

Deloitte Access Economics

Reforming regulation of the Australian food and grocery sector

Commissioned by the
**Australian Food and
Grocery Council**

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Executive Summary

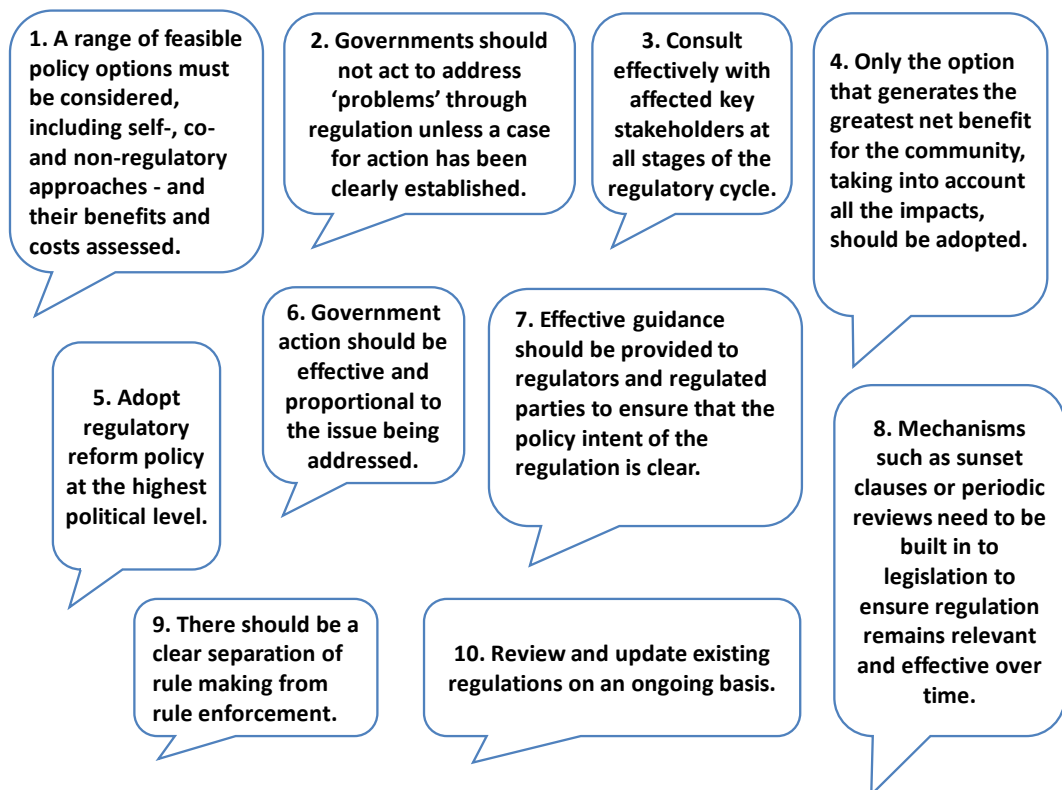
The Australian Food and Grocery Council engaged Deloitte Access Economics to work with food and grocery manufacturers to identify regulatory reforms for their sector, and to estimate the economic impacts of those reforms.

This report does not address issues of industry assistance, concessions or other government interventions to support the food and grocery sector. Rather, this report identifies options where the bureaucracy could spend *less* time and *less* money intervening in the food and grocery industry, allowing the competitiveness and growth of the industry to increase, while also producing a net saving to the Commonwealth budget. We have focussed on those areas of reform that can generate substantial savings in red tape or sovereign risk, while maintaining Australia's strong public health and safety standards.

Principles of good regulation

The principles of 'good' regulation are widely known, widely accepted, uncontroversial, and have been written about on many occasions. They are summarised below.

Figure i: Principles of good regulation



Source: DAE, COAG, OECD, NSW Government

While the principles are well documented, and worth repeating, achieving good regulation in practice is much harder. It is somewhat easier to say 'subject regulations to a robust cost-benefit analysis and consultation' than it is to build a regulatory culture where cost-benefit

analyses and consultation processes are a meaningful part of developing good regulation, rather than being treated as backfilling or box-ticking exercises, or ignored when the results are inconvenient.

Setting up the right frameworks, governance and procedures, so that the resulting regulation is optimal, is challenging. There is a lot of history, momentum and a large bureaucracy that has evolved around administering regulation in the current way, making it difficult and complex to achieve change, but not impossible.

