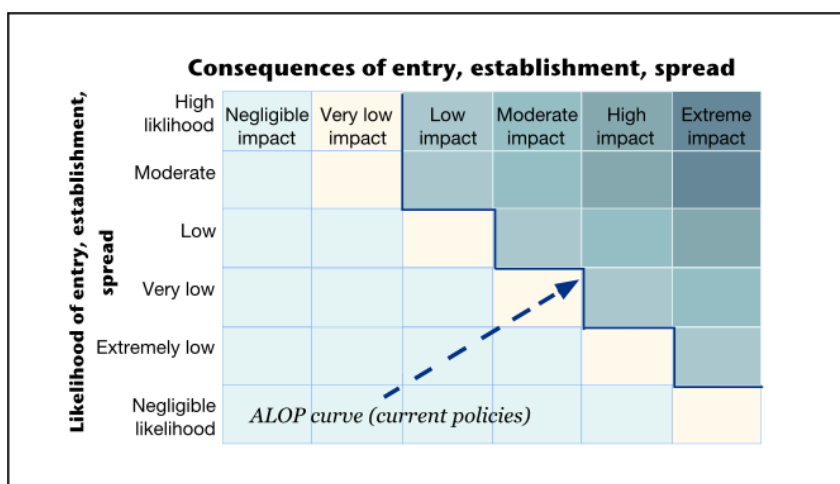


Figure 1: AQIS determination of the 'Appropriate Level of Protection'

When AQIS assesses a risk, they are assessing only the risk to the affected industry – not the risk to other industries of losses due to the proposed quarantine measure. The Senate Committee on Rural and Regional Affairs heard emphatic evidence that AQIS does not take trade implications into account, other than the implications for the exports of the affected industry if the disease or pest establishes in Australia (*Senate Committee on Rural and Regional Affairs inquiry on 'An Appropriate Level of Protection' Feb 2000 paras 4.43 and 4.44*).

The AQIS Risk Analysis Procedures Handbook says

“Relevant economic considerations in quarantine risk analysis include the cost of programs required to manage disease and pest outbreaks, the cost to industry of an outbreak and the cost to industry of loss of markets due to an outbreak.” *AQIS Import Risk Assessment Procedures Handbook* p 11

In practice, this assessment includes some trade-related impacts of the adverse event *on the beneficiary industry*: for example

- changes in consumer demand should the disease or pest become established
- effects on other domestic industries should the domestic industry's output be affected by the imported disease or pest



- loss of international markets should the domestic industry be affected by the imported disease or pest

But the risk to the affected industry or – what is the same thing – the benefit of protection, is only half the picture. The other half of the picture is the cost of a quarantine measure for the Australian economy as a whole or the effects on industries other than the industry that benefits from the measure.

### **Bananas: a case for cost–benefit analysis**

The current draft AQIS IRA on “Importation of Fresh Bananas from the Philippines” concludes that only a continuation of the current import ban would reduce the risk to the Australian banana industry of the establishment or spread of the Moko bacterium to ‘very low’ levels or less. These are the levels that AQIS considers ‘appropriate’ *in all cases* under current procedures that take account of the benefits of quarantine barriers to the potentially affected industry but take no account of the costs.

AQIS considers that if the Moko bacterium became established in Australia the necessary control measures would result in substantial modification of horticultural practices: in particular, a reduction in the degree of mechanisation and an increase in manual labour costs. Given the relatively low profit margin in banana production, AQIS concludes – *although without any direct supporting evidence* – that it is likely that many Australian producers “would not remain economically viable in such circumstances”. The current draft IRA report places no **value** on the likely losses but, since it does not claim that the whole industry would become unviable, we can assume that the losses are less than the gross value of current production – estimated by the draft IRA report at \$320.9m.

But the costs of the current import ban for consumers, taxpayers and other industries are higher than the value of the banana industry’s output. Professor Kym Anderson showed in 1998 that **removing Australia’s ban on banana imports would have increased net social welfare in Australia by \$100 million a year** even if the domestic banana industry shut down as a result of imports. (James, S. and Anderson, K. 1998, “*On the need for more economic assessment of quarantine policies*”, Australian Journal of Agricultural and Resource Economics, vol 42, no. 2, pp. 425 - 44.)

Crucially, even if the entire Australian crop were to be lost to the Moko bacterium as a result of imports from the Philippines (a threat that is not substantiated by the IRA), the value of the loss would be **less than the value of current Australian dairy exports to the Philippines** which is \$364.4 million.

## **5 Cost-benefit analysis should decide the ALOP**

The current IRA procedures, by focusing only on the benefits of a measure to the protected industry, do not result in a full accounting of the costs and benefits of a quarantine measure. They are inadequate for the determination of the ALOP.

The situation can be remedied by taking into account, when determining the ALOP in any circumstance, the possibly substantial costs to importing and exporting industries and to consumers. This need not affect current import risk analysis procedures: they remain appropriate to the full assessment of the benefits and costs of a quarantine measure.

Legislation should require the Minister to assess the full impact of a quarantine measure as would be the case in any other decision to substantially increase trade protection. This 'cost-benefit analysis' would normally be conducted in parallel with the analysis of the benefits of a measure – as set out in the current AQIS IRA procedures handbook – and need not entail further delays in an already lengthy process of investigation.

Because the losses to 'stakeholders' on the cost side are likely be more diffuse than the benefits to the 'stakeholders' on the benefits side, complex or difficult cost analyses could be supported by an investigation and economic evaluation undertaken by an independent agency with expertise in economy-wide assessments – such as the Productivity Commission.

