



Charges for Raw Milk Businesses

Regulatory Impact Statement

ISBN 978-1-77665-246-4 (online)

22 March 2016

Disclaimer

While every effort has been made to ensure the information in this publication is accurate, the Ministry for Primary Industries do not accept any responsibility or liability for error of fact, omission, interpretation or opinion that may be present, nor for the consequences of any decision based on this information.

Unless noted, all figures in the document are shown in New Zealand dollars and are exclusive of Goods and Services Tax.

Requests for further copies should be directed to:

Publications Logistics Officer
Ministry for Primary Industries
PO Box 2526
WELLINGTON 6140

Email: brand@mpi.govt.nz
Telephone: 0800 00 83 33
Facsimile: 04-894 0300

This publication is also available on the Ministry for Primary Industries website at <http://www.mpi.govt.nz/news-resources/publications.aspx>

© Crown Copyright - Ministry for Primary Industries

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by the Ministry for Primary Industries (MPI).

It provides an analysis of options to fund activities MPI will begin to perform in relation to companies involved in the sale of raw milk directly to consumers. This is a newly regulated area – MPI has not previously performed activities specifically in relation to the sale of raw milk.

The exact size of the raw milk industry is currently unknown. This information is lacking because many dairy farmers selling raw milk to consumers do not advertise widely (or at all), and none are registered with MPI specifically for that activity.

To help inform the analysis, MPI has relied on information received in 2014 from the Raw Milk Producers' Association (*the association*) and an MPI self-selected online survey. The association informed MPI that it had 54 members and estimated that there were a similar number of non-members. This finding is similar to the survey which identified 74 suppliers of raw milk to consumers. Based on this, MPI estimates up to 100 raw milk suppliers will register under the new regulations.

MPI has used an estimate of the average time required to perform these raw milk activities as the basis for the proposed charges. The underlying hourly rates are the same as those applied to other dairy businesses for similar activities. These charges were developed last year as part of a review of MPI's cost recovery arrangements and should therefore allow MPI to recover its expected costs.

The operation of the new regime (including the associated charges) will be reviewed once they have been in place for 18-24 months.

John Ryan

Deputy-Director General, Corporate Services

Ministry for Primary Industries

22 March 2016

Background

1. The sale of raw milk was previously regulated under the Food Act 1981 which allowed farmers to sell up to 5 litres of raw milk at any one time from their dairy premises (farms) to people wanting to consume it themselves or give it to their family. However, beginning 1 March 2016 the sale of raw milk is regulated under the Raw Milk for Sale to Consumers Regulations 2015, developed under the Animal Products Act 1999 (APA) and the Food Act 2014.
2. Under these regulations farmers are able to sell raw milk directly to consumers, either from their farm via home deliveries. There are no limits on the amount farmers can sell to a consumer, or the amount they can sell overall. However, given the food safety risks associated with consuming raw milk, the regulations impose strict requirements that apply to farm dairy operators that intend to sell raw milk to consumers (referred to as suppliers), as well as transport operators and depot operators who are involved in the delivery and transport of raw milk to consumers.
3. The size of the raw milk industry is small, though its precise size is not known. MPI estimates up to 100 raw milk suppliers will register under the new regulations but the actual number of suppliers that will register is unknown.
4. The 2014 survey provided some information on the size of raw milk sellers' operations. The median volume sold was between 21 and 40 litres a week. The sales volume per farm ranged from less than 20 litres/week to more than 1,000 litres/week.

Status quo and problem definition

5. Under the Raw Milk for Sale to Consumers Regulations 2015 the Ministry will be required to undertake the following activities in relation to the sale of raw milk to consumers:

Activity	Relevant to
Processing registrations (and renewals) for businesses required to operate under a regulated control scheme, under which risks associated with raw milk are identified, monitored and managed	Suppliers Depot operators
Verification services (where not provided by a third party agency), which check that the requirements for producing, transporting and storing raw milk being adhered to	Suppliers Transporters ¹ Depot operators
<i>Programme activities</i> , including the maintenance of standards relating to raw milk, performance monitoring in relation to raw milk, and the administration of the residue monitoring programme ²	Suppliers

¹ Transport operators will be required to be verified. Generally this will be done as part of the verification of the farm dairy operator. It will be up to the farm dairy operator whether they pass on the costs of this onto their transport operators or if they absorb them themselves.