National regulation of food and grocery manufacturing

This report focuses on national regulations specific to the food and grocery manufacturing sector. Regulations that affect a wider cross-section of manufacturing, and State/Territory regulations are also important to the food and grocery manufacturing industry, as is retail market concentration. However, the focus of this report is on reforms specific to this sector that can be implemented by the Commonwealth Government, or COAG/multi-jurisdiction reforms that can be led by the Commonwealth Government.

We have drawn on input from around 30 food and grocery manufacturers, as well as previous inquiries, reviews and taskforces into food and grocery manufacturing, to identify opportunities for reform. As many of the issues have been raised as a result of those past inquiries, reviews and taskforces (and noting industry concerns of ‘review fatigue’), we do not cover that ground again here, rather, this report focuses on tangible actions to deliver reform.

Regulating the regulators

The challenge is to ensure that Australia achieves optimal balance in the design, implementation and administration of our food and grocery regulations. Achieving this balance involves some complex trade-offs, and the public’s concerns around various issues (including the cost of living, employment, safety, animal welfare concerns and tolerance for risk) change over time.

Regulators of food and groceries are powerful – regulations are subject to some oversight on creation, but with little ongoing oversight. There are limited avenues for appeal. Regulators in other sectors (eg aviation) have an Industry Complaints Commissioner and a separation of the ability of the regulator to (a) determine the extent of regulatory approvals required; (b) set the cost recovery prices for it; and, (c) process applications for approvals. In the case of the food and grocery sector, the governance and structure of regulators have not evolved to the same degree as in other sectors, or as in other countries.

The current regulation of food and grocery manufacturing falls well short of best practice and may indeed be one of the poorest examples of industry regulation in Australia.

The major problems with current regulatory practice

Our consultations revealed five major problems with current regulatory practice for food and groceries. In approximate order of magnitude (beginning with the most significant impact on the sector), they are as follows:

Reinventing the wheel

Determinations by authoritative overseas regulators are not accepted – duplication, measures that overlap existing codes of practice and wasted regulatory effort

Not achieving best practice regulation

Not properly enforcing requirements for RIS/ impact assessment. CBAs done poorly, or not at all. Need for ex-post reviews and reduction of burdens over time.



Regulatory conservatism

Highly risk-averse approach. Imbalances from regulators not weighing jobs/cost of living impacts with health/ safety impacts. Slow approvals process.

Australian-specific standards

Uniquely Australian rules for labelling, approvals and registrations. Impedes trade, and create sovereign risks

Nano regulation

Regulatory creep resulting in over-regulation

Excessively detailed and onerous approval processes

Results of current practice

Some regulatory approval processes for low-risk products are excessively slow, uncertain and costly (sometimes taking years to grant approval for something with little apparent risk). These regulations do little to improve outcomes for humans, animals or the environment, yet impose costs, delays and lost opportunities on the industry.

Some products cannot navigate a way through, due to regulations akin to a 'dead end'. A rules-based approach to regulation has resulted in many examples where a low-risk or beneficial product cannot be supplied in Australia (in some cases, products that pose little risk were banned from the Australian market) due to arbitrary rules, rather than a common sense risk-based approach to improving outcomes for humans, animals or the environment.


There are some regulations that seem effective and are supported by industry. Some areas of regulation around food safety and hygiene were so important for the industry, although are improvement still exist.

An effective appeals mechanism does not exist. When a food or grocery company reaches a 'dead end' that blocks a product from being supplied to the Australian market, without reasonable justification, there is no robust mechanism for obtaining a review of the decision.

The current regulatory stance is overly risk averse, with a narrow focus on minimising risks to public health and the environment. If this stance arose because the public were only concerned about health and environmental outcomes, and were not concerned about the cost of living, employment and economic choice, then it would be fine. However, in the implementation of regulations has evolved in a way that focuses on a more narrow set of issues than the set of issues that is important to the public.

A regulatory culture has developed where extensive evaluations are required for minor risks. It takes years for regulators to review long and complex dossiers for many years before each approval can be granted. This erects high technical hurdles for low-risk products.


Regulating low risks in an onerous way



Costly and slow processes for approving low risk products. Not really improving safety, just slowing people down.



Regulatory imbalance



Regulators demand complex dossiers and detail to grant...