### **5.1 Would a 'cost-benefit' analysis increase quarantine risks?**

No. A 'cost-benefit' analysis would do nothing more than match the current IRA process by telling us what a chosen levels of protection would cost us; just as an IRA tells us what the benefits of protection are. The decision on whether this cost is greater than the benefits – and therefore whether a lower-cost protection regime is appropriate – would be a matter for decision by the Minister on behalf of the whole community.

The decision to reduce a risk to levels where the benefit of lower risk is in line with the costs of risk reduction is a decision that each of us makes every day without hesitation. For example, in choosing a medical benefits insurance scheme or a house insurance or car insurance policy, most of us are willing to accept a 'front-end deductible' or a 'threshold' payment in the case of a claim in order to cut the

premium cost. We are prepared to take on some part of the risk in order to cut the cost of protection to a level where it equates to our perception of the value of protection.

It's important to remember that protection from the risk of a pest or disease is not a benefit for its own sake, but only a way of ensuring our future welfare. Under a 'cost-benefit' approach to setting the quarantine ALOP, the risks of the entry, establishment or spread of a pest or disease would be identified in the same way as they are identified now. The final decision on the ALOP would be one that takes account of the future welfare of the whole economy.

Very likely, many existing quarantine measures would be confirmed under a 'cost-benefit' approach to risk management. Some measures might be changed to implement lower-cost 'containment' or prevention controls.

## 5.2 Is a 'cost-benefit' analysis WTO-compliant?

Some people have claimed that because WTO does not *require* an analysis of the full costs of a quarantine measure, such an evaluation would not be *permitted* by the WTO. We do not agree. There is nothing in the text of the SPS Agreement that would prohibit the Government bringing broader economic considerations to the determination of an ALOP. In fact, the SPS Agreement allows Members broad latitude in determining their own ALOP.

Others have claimed that an evaluation of the ALOP for each quarantine measure that results in different measures being taken in similar cases would violate the WTO requirements for *consistency* in the application of an ALOP.

Again, we do not agree. The objective of the SPS Agreement is not to maintain 'consistency' as such but to uphold, in the SPS context, the key WTO objectives of non-discrimination and 'least trade restriction'. The provisions of Article 5 of the SPS Agreement suggest that measures which apply different approaches in similar circumstances are likely to breach the WTO rules only if they also arbitrary, unjustified, discriminatory or more restrictive than is necessary. There is strong support for this view in the *dicta* of the WTO Appellate Body in recent SPS disputes (*EC Measures Concerning Meat and Meat Products (Hormones)*, report of the Appellate Body, WT/DS26/AB/R, WT/DS46/AB/R.)

An ALOP which specified that the overall economic costs and benefits of a measure should be taken into account would not lead to arbitrary, unjustified, discriminatory

or more restrictive measures. On the contrary, we believe that an ALOP that is as vague and unspecific as Australia's current ALOP is more likely to give rise to decisions that appear 'arbitrary' or 'unjustified' than an ALOP that is more formally specified.

An ALOP that is based in part on a cost-benefit analysis may give rise to decisions to vary the level of 'appropriate protection' in circumstances where the economic costs of protection tend to outweigh the economic benefits. But this variation need not be trade-discriminatory. The measures adopted against a certain pest or disease would continue to apply to *imports from all sources of that pest or disease* that are assessed to pose the same levels of risk. Only the nature or trade-restrictiveness of the measures need be affected, and only on a non-discriminatory basis.

### **5.3 Is a 'cost-benefit' approach practical?**

The Productivity Commission has published a Research Paper entitled '*The Role of Risk and Cost-Benefit Analysis in Determining Quarantine Measures*' (Monika Binder, Staff Research Paper, Productivity Commission 2001) which considers the application of cost-benefit analysis (CBA) to quarantine decisions. The author finds that CBA techniques are applicable to quarantine decisions but points out that the data requirements for a full CBA analysis may be very large and the technical issues are likely to be complex, implying "a need for expert knowledge and judgment residing in independent institutions subject to public accountability and transparency" (p viii).

We acknowledge this practical concern but we believe that a pragmatic approach offers a partial solution. Not all proposed quarantine measures will demand a formal CBA analysis. Just as, from a risk-assessment viewpoint, there are IRAs that are likely to raise complex issues and require elaborate assessment and those that do not, so we think there will be many cases where it is apparent on the surface that an elaborate CBA analysis is not required. AQIS employs two different 'streams' for processing complex IRAs and non-complex IRAs. The approach to CBA analysis could similarly distinguish between those cases where, because of the value of the imports potentially affected, or the importance of the product as an input for other industries, or the value of domestic consumption or because of the costs of maintaining the barrier there is a need for more elaborate analysis and those case where a less formal 'consensus' evaluation is possible.

A second response to the practical concerns thrown up by the Productivity Commission staff would be that the costs of even an elaborate CBA analysis are likely to pale in comparison with the current and continuing costs of an inappropriate level of protection. The scale of costs imposed by quarantine measures is not widely appreciated, in part because the measures go un-examined from an economic point of view and in part because – as non-tariff barriers – quarantine barriers conceal even their nominal costs to consumers and taxpayers.

The example given above of the probable costs of the import ban on bananas is a case-in-point. No matter how elaborate a CBA might be undertaken to establish the benefits of the ban, it is unlikely that it would be greater than a small fraction of the \$100million that the ban has been said to cost the Australian economy every year.