Stage 2 Cost Recovery Impact Statement

A review of cost recovery for selected services provided by the Ministry for Primary Industries

Ministry for Primary Industries

April 2018

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Agency Disclosure Statement

This Stage 2 Cost Recovery Impact Statement has been prepared by the Ministry for Primary Industries (MPI).

It provides an analysis of options to update some fees and levies charged by MPI for services, including to:

- increase the maximum rate to allow for an increase in the Biosecurity System Entry Levy (BSEL)
- allow the levy period for the Border Clearance Levy (BCL) to be extended to up to 36 months
- update Animal Products Act (APA) levies for red meat, dairy, and fish processors
- introduce new charges relating to templates for food control plans under the Food Act 2014 (and for a small number of other low-volume services)
- update rates to fully recover costs for circuit verifications, including introducing a targeted rate for storage premises and fish processing facilities.

The proposed updates to fees and levies are based on prior decisions in respect of:

- the nature, delivery mode and volumes of MPI services provided (including in some instances, additional services needed for compliance with the requirements of overseas governments for exported products)
- the structure of fees and levies, which is largely unchanged (unless otherwise indicated)
- priorities for fee updates from 1 July 2018 – generally those where is a risk of significant under-recovery of ongoing costs and/or unrecoverable deficits.

The analysis is based on MPI’s cost recovery policy guidance, and general guidance on cost recovery for public entities published by the Treasury and Controller and Auditor-General. The analysis includes an assessment of the appropriate structure of each of the fees and their levels (in light of historical and future costs).

The fees have been calculated on the basis of recovering/returning forecast deficits or surpluses accumulated on 30 June 2018, and fully recovering forecast ongoing costs.

Assumptions on which the proposed fee rates are based are set out in each section.

All dollar figures in this document are exclusive of Goods & Services Tax (GST) unless otherwise indicated.

Bruce Arnold
Acting Director, Cost Recovery
3 April 2018

Executive summary

The CRIS analyses five proposals for updating fees and levies charged for services provided by the Ministry for Primary Industries. These changes are the first that directly result from First Principles Review of MPI's cost recovery arrangements which commenced in late 2015.

The underlying principles that guide these cost recovery proposals are set out in MPI policy guidance and include *equity, efficiency, justifiability* and *transparency.* In addition to these principles, MPI also applies the general guidance on cost recovery for public entities published by the Treasury and Controller and Auditor-General (CAG).

The proposals were included in a discussion document *A review of cost recovery for selected services provided by the Ministry for Primary Industries* released on 21 February 2018. Submissions were sought from affected businesses and other stakeholders. 39 submissions were received; the feedback is outlined in relevant sections of the CRIS, including some information on the impacts of the proposals.

The proposals and the rationale for each are set out in the table on the next page. All proposals would apply from 1 July 2018 unless otherwise indicated.

Several issues were raised in submissions that cannot be addressed immediately but merit further examination. This will be done as part of the next stage of the cost recovery work programme, for implementation on 1 July 2019.

MPI will continue to monitor the impact these charges will have on the relevant memorandum accounts to ensure that surpluses and deficits are managed appropriately, and that costs are being fully recovered but not over-recovered.

MPI will improve transparency, as well as ensuring ongoing system efficiency by publishing reports to businesses that pay the fees and levies, and other stakeholders on cost recovered services. It will work with industry to ensure that information provided in this way is meaningful, and aims to have completed the reporting framework by 1 July 2018.

MPI is undertaking an ongoing programme of "rolling reviews" across all of its cost recovered systems, through which each cost recovery regime will generally be reviewed once every three years. Reviews will consider both the policy setting and the actual fee and levy rates, and will ensure that cost recovery regulatory settings remain appropriate, including preventing any significant deficits or surpluses from accumulating.