Regulatory 'activism'



Regulatory futility



Island nation



Several national regulators in the food and grocery space are able to initiate new rules, make rules (eg decide on what should be regulated) and enforce rules (eg process and grant applications for registration), resulting in the potential for regulatory 'activism': the ability to expand the range of activities to be regulated and to create their own work program.

Increasing regulation over time and the threat of new regulations create sovereign risk issues which threaten future investment in new production facilities. For example, investors considering a new product launch may be discouraged by threats of: future new regulations; a 'fat tax'; advertising restrictions; national container deposit legislation (CDL); front of pack labelling (FoPL) star scheme; and many other policies that are floated from time to time, all of which create uncertainty about the future viability of new investments.

A limited number of food ingredients, allergens or contaminants can cause illness if consumed in a *single* product on a *single* occasion: the regulation of which is mostly effective and necessary. A much greater number of food ingredients can contribute to the risk of illness depending on the combination of *several* products consumed on *several* occasions over a long period of time (or deficiencies from a lack of consumption): regulation of a single product or ingredient is likely to be ineffective at addressing a risk related to the combination of products consumed. Smarter options (such as smartphone apps) can address dietary issues relating to a combination of products consumed over time.

Consumers are interested in a wide range of ethical, environmental or provenance attributes of the food and groceries they buy, and the list is growing rapidly. The ability to regulate information effectively, or to regulate these concerns, is very poor and can have unintended consequences. Again, smarter solutions could be developed, using technology to provide information for those

interested in certain attributes, rather than old-fashioned ink and paper solutions.

Since the Taskforce on reducing regulatory burdens on business (2006), there have been calls for reforms to prevent '*uniquely Australian*' variations of international standards or agreements. As a small trading nation in a globalised world, there needs to be a very high threshold for the creation of uniquely Australian standards. Attempts by national regulators

to block consumers from accessing (correct) information that is readily available on the internet (including on State Government websites) also seems futile.

Regulations that involve mandatory reporting, 'name and shame' requirements, or give official status and prominence to unfounded fears about certain food technologies can impede the production of healthy and nutritious food.

A range of other issues around intellectual property, maximum residue limits, regulatory overlap, regulatory silos, less onerous rules for imported products and various loopholes have also been identified. The details are in the main body of this report, and solutions are summarised below.

Consequences

The impacts of current regulatory practices include:

- **Choice:** many beneficial or low-risk new products are not supplied to the Australian market, or supplied with considerable delay, compared with other developed countries. Consumers are missing out on the range of products available in other countries, and businesses are missing out on revenue opportunities without adequate justification.
- **Cost of living:** excessive costs are imposed on businesses, including direct costs (employing staff to deal with compliance), payments of fees and charges to cost-recovering regulators, and the hiring of third party advisers to assist with compliance and regulatory applications. To the extent that some regulators are not fully cost-recovered, it is also costing taxpayers.
- **Investment and employment:** local investment, employment, production and growth opportunities are lost if red tape pushes production offshore. The path from research, trialling a new product, through to investment in local manufacturing capacity, is becoming more uncertain and difficult.

The impacts of these regulatory practices make the cost structure of Australian food and grocery manufacturing higher than it needs to be, makes new investments more risky than they should be, and reduces the overall competitiveness of Australian food and grocery manufacturing. Because food and groceries are mostly internationally traded products, the consequences of regulation-induced lack of competitiveness have a more rapid impact on local manufacturers than for non-traded products and services.

Two approaches to improving regulation

Fortunately, there are some opportunities for reform, and many areas where regulatory burdens can be reduced without any significant increase in risks to human, animal or environmental health. Reform needs to follow a two-pronged approach: both a top-down and bottom-up approach, as described on the following page.

A top-down approach: make some broad but significant changes to the way regulation is approached and funded, thus creating the right incentives for regulators to themselves want to implement the 'bottom-up' reforms we have identified, while leaving some scope for individual regulators to figure out how to best implement reform in the areas of their responsibility. This would be a powerful and effective complement to the 'bottom-up' approach, by ensuring a motivation to reform is created within the regulators. Just as a strong \$A forced manufacturing to pursue efficiencies, a 'funding depreciation' could help drive efficiencies in regulators.

RED TAPE

A bottom-up approach: implement a number of specific changes to individual regulations, procedures and practices (an extensive list is provided at the end of this summary). There is the opportunity for several 'quick wins' by following this approach, delivering immediate relief to business, but also the potential for some changes to result in the government becoming embroiled in 'trench warfare', bogged down in dozens of complex changes to a number of regulators, and multiple reviews or inquiries. This also requires engaging in some reforms at a level of detail where regulators could potentially frustrate reforms.

The top-down approach to reform

The Government could consider the following changes (in addition to Coalition policy already announced, in relation to OBPR, repeal days, RISs and red tape):

- Cut the operating budgets of the rule-making regulators relating to the food and grocery sector by around $\frac{1}{3}$ to $\frac{1}{2}$. These include APVMA, FSANZ, NMI, NICNAS, the part of TGA relating to low-risk groceries, and the parts of ACCC involved in labelling and incident reporting. Put simply, to cut red tape, the most direct mechanism is to significantly cut the operating budgets of these regulators. There is ample scope to reduce activities back to the core, original purpose of protecting health and safety.
- Require regulators to process all applications within six months (time limits are needed so that reduced budgets cannot be used as an excuse for slower processing).
- Specify that the default decision (ie the null hypothesis) is to grant an approval, unless there are sufficient grounds to justify the refusal of an application.
- Instruct all regulators to focus their reduced resources on the areas of risk that regulators are more effective at reducing (eg focusing on product safety), and devote fewer resources to areas of: low risk; duplication; reinventing of wheels; self-initiated activities; low-risk companies with good compliance histories; or, areas where the effectiveness of regulation is low (such as lifestyle or chronic health issues).
- Create an effective appeals mechanism so that applications refused without a reasonable justification can be reviewed (see main report for more details).

The above solution (on its own) could achieve powerful change, though the Government would have less control or influence over the way regulators adapt to the new reality. This

may be a good thing, as it avoids having to micromanage the reform, and leaves the detail to the regulators to sort out, thus ensuring the Government's role remains to 'govern' the regulators rather than taking on an active role in 'managing' the regulators.

The reduction in operating budgets (which may be a combination of cost-recovered and appropriation-funded activities) of 'around $\frac{1}{3}$ to $\frac{1}{2}$ ' is clearly not a precisely calibrated figure. However, it is a broadly sensible assessment of the operating budget that would be needed if regulators reduced the time spent on duplication, reinventing wheels, low-risk products and low-risk companies. Because a large part of these regulatory functions are cost-recovered from industry, a cut to operating budgets would partly (and directly) flow through to lower fees and charges on industry and partly result in a net saving to the Commonwealth Budget, depending on the regulator (eg APVMA is almost entirely cost-recovered from industry, while FSANZ is largely appropriation-funded). Careful monitoring of cost-recovery arrangements would be needed to prevent any appropriation-funded activities being inappropriately shifted into the cost-recovery bucket.

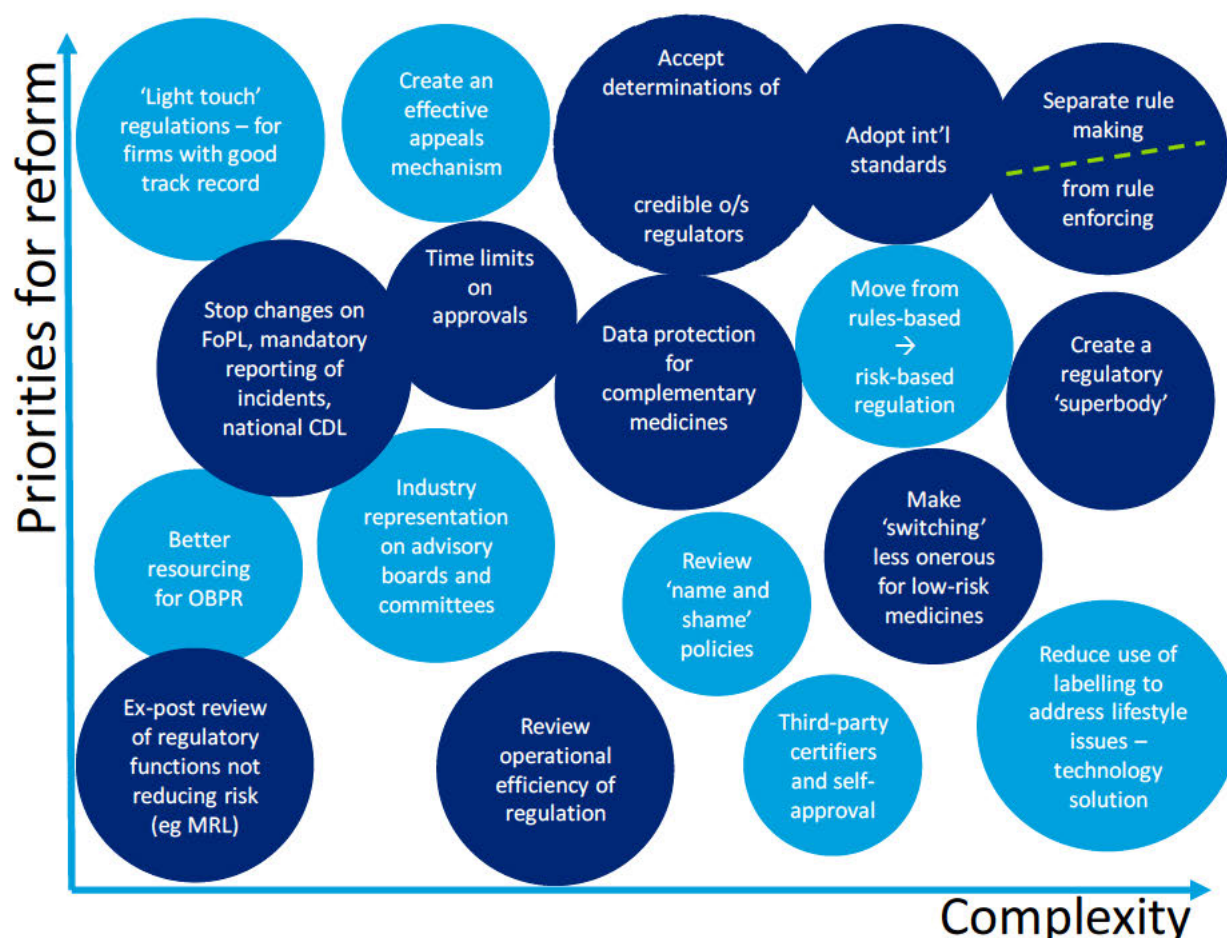
A specific reform that bridges both the 'top-down' approach and 'bottom-up' approach is the consolidation of all regulation of food and grocery manufacturing into a single one-stop-shop (similar to the US FDA), and ideally to move that one-stop-shop into a central portfolio, or under the industry portfolio. This would merge a wide range of manufacturing regulations administered by FSANZ, APVMA, NICNAS, NMI, the part of TGA relating to groceries and cosmetics and the part of ACCC relating to labelling and incident reporting. This is a complex reform, but cannot be achieved without a hands-on involvement from Government to achieve this restructure. The potential for this change to improve the regulation of manufacturing is significant.

The bottom-up approach to reform

While there are a large number of problems to be addressed, and the risk of micromanaging reform, when combined with the 'top-down' pressure to reform, there are many specific problems and poor individual regulations that could be addressed fairly quickly. The bottom-up approach thus complements the top-down approach, by giving some guidance to regulators on where to best apply their reduced operating budgets, and by identifying areas where savings could be made (eg from reduced duplication of international standards and reinventions of wheels).

As well as specific issues (such as the regulation of MRL, sunscreen, FoPL Star ratings and CDL), the opportunities for reform summarised in the figure on the following page include some changes to the structure and design of regulation, which would improve how regulation functions:

Figure ii: Opportunities for reform



A full list of opportunities for ‘bottom-up’ reform proposed by AFGC members during our consultations and arising from our research (including those highlighted above) is in the main body of this report, and following the Executive Summary.

Benefits of these solutions

DAE (2011) noted that Australia’s overall level of total factor productivity peaked in 2003-04. In 2008-09, the level of total factor productivity fell by 2.3 per cent compared to the previous year. This was the worst productivity performance in Australia in at least the last 25 years. On average, since 2001-02 productivity growth has made a negative contribution to Australia’s economic growth.

Appropriate regulations, which are risk-based and subjected to rigorous cost-benefit tests before being introduced, can boost aggregate and industry-wide productivity by reducing barriers to entry and by improving the flexibility of input and product markets. However, poor regulations can have the opposite effect. Poor regulation is likely to have been a key contributor to the poor productivity performance of Australia in recent years.

Noting that food and grocery manufacturers face challenges in passing on the costs of red tape (particularly in the short term, due to retail market concentration, import competition and supply contracts), ultimately regulatory costs have to go somewhere – they either have

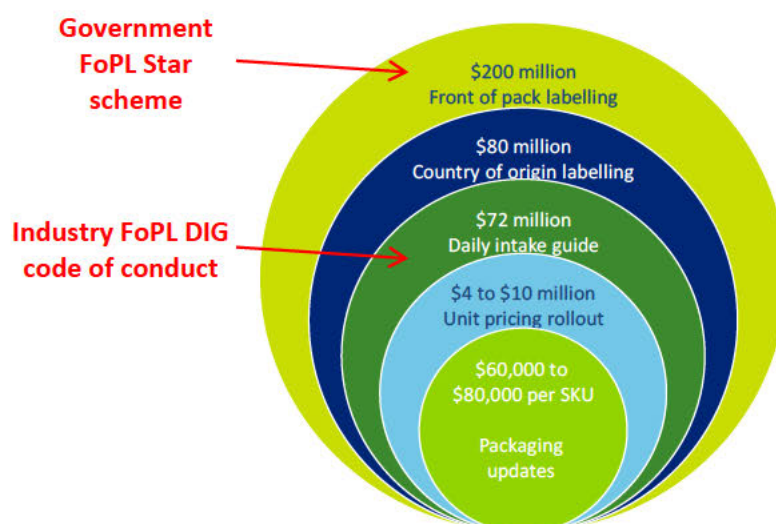
to be passed on as an increased cost of living for consumers, or where that is not possible, as a reduction in profits for producers (which invariably leads to reduced investment in new facilities or new products, and thus less choice for consumers).

The economic benefits of this competitiveness-increasing package of reforms were estimated based on inputs from industry stakeholders, with economy-wide impacts estimating using the DAE general equilibrium model. The model was customised to separate food and grocery from the rest of manufacturing using the industry classification in Appendix A of the AFGC State of the Industry report (2013).

The exact amount of reduction in red tape and the timelines over which those reductions are achieved depend on which combination of the above reforms are adopted and when. Some examples of costs of specific changes are shown in the figure below.

In particular, note the difference between the cost-effectiveness of an industry code of conduct such as the FoPL daily intake guide (DIG, \$72 million) and the cost if government introduces a FoPL Star scheme (\$200 million). Allowing for the sunk costs already invested in developing the FoPL DIG, which become redundant, implementing FoPL Star scheme would thus cost a total of \$272 million, and arguably result in little change to outcomes for consumers (noting there is little evidence that the FoPL Star scheme would influence consumer behaviour significantly more than the current code of practice, and the OPBR currently lists the FoPL Star scheme as non-compliant with COAG best practice regulation¹).

Figure iii: Cost examples for specific regulations



The following scenario illustrates the impacts of some of the more immediate and achievable reforms: a \$100 million (in 2011-12 dollars) per annum reduction of regulatory burden on the food and grocery manufacturing sector is estimated to increase GDP by \$243 million to \$255 million and employment by around 214 FTEs to 231 FTEs.

¹ <http://ris.finance.gov.au/2013/07/03/non-compliance-with-coags-best-practice-regulation-requirements-front-of-pack-nutrition-labelling-legislative-and-governance-forum-on-food-regulation/>

An ongoing reduction in regulatory burden of \$200 million per annum is within reach based on the reforms identified in this report, and may be higher in years if one-off implementations (such as FoPL Star scheme) were introduced. The economic impacts of savings of that magnitude (and allowing for a few years of transition to adjust to the new level of competitiveness) would increase GDP by \$485 million and increase employment by 462 FTEs.

Due to the large number of issues identified and the many opportunities for reform, the exact magnitude of economic impacts will depend on the measures adopted, and the extent of the reduction in resourcing for individual regulators.

Conclusion

Regulation of food and grocery manufacturing is poor and requires urgent reform. The problems are so significant that we have recommended both a 'top-down' approach and a 'bottom-up' approach to create: the right incentives; pressure to reform; and, the detailed ideas for implementing reform – all of which are necessary to achieve the scale of reform required.

With the potential gains from increased prosperity, lower costs of living and increased employment – and the mechanisms necessary to achieve reform – we recommend this reform package as a way forward for food and grocery manufacturing in Australia.