² This includes the National Chemical Contaminants Programme (NCCP) and an Independent Verifier Programme (IVP). The NCCP conducts random monitoring, targeted surveillance and surveys of dairy products to confirm that residue or contaminant levels do not exceed acceptable limits. The IVF provides independent sampling and testing of product to confirm the accuracy of routine monitoring by the NCCP.

6. MPI will incur costs in carrying out these activities. The expected cost could be up to \$100,000 per year.³ As these are new activities there are no specific cost recovery arrangements in place for them – the status quo is therefore that these activities are not cost recovered.
7. While this is a small amount in the context of MPI's overall budget, the APA requires all reasonable steps to be taken to ensure that the costs of administering the Act are recovered unless there is Crown funding for the activities. At present neither of these things are in place – either cost recovery arrangements for these activities need to be implemented or the Government should agree to fund them.

Objectives

8. The objective is to ensure services are funded in a way that is consistent with the principles of cost recovery under the APA as set out below:
 - **Equity** – Funding should generally be sourced from the user or beneficiaries of a function, power, or service at a level that reflects their use or benefit.
 - **Efficiency** – Costs should generally be allocated and recovered in a manner that ensures maximum benefits are delivered at a minimum cost.
 - **Justifiability** – Costs (including indirect costs) should be collected only to meet the reasonable costs for providing a function, power or service.
 - **Transparency** – The Cost of providing a service, function or power should be identified and allocated as closely as is practicable to the period when the service is provided.

Options and impact analysis

9. In developing cost recovery options MPI considered similar services already provided to other dairy businesses. For processing registrations and verification audits, MPI recovers its costs through an hourly charge (at \$155 and \$165 per hour, respectively). These charges were set as part of the 2015 review of MPI's cost recovery arrangements, set at a level that ensures MPI can recover its full costs (both direct and indirect) of providing registration and verification activities.
10. *Programme activities* performed for other dairy businesses are recovered through an annual levy (this levy is referred to as the *programme charge*). These activities are funded through a levy as they can benefit the dairy industry as a whole (for example, maintaining standards is of benefit to all dairy businesses). For small dairy processors the programme charge is currently \$465 per year. This charge was also set as part of the 2015 review of MPI's cost recovery arrangements, again to ensure that MPI recovers its full costs.

³This is based on the assumption that 100 suppliers and 10 depot operators will register, and that MPI will carry out 30 verification audits. The estimate assumes that most verification audits would be provided by another verification company rather than MPI. This is because MPI only acts as a verifier of last resort, performing verification services only if no other verifier is available. If fewer businesses register MPI's costs will be lower because it will need to process fewer applications and conduct fewer verification audits. MPI's costs for carrying out the *programme activities* may also be lower as, for example, the costs of running the monitoring regime could reduce if there are fewer raw milk businesses.

11. While MPI conducts *programme activities* for both raw milk businesses and other dairy businesses, raw milk businesses will be subjected to a more rigorous monitoring regime, a component of the *programme activities*, administered under the National Chemical Contaminants Programme and the Independent Verifier Programme. Because of this higher monitoring, MPI expects its average costs per supplier for carrying out programme activities will be \$116.25 higher for raw milk businesses, totalling \$581.25.⁴

12. MPI considered three options for recovering the costs of performing these activities:

- Option 1: Apply the same cost recovery charges that are applied to other similar dairy operators.
- Option 2: Apply charges that will recover expected costs for the services provided to raw milk businesses.
- Option 3: Do not charge (status quo).

Option 1: Apply the same cost recovery charges that are applied to other similar dairy operators

13. This option would involve charging business involved in selling raw milk directly to consumers the same amount that is charged to other similar dairy businesses. This would mean that processing registrations and conducting verification audits for raw milk businesses would be charged at \$155 per hour and \$165 per hour, respectively. These activities are carried out by the same MPI staff that process registrations and conduct verification audits for other dairy businesses. It is therefore reasonable to expect that the per hour costs to MPI of providing these activities to raw milk businesses will be the same.

14. In terms of the *programme charge* raw milk suppliers will meet the definition of a small dairy processor, and accordingly under this option would also be charged the same levy of \$465 per year. However, as noted above MPI will subject raw milk suppliers to a more rigorous monitoring regime than other dairy businesses. Under this option the costs of this additional monitoring would not be recovered and would have to be Crown funded.

Option 2: Apply a charge that will recover expected costs for the services provided to raw milk businesses

15. Option 2 would involve identical hourly fees as in option 1 for processing registrations and verification services.

16. However, under this option the *programme charge* for raw milk businesses would be \$581.25. This would mean the expected additional costs arising from the additional monitoring for raw milk suppliers can be recovered.

Option 3: Do not charge (status quo)

17. Option 3 would involve not charging the industry for any of the activities MPI carries out in relation to the sale of raw milk directly to consumers. As MPI is not currently funded for these activities, it would have to seek Government approval for such funding as required by the APA.

⁴ This is because MPI expects that, on average, it will need to spend an additional 45 minutes per year conducting monitoring per raw milk supplier. The cost of this monitoring was set in the 2015 review and is \$155 per hour. The additional monitoring will therefore on average costs MPI \$116.25 per supplier.

18. Table 1 sets out the charges for each activity under each option.

Table 1: Charges under each option

Activity	Relevant to	Charge under each option (ex. GST)		
		Option 1	Option 2	Option 3 (status quo)
Processing registrations/renewals.	Suppliers Depot operators	\$155 per hour (with registrations expected to take 2 hours)	\$155 per hour (with registrations expected to take 2 hours)	\$0
Conducting a verification audit (where not provided by a third party agency).	Suppliers Transporters Depot operators	\$165 per hour	\$165 per hour	\$0
Carrying out programme activities.	Suppliers	\$465 per year (equivalent to other small dairy processors)	\$581.25 per year (based on a total of 3.75 hours spent on each raw milk supplier per annum)	\$0

Analysis

No cost recovery charges

19. MPI considered option 3 (status quo) – not applying any charges for these activities. This option would have the smallest impact on raw milk businesses of the options considered as the activities would be funded by the Crown.

20. However, this option would not be consistent with the principle of equity under the APA. It would mean that businesses involved in the sale of raw milk directly to consumers are not paying the costs MPI incurs in managing the associated risks with this activity. In addition, this would be inconsistent with how other dairy businesses are treated, which are charged by MPI for all activities performed in relation to their businesses. Both these factors mean the equity principle would not be achieved.

21. Not charging would also be inconsistent with the principle of efficiency. It would mean raw milk businesses have no incentive to take steps to help MPI perform its activities

quickly (for example, by ensuring all pertinent information is included on application forms).

Apply cost recovery charges

22. In terms of the choice between options 1 and 2, as noted above the key difference between them is the *programme charge*. Current programme charges for small dairy processors are \$465 per year while MPI's estimate of the actual cost of covering the costs of running its *programme activities* for raw milk is \$581.25 per year per supplier.
23. MPI considers that both options 1 and 2 meet the principles of efficiency, justifiability and transparency because:
- *Efficiency* – charging creates incentives for businesses to ensure MPI can carry out these activities at minimum cost.
 - *Justifiability* – the charges should result in only reasonable costs being recovered.
 - *Transparency* – the charges, as much as possible, are closely related to actual activities being performed by MPI.
24. Option 1, however, does not meet the principle of equity. Under this option, MPI would not charge raw milk businesses for the additional monitoring activities it will be carrying out. Option 2, on the other hand, is consistent with the equity principle. This is because under option 2 the full costs of carrying out programme activities would be recovered from the users/beneficiaries of those activities (raw milk businesses).
25. This is a newly regulated sector so demand for these activities and their associated costs are difficult to predict at this stage. For example, the *programme charge* required to recover MPI's costs depends on how many farm dairies decide to supply raw milk directly to consumers under the new regulatory regime. The average cost of some components of the *programme activities*, such as standards maintenance, may decrease as more suppliers enter if economies of scale can be realised. As noted below, these charges will be reviewed after they have been in place for 18-24 months. At that time they could be adjusted if need be.
26. Both options 1 and 2 will have a financial impact on raw milk businesses. This will also be the case for depot operators and transporters. The size of this impact will depend on factors such as the size of the business: the charges as a proportion of revenue will generally be smaller for larger businesses than it will be for smaller businesses. Detailed analysis, however, of this impact was not undertaken. MPI is required to carry out the activities described above in order to manage the risks of raw milk, and the principles of cost recovery under the APA (in particular the principle of equity) requires raw milk businesses be charged the associated costs.
27. Table 2 summarises the extent each option achieves the principles of cost recovery as set out in the APA (equity, efficiency, justifiability, transparency).

Table 2: Consideration of proposals against the principles of cost recovery:

Option	Equitable	Efficient	Justifiable	Transparent
Option 1	X	✓	✓	✓
Option 2	✓	✓	✓	✓
Option 3 (status quo)	X	X	N/A Justifiability not relevant as costs are not passed on to industry.	N/A Transparency not relevant as costs are not passed on to industry.

Key: ✓ - consistent with principle, X - inconsistent with principle, N/A – not applicable

Consultation

28. MPI released a discussion document discussing, among other things, these proposed charges for raw milk businesses (Discussion Paper No: 2016/06, *Changes to Animal Products Cost Recovery Regulations*⁵). Links to the discussion document were sent to raw milk businesses known to MPI (around 80 raw milk businesses) and relevant industry bodies such as Federated Farmers and DairyNZ. The submission web page had 313 unique page views and the consultation document was downloaded 173 times.
29. Four submissions were received on the proposed raw milk charges, including one from the Raw Milk Producers Association of New Zealand (*the association*) which represents 54 raw milk businesses. Three of the submitters, including the association, agreed that the costs of performing the activities in relation to the sale of raw milk should be cost recovered. The fourth submitter disagreed with charging, though did not discuss how this would be consistent with the principles of cost recovery as set out in the APA.
30. Of those who supported cost recovery, two submitters supported our preferred approach. The other submitter (the association) suggested applying the same cost recovery charges that is applied to other similar dairy operators on the basis that, in time, the costs incurred by MPI in relation to raw milk will be similar to that for other dairy businesses.
31. MPI considered the association's suggestion (as Option 1 in this RIS). But as the analysis above shows, this is not the preferred cost recovery approach. It is considered more equitable to set charges that fully recover expected costs.
32. The association also requested that the initial costs of creating the regulations and standards for selling raw milk directly to consumers be recovered over a number of years. However, MPI is not proposing to recover any of these initial set-up costs. This is standard practice for newly regulated areas.

⁵ Available at <http://www.mpi.govt.nz/document-vault/11012>.

Conclusions and recommendations

33. MPI's preferred option is option 2 – to apply a charge to recover expected costs for the services provided to raw milk businesses (in particular, in relation to *programme charges*). MPI considers that option best meets the principles of cost recovery set out in the APA (equity, efficiency, justifiability, transparency).

Implementation

34. This change will be implemented through amending the Animal Products (Dairy Industry Fees, Charges, and Levies) Regulations 2015. This change is intended to come into force 1 July 2016.
35. Transitional arrangements have been developed for the regulations that govern the sale of raw milk directly to consumers. Under the transitional arrangements, existing suppliers of raw milk will not need to register with MPI until 1 November 2016. These businesses will not be charged any fees until they have registered.
36. These charges will be notified in the New Zealand Gazette and will also be published on MPI's website. MPI will also write to inform the association and other known raw milk businesses of the charges once they have been gazetted.

Monitoring, evaluation and review

37. As selling raw milk directly to consumers is a newly regulated area, the operation of the new regime (including the associated charges) will be reviewed once they have been in place for 18-24 months. At that time it will be clearer how many businesses are involved in the sector and the actual costs to MPI of carrying out activities in relation to raw milk businesses. This new information will enable MPI to adjust its charges, if necessary, to ensure the revenue it collects from those involved in the sale of raw milk will cover its costs.
38. This timeframe for the cost recovery aspects of this review could be brought forward if the number of registered raw milk businesses is substantially different to what is expected.