Table 1: Summary of proposals

Proposal	Rationale
Increase the Biosecurity System Entry Levy (BSEL)	
• increase the maximum levy rate specified in the Levy Order from $18 to $23 per consignment, to enable: ○ an increase the actual BSEL rate from $17.37 to $20.36 per consignment ○ charging all imports the Joint Border Management System (JBMS) component of the BSEL.	Improve equity by charging importers the full costs of biosecurity services at the border relating to imported goods
Extend the levy period for the Border Clearance Levy (BCL)	
• allow the Director-General of MPI to set the BCL levy period at up to 36 months (rather than the current 12 months)	Improve transparency and efficiency, through providing flexibility to smooth adjustments over time and align with Customs' levy period.
Update Animal Products Act (APA) levies	
• update the domestic and export levy rates for red meat, dairy, and fish processors • simplify the red meat levy by including deer in it, and consolidating deer and similar smaller categories into a '*Deer & other large species'* category	Improve equity and justifiability by ensuring some businesses using standards-related services under the APA are charged full costs, by updating levies for red meat, dairy, and fish processors to recover historical and ongoing deficits.
Introduce new charges under the Food Act 2014	
• introduce charges: ○ for approval, amendments and renewals of templates developed by industry for Food Control Plans (FCP) ○ for approval, amendments and renewals of FCPs based on templates ○ for a small number of other, low-volume MPI services.	Improve equity by ensuring businesses using MPI services under this Act are charged consistently for comparable services. The new charges would rectify omissions from current fee regulations, and are based on the current rate for approvals-related services of $155 per hour.
Update rates for circuit verification services	
• update the fee for circuit verification services from $165.00 to $204.56 per hour	Improve equity and justifiability by ensuring businesses using MPI circuit verification services are charged at rates that fully recover historical deficits and ongoing costs.
• introduce a targeted rate of $20.60 per hour (in addition to the above rate) to be applied to storage premises and fish processors, for two years only.	This rate is to recover a specific charge which was not collected in 2015/16 because of an omission in the fee regulations in force at the time.

Context

MPI works to ensure that New Zealand is the most trusted source of high value natural products in the world, through the following outcomes:

- *growth* - New Zealand's food and primary sector grows the value of its exports
- *sustainability* - New Zealand's natural resources are sustainable, in the primary sector
- *protection* - New Zealand is protected from biological risk and our products are safe for all consumers
- *participation* - New Zealanders participate in the success of the primary industries.

Cost recovery plays an important role in achieving MPI's priorities by ensuring that MPI is sufficiently funded to provide a wide range of services, such as supporting access to key overseas markets, providing clearances of imports, and verifying compliance with requirements that our primary products are fit for export.

MPI receives approximately 40% of its departmental funding from cost-recovered activities. Given the scope and significance of cost recovery, MPI has been undertaking a programme of work to ensure the systems and processes that support cost recovery are fit for purpose, as set out below.

First Principles Review

In late 2015, MPI commenced a First Principles Review of its cost recovery arrangements. The objectives of the review were to support a more consistent and transparent approach to cost recovery across the range of services that MPI provides, and to ensure alignment with the Treasury and the Controller and Auditor-General's cost recovery guidance. The review found MPI's cost recovery settings are broadly appropriate, but identified a number of areas where changes could be considered.

Over the last 12 months MPI has been developing a package of proposals to improve our cost recovery arrangements. In parallel MPI has also undertaken a comprehensive review of the levels of existing charges and identified a range of adjustments that will be required to ensure we continue to appropriately recover costs. As a result of this MPI proposes to make the changes discussed in this document (along with one that does not require analysis within the CRIS framework[1]). These proposals are considered by MPI to be highest priority for implementation from 1 July 2018, and seek to improve equity of charges and adjust rates that are driving significant surpluses or deficits in memorandum accounts.

Cost recovery objectives and principles

The underlying principles that guide these cost recovery proposals are common features in most legislation that authorises MPI to recover costs. They are set out in MPI policy guidance and are defined as:

- *equity* – services should be funded from users that benefit from the service and/or persons that create risks that the service is designed to manage ('risk exacerbators')
- *efficiency* – costs should be charged to ensure that maximum benefits are delivered at minimum cost

[1] The proposal to align biosecurity inspection rates for imports from all jurisdictions, in accordance with World Trade Organisation requirements, is exempt from CRIS requirements.

- *justifiability* – charges should only recover the reasonable costs (including indirect costs) of providing the service
- *transparency* – costs should be identified and allocated to the service, for the recovery period in which the service is provided.

These four principles are the criteria that have been used to assess options in the proposals set out in this CRIS.

In addition to these principles, MPI also applies the general guidance on cost recovery for public entities published by the Treasury and Controller and Auditor-General (CAG)[2].

MPI recovers costs associated with activities and services that deliver *outputs*, because it is at this level that costs are incurred. MPI charges do not generally seek to recover costs or reflect benefits associated with the *outcomes* a service may contribute to, as the linkages between services and outcomes are generally indirect and subject to a range of other influences – for example, businesses decisions by the firms to which the services are supplied.

MPI does not seek to recover the costs of all of its services. However, when it does decide to recover costs of a service, it is generally able to fully attribute the service outputs to a group of identifiable persons and businesses responsible for the risks managed by the service, and/or benefitting from it. Therefore, MPI will usually aim for full recovery of all costs of the relevant service from the responsible persons and businesses.

In addition, revenues and expenditures of most cost-recovered MPI services (including all of those in this document) are managed through memorandum accounts and it is a requirement of memorandum accounts that all attributable costs are fully recovered.

Costing and calculation methods

MPI allocates expenditure from cost centres to chargeable activities, and in the case of some levies, to particular sectors. Broadly there are three types of costs allocated to activities:

- *direct costs* - directly related to delivering a specific activity or service and typically include personnel, service specific contracts and other operating costs such as travel and equipment
- *operational support costs* - an allocation of costs of administrative support and management associated with a specific service or group of services
- *business support costs* – an allocation of corporate costs such as finance, HR, legal services, accommodation and communications.

Expenditure is adjusted to take into account the memorandum account balance, (ie eliminating any prior surpluses or deficits) to generate an estimate of total expenditure to be recovered.

Once an estimate of total recoverable expenditure has been determined, it is converted to an annualised amount and then divided by an appropriate denominator (eg annualised volumes or hours over the same forecast period) to determine the chargeable rate.

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2 As set out in http://www.treasury.govt.nz/publications/guidance/planning/charges/settingcharges-apr17.pdf and http://www.oag.govt.nz/2008/charging-fees/docs/charging-fees.pdf/at_download/file respectively.

Consultation

The proposals were included in a discussion document *A review of cost recovery for selected services provided by the Ministry for Primary Industries* released on 21 February 2018 with a four week consultation period. Submissions were sought from affected businesses and other stakeholders.

39 submissions were received. The responses to specific proposals are discussed in individual sections following; however, there were four key themes from the consultation:

- *transparency*: submitters wanted more detail on the analysis of options, more justification of proposed cost increases, and improved reporting of cost recovery charges and memorandum accounts, including confirmation that cross-subsidisation is not occurring. MPI has work underway to address these concerns.
- *efficiency of service delivery*: submitters generally considered MPI to be inefficient, particularly in regard to circuit verification services.
- *costs of compliance to small and remote business*: in particular, submitters on the food system proposals considered the increases significant. MPI will undertake work to identify opportunities to make compliance easier for small food business in terms of time, effort and money while maintaining food safety standards.
- *importance of biosecurity:* this was noted, along with the need to properly fund biosecurity services.

Proposal: increase the Biosecurity System Entry Levy (BSEL)

This proposal aims to improve equity by charging importers the full costs of biosecurity services at the border relating to imported goods. To do this it is proposed to increase the maximum levy rate to enable an increase in the Biosecurity System Entry Levy (BSEL), including recovering the full costs of the Joint Border Management System (JBMS) component of the BSEL.

Status Quo

The Biosecurity Act 1993 sets out a system for managing biosecurity risks faced by New Zealand. This is achieved through a series of interconnected activities that reduce or minimise risk at different points in the import/export supply chain, including:

- *pre-border* – setting import health standards[3] to support the management of risk before it arrives in New Zealand, developing international standards and rules and entering into trade agreements and bilateral arrangements for biosecurity cooperation to support exports; these services are funded through a mix of Crown funding and cost recovery.
- *at and around border* – processing cargo, people and craft as they enter New Zealand; these are predominantly cost recovered.
- *post-border* – surveillance, readiness, response and long-term pest management; these are predominantly Crown funded.

Current cost recovery mechanisms

The BSEL recovers some of the costs MPI incurs to manage biosecurity risks posed from the importation into goods into New Zealand. This is intended to fund investment in the biosecurity system to manage demand for biosecurity clearance of increasing volumes and changing risk profiles of goods entering New Zealand.

The BSEL is collected on all consignments[4] of imported goods for which an import entry or equivalent documentation is lodged with the New Zealand Customs Service (Customs). For the vast majority of consignments, the requirement to lodge an import entry is triggered by the consignment attracting Customs duties (GST and any tariff or other duty payable) of $60 or more[5] (this threshold is referred to as the *de minimis*).

The BSEL also recovers some costs associated with the JBMS as a component of the levy. The JBMS was introduced in 2013 to provide a single point of contact for customers who are required to engage with Customs and MPI at the border.

The Biosecurity Act sets out the cost recovery provisions in Part 6 and s165. The Biosecurity (System Entry Levy) Order 2010 (the Levy Order) is made under s137.

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3 Import health standards are documents issued under section 24A of the Biosecurity Act 1993 that state the requirements that must be met before high-risk goods can be imported into New Zealand.

4 'Consignment' includes all goods listed on an import entry lodged with Customs seeking permission to import the goods. The import entry is an electronic document used for primary screening purposes by MPI and charged at a single BSEL rate.

5 Generally this equates to a consignment value of $400 but for some types of goods a lower value may still attract this amount of duty.

Part 8 of the Levy Order sets out the maximum rate of the levy (currently $18); the Director-General of MPI may set a levy rate up to this maximum through the normal gazetting process. Part 6B sets out the levy rate, which is currently $17.37 (including the JBMS component).

Revenue and expenditure associated with the clearance of cargo entering New Zealand is managed primarily through The *Border Biosecurity Clearance Fees* memorandum account. Approximately 78% of expenditure and revenue managed through this account relates to the BSEL.

Problem Definition

The Biosecurity Act requires MPI's Director General to ensure its biosecurity costs are recovered in accordance with the principles of equity and efficiency where funding is not provided by Parliament.

Since the BSEL was last reset, the costs of providing biosecurity services at the border have increased and these increases are expected to continue through the next levy period.

The cost per consignment is increasing for a number of reasons. There is a wider range of imported products entering New Zealand from a greater number of suppliers and source countries, meaning an increasingly complex risk profile. This in turn is making biosecurity risk management more challenging than would be indicated purely by growth in import volumes.

The cost increases are also due to additional investment in the resources and infrastructure required to cope with increasing volumes and more complex risk profiles of consignments. Other investment includes a workforce planning tool for more effective deployment of staff, and capability standards to ensure consistency and quality across the country.

These investments in new and better services are necessary to ensure we can continue to maintain an acceptable level of biosecurity risk protection in the face of these challenges.

Additionally, the JBMS component of the BSEL is only partially recovered at present, with the Crown contributing to the costs of the JBMS since its introduction. The use of the JBMS is scheduled to apply to all imported goods from 1 July 2018; after then it is appropriate that the ongoing operating costs of the JBMS are fully recovered from importers.

The Director-General is able to increase the levy rate by notice in the Gazette but only up to the current specified maximum rate (the 'cap') in the Levy Order of $18. As discussed below, it is estimated that a rate of $20.36 is required to fully recover costs; therefore for full recovery to be achieved, the cap will need to be increased.

Policy Rationale

The objective of the levy is to fully recover the costs of MPI providing biosecurity clearance services for goods entering New Zealand.

The principle that is most relevant to the proposal is *equity.*

The outputs of biosecurity clearance services are private goods, in that:

- MPI can decline to clear goods, including when the importer does not pay for the clearance (excludable)
- the clearance is specific to the goods cleared for import (rival).

The primary beneficiaries of the service are importers who bring goods into New Zealand. They are also the risk exacerbators as it is their imported goods creating the biosecurity risk that MPI must manage. Therefore it is equitable that they be expected to meet the full costs of the services. As a corollary, it would be inequitable for taxpayers or other businesses to meet any of the costs of the services.

As the proposed charge is intended to fully recover the costs of the services from the businesses to which it is provided, without relying on funding from taxpayers or other businesses, it meets the primary objective of equity.

Proposal

Raising the cap in the Levy Order allows more flexibility for the Director-General to make adjustments to the BSEL rates without requiring decisions from Ministers. The BSEL rate is still set pursuant to the prescribed formula; and in making a decision to raise the levy rate, the Director-General must still consult if significant changes are proposed to the way in which the levy is spent.

Level of proposed fee

It is proposed to increase the BSEL by $2.99 per consignment. The proposed charges are as follows:

Table 2: Proposed fee – BSEL

$ per consignment	Current	Proposed	Change	
BSEL	13.15	15.24	2.09	+16%
JBMS	4.22	5.12	0.90	+21%
Total	17.37	20.36	2.99	+17%

This includes full cost-recovery of the costs of the JBMS from 1 July 2018, when all imports will be entered and cleared through the system.

To enable higher BSEL rates to fully recover costs (including JBMS), we propose to increase the maximum rate of levy in the Levy Order from $18 to $23. This would allow the Director-General to make future adjustments to the levy rate (after the above increase is implemented) through the existing Gazette process up to the proposed maximum of $23.

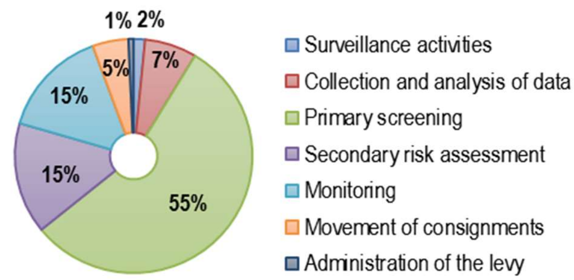
The proposed maximum levy rate allows a 13% buffer above the proposed levy rate of $20.36 to account for any future variations. This should provide sufficient headroom in the maximum rate to avoid further changes to the Levy Order in the medium term.

Forecast costs and revenue

Forecast 2018/19 cost break down by activity

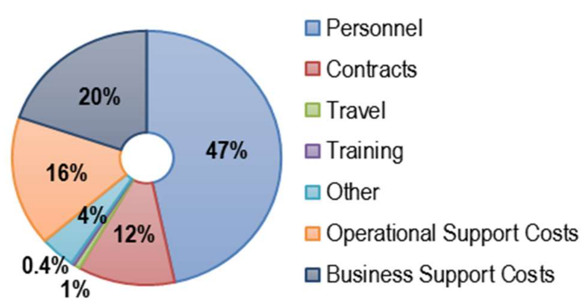
More than half the costs recovered from the BSEL relate to primary screening activities at the border, followed by secondary risk assessments for consignments identified as risk goods, and monitoring activities at high-risk sites such as ports.

(This breakdown does not include costs associated with the operation of the JBMS)



Forecast 2018/19 cost break down by MPI cost type

The largest cost component of the BSEL is personnel costs (47%). Business support (or corporate) costs are in line with most MPI services at around 20%.

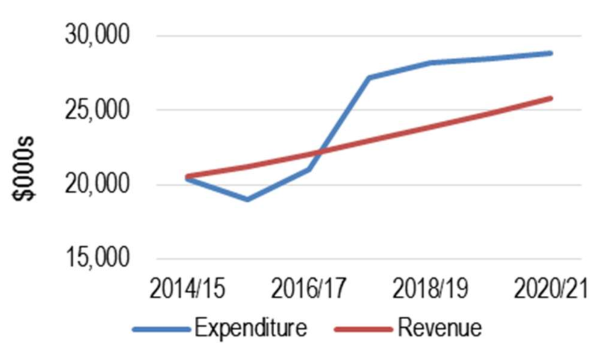


Revenue and expenditure forecasts are based on the following assumptions:

Revenue and expenditure (actuals and forecast) 2014/15 - 2020/21

Revenue has been increasing as volumes have increased and is forecast to continue at the same rate (5% per annum).

The reasons for cost increases are discussed elsewhere.

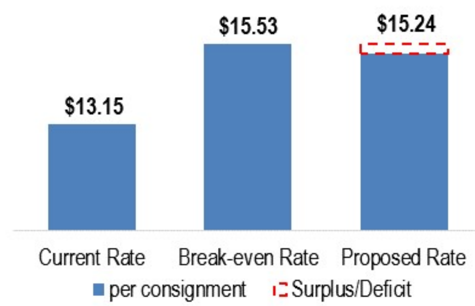


The levy rate is calculated by dividing the total costs of activities to be funded by the BSEL by the estimated volume of leviable importations. The calculation also takes into account the surplus or deficit in the year immediately preceding the new levy year (reflected in the balance of the memorandum account).

Table 3: Rate calculation – BSEL (excluding the JBMS component)

A Forecast opening surplus/(deficit)	B Forecast annualised costs for 2018/19	C Recoverable annualised costs = B-A	D Forecast volumes	Break even rate = B/D	Proposed rate =C/D
528,900	28,186,000	27,657,100	1,815,000	15.53	15.24

Note: The Levy Order requires any surplus or deficit from the previous period to be taken into account when setting a new rate. Therefore the opening surplus is deducted from (or any deficit added to) the costs to be recovered in the subsequent year.



At forecast expenditure and volumes, levy rates would break even at $15.53. However, because there is a small opening surplus in the memorandum account, this offsets the levy rate by $0.29 (shown in red on the third column in the graph on the right).

The total impact of the proposal to MPI will be an additional $5.4 million per annum from 1 July 2018. This will enable full recovery of costs, including planned investment in the biosecurity system, and the memorandum account should balance by 30 June 2019. MPI will continue to monitor how the memorandum account balance is tracking. The levy rate is reviewed annually and reset if required.

If the volume of consignments is significantly different from the forecasts, volumes 2% higher or lower would result in higher or lower revenues of $0.74 million respectively, and a surplus or deficit in the memorandum account of that amount by 30 June 2019.

As there is limited scope to rapidly adjust MPI resourcing for border biosecurity, significantly higher or lower volumes would initially result in slower or faster clearances of goods (rather than cost increases or decreases), until MPI is able to adjust its resource allocation in line with volumes.

Efficiency and productivity improvements

MPI is continuously looking for ways to improve efficiency and reduce compliance costs. However as noted above, increased import volumes are associated with a more complex risk profile of goods entering New Zealand, which is driving per consignment costs upward.

Intelligence and risk-based profiling is also becoming increasingly important to the identification of higher-risk goods, craft, people and pathways. MPI, with other border agencies such as Customs, is using improved technology, better information and data analysis to allow for more effective and efficient risk management. These tools allow MPI to better prioritise and target resources at higher-risk goods, people, craft and pathways, while facilitating lower-risk trade and travel.

Other options considered

Other options have been considered but it is not intended to proceed with them.

Maintain status quo for another year

Maintaining the status quo by waiting another year before increasing the BSEL is not technically permitted under the current Levy Order because the formula prescribed for the levy includes the estimated annual expenditure. The only way to avoid an increase to the BSEL in 2018/19 is for MPI to reduce expenditure attributable to the levy. Recent investments in frontline staff, infrastructure and technology mean this is unlikely to be achievable, and there would be a deficit of $5.4 million in 2018/19.

Raise the BSEL to cover costs other than for the JBMS

Under this option costs for services other than the JBMS would be fully cost-recovered, but there would still be partial Crown funding for the JBMS. This option would be less equitable than full cost recovery. Taxpayer funding has already supported a significant portion of the costs associated with JBMS, including development costs. At the point that the system is fully implemented (from 1 July 2018), it is appropriate that ongoing operating costs are met by beneficiaries of the service (i.e. importers).

Increase the BSEL but only to the regulated maximum threshold

Increasing the BSEL only to the regulated maximum threshold, from the current $17.37 to $18.00, would constitute a significant under-recovery. It would mean the taxpayer would continue to partially fund the costs of JBMS, and would start topping up part of the costs of the BSEL. The total impact would be $4.3 million per annum.

This would reduce the impact of the rate increase to importers, but MPI would face increasing cost pressures from costs of border biosecurity. This option may be marginally more administratively efficient, as it avoids the need to raise the cap in the Levy Order. However, this is a short-term benefit as the cap and full recovery of JBMS and BSEL will need to be considered again for 1 July 2019.

A higher cap

Options for raising the maximum levy rate (the cap) were also considered. A cap of $25 was consulted on, which would provide for a 23% buffer for managing increasing costs.

However, this buffer is larger than is expected to be necessary for cost increases in the foreseeable future, and could be seen as inconsistent with MPI's commitment to efficient provision of services.

Impact analysis

Impacts on levy payers

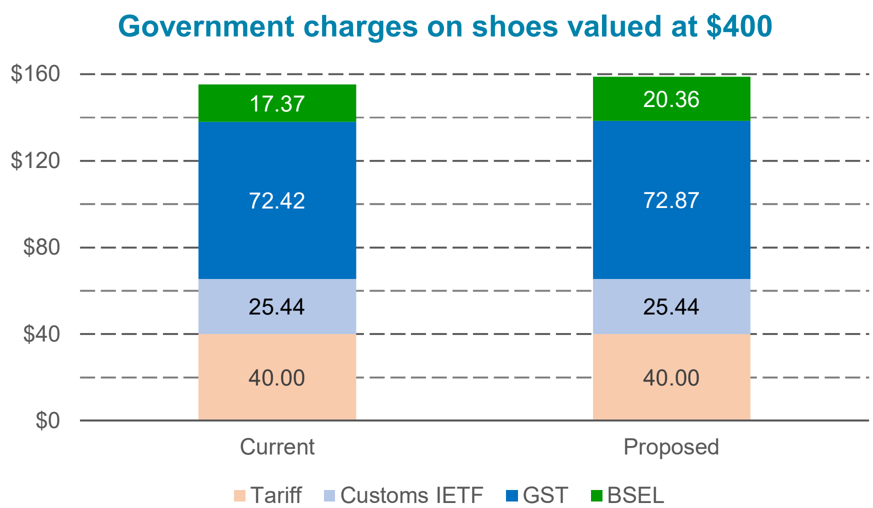
Increasing the BSEL rate will affect all importers of goods valued over approximately $400. This increase is unlikely to have a significant impact on importers, the majority of whom are businesses importing in bulk, as the BSEL is payable per consignment rather than on the individual goods within each consignment. The volume of imports is also unlikely to be affected as the proposed increase per consignment is minor compared to the value of the goods.

There may be some impacts on members of the public who import goods from overseas if they attract Customs duties of $60 or more. For those required to pay the BSEL, total fees and duties payable (GST, Import Entry Transaction Fees and other Customs duties – see the case study below) would rise from $126.73 to $132.17, an increase of 4.3%. The BSEL would will still represent the smallest portion of total fees and duties (18%).

Case study –Shoe imports

The BSEL is payable on imports that attract duties above NZ$60. For shoes, this means an import valued at or above approximately NZ$230, because footwear is also subject to tariffs (otherwise known as Customs duty).

The impact of proposed changes to the BSEL on an imported pair of shoes valued at NZ$400 is illustrated below.



(1) *For these goods the BSEL would include the JBMS component.*

(2) *'GST' includes GST payable on the value of the goods themselves ($60), plus GST on the tariff, Customs' Import Entry Transaction Fee (IETF) and the BSEL*

The increase in the BSEL is $2.99, plus an additional $0.45 GST on this amount.

For larger commercial imports the financial impact will be the same, $2.99 plus GST more per consignment. Given that consignments for commercial importers are generally valued at significantly more than for consumers (and frequently include multiple items), the impact per item will be significantly less.

The final incidence of the BSEL will depend on the extent to which importers pass it on to final consumers. As indicated above, even if the fee is fully passed on the impact would be minimal, especially where the fee applies to multiple goods in a single consignment.

International comparison

MPI is the sole provider of biosecurity clearance services. For comparative purposes, the Australian system is the closest to New Zealand's for passenger and goods clearance and cost recovery. New Zealand's system compares favourably with Australia in terms of cost recovery.

In Australia the biosecurity system is regulated by the Biosecurity Act 2015 and administered by the Department of Agriculture and Water Resources. The Department's Charging Guidelines provide lists of services that are provided in the context of imports and exports, eg permits, certifications, inspections and audits or post-quarantine and the charges for these services.

Table 4: Comparison with Australia
($NZ unless otherwise stated)

	New Zealand (current)	Australia
Biosecurity – Border entry for goods	Biosecurity System Entry Levy of $17.37 (including JBMS) for goods with duty exceeding $60 (generally equivalent to consignment value of $400)	No charges for goods valued up to $A1,000. Import entry charges apply on goods exceeding this and will be charged $A33 (for air cargo) or $A42 (for sea cargo).
Biosecurity inspections and audits	$102.27 per hour for each inspector or biosecurity adviser involved $186.30 per hour for veterinary inspection	Inspection rates range from $A160 to $A200 per hour, though audit and inspection costs vary based on who is performing the inspections and what is being inspected

Consultation

Responses on this proposal were received from 9 (nine) submitters, including five in support (one conditionally), three opposed and one unclear.

Submitters in support commented on the value of the biosecurity system, and the need to adequately resource it to provide effective protection for New Zealand's primary industries.

The main condition requested was ensuring that the MPI Director-General would consult with industry on any changes to the rate within the cap and/or that the $25 cap is too high ($22 was proposed).

Opposing views included:

- a pest free primary sector is effectively a true public good and should be funded by the Crown
- the maximum levy rate should not be increased and MPI should be able to manage the memorandum accounts without the additional 'headroom'
- more information is required to justify full cost recovery of the JBMS, and an independent evaluation of the JBMS should be carried out before a decision is made to fully cost recover it.

MPI's response to these submissions is discussed in the following section.

Conclusions and recommendations

Since the BSEL was last reset, the costs of providing biosecurity services at the border have increased. Expenditure is projected to continue to increase more rapidly than import volumes and revenue, primarily due to additional investment in frontline staff and infrastructure to manage a more complex import risk profile.

To meet increased costs it is proposed to increase the BSEL to $20.36 per consignment to adequately fund biosecurity services at the border.

The maximum levy cap is designed to allow MPI the flexibility to respond more efficiently to moderate changes in volume and cost, pending the next formal reset of the BSEL. An increase in the current cap of $18 is required to enable the BSEL to be increased to the proposed level.

MPI recommends increasing the levy cap to $23, rather than $25 as initially proposed, to incentivise efficient management and a continuous programme of improvements within the biosecurity system, and demonstrate its commitment to efficient provision of services. The proposed cap provides a buffer of 13% above the proposed BSEL rate.

The JBMS component is scheduled to apply to all imported goods from 1 July 2018. It is appropriate that the ongoing costs be fully recovered from importers and the Crown contribution to the JBMS costs cease.

Therefore MPI proposes to proceed with:

- the increase in the maximum levy rate to $23
- the increase in the BSEL rate to $20.36
- all imports being charged the JBMS component of the BSEL.

There is currently no requirement in the levy order for the MPI Director-General to consult with affected parties when levy rate is reset within the maximum cap. As part of the First Principles Review of Cost Recovery (the Review), MPI is committed to engaging with industry in an open and transparent way, including consulting with affected parties whenever a rate is reset. MPI intends to include the question of whether this process is formalised in respect of the BSEL in the Levy Order, as part of the Tranche 2 work programme for implementation on 1 July 2019.

Implementation plan

To give effect to this proposal, the Levy Order will be amended to increase the maximum levy rate from $18 to $23. At the same time the rates in the Levy Order will be changed from $17.37 to $20.36 for the next levy period from 1 July 2018, and extended to apply the JBMS component to all imports.

As this is an adjustment to an existing levy we do not anticipate any increased compliance costs. Fee payers will be notified of the changes through key industry groups (e.g. Customs Brokers and Freight Forwarders Federation of NZ Inc).

Proposal: extend the levy period for the Border Clearance Levy (BCL)

This proposal aims to improve transparency and efficiency recovering costs of biosecurity services at the border relating to travellers entering New Zealand from abroad. It is proposed to enable the Director-General of MPI to set the BCL levy period to up to 36 months (rather than the current 12 months), to enable flexibility to smooth adjustments over time and align with Customs' levy period.

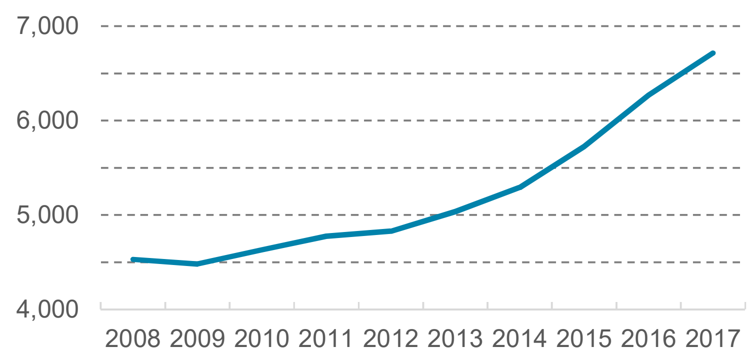
Status quo

The Biosecurity Act 1993 provides the legislative framework to ensure effective management of New Zealand's biosecurity system. See the previous section for a full description of the system.

Travellers arrive in New Zealand via air or cruise pathways or on private vessels (ie yachts). MPI (and Customs) provides a range of border services to manage biosecurity and other risks for all travellers arriving to New Zealand.

The number of people crossing the border (both visitors and New Zealand residents) has been increasing rapidly in recent years, especially since 2012.

Total passenger arrivals into New Zealand
(000 persons: calendar years)



Source: Statistics New Zealand Infoshare [downloaded 23 March 2018]

In 2017, 6.7 million people arrived in New Zealand, an increase of 48% since 2008. The growth is expected to continue. In 2016/17 eight new international airlines introduced services to New Zealand. International visitor arrivals are forecast to grow by 30% between 2017 and 2023.[6]

One consequence of this growth is that biosecurity risks are growing in scale and complexity, and New Zealand is being exposed to more and different pests and diseases from a wider range of sources. The biosecurity risk profile is also becoming more complex because the mix of travellers is increasingly diverse, particularly with significant growth of travellers from Asia.

[6] Source: Ministry of Business, Innovation & Employment (MBIE 2017) *MBIE tourism forecasts 2017-23* http://www.mbie.govt.nz/info-services/sectors-industries/tourism/tourism-research-data/international-tourism-forecasts/2017-2023-forecasts [downloaded 22 March 2018]

Over the past few years MPI has strengthened many parts of the biosecurity system through new initiatives. Intelligence and risk-based profiling is becoming increasingly important to identification of higher risk goods, craft, people, and pathways. MPI, with other border agencies such as Customs, is using improved technology, better information, and data analysis to allow for more effective and efficient risk management. These tools allow MPI to better prioritise and target resources at higher risk goods, people, craft, and pathways, while facilitating lower risk trade and travel.

Current cost recovery mechanisms

MPI's and Customs' costs for processing travellers are recovered via the Border Clearance Levy (BCL - also known as Border Processing Levy), which came into force on 1 January 2016. The purpose of the BCL is to ensure that Customs and MPI are resourced to manage risks at the border effectively.

The biosecurity component of the BCL is set under the Biosecurity (Border Processing Levy) Order 2015, which requires the levy rate to be set annually according to a specific formula (requiring any surplus or deficit from the previous period to be taken into account when setting a new rate).

The biosecurity component of the BCL can be set by the Director-General of MPI by notice in the New Zealand Gazette, up to prescribed maximums.

The Levy Order specifies a levy period of 12 months beginning on 1 July and ending on 30 June. This requires MPI to review and, if appropriate, reset the levy annually and notify the rates in the Gazette. However, the Customs and Excise (Border Processing Levy) Order 2015 requires that Customs manages its revenue over a 36 month levy period.

MPI's current 12 month levy period means that any surpluses or deficits must be recovered or returned during the next 12 month period.

The initial levy period was set to expire on 30 June 2018.

Problem definition

Although the 12 month levy period allows MPI to respond to any changes in expenditure or revenue, it could create volatility in the levy rates if there are major fluctuations in expenditure or revenue (volumes) and therefore unstable annual balances in the memorandum account. This volatility means that the levy rate could increase or decrease significantly from year to year. Large surpluses or deficits in the memorandum account can contribute to volatility in the BCL because of the requirement to return/recoup these in the subsequent 12 months.

As discussed above, traveller volumes have increased dramatically over recent years, at a much higher rate than was forecast when the BCL was initially set. This is one reason for the current reduction proposed in the BCL; as a result of traveller volumes being significantly higher than forecast over the first 30 months of the BCL, revenue has also been much higher than forecast. This has resulted in a projected surplus of $9.55 million at 30 June 2018. This would represent 6.6% of revenue over the 30 month period, which must be returned within one year through setting the BCL below breakeven level.

However, if this results in the memorandum account moving to an approximately zero balance by 30 June 2019, it is likely that the BCL rate would have to be increased in the following year (assuming the breakeven levy rate is similar to the estimate for 2018/19). The 12 month levy period prevents MPI from smoothing impacts over a longer period. This causes surpluses or deficits because of the lag between changes in traveller volumes and revenue, and the time needed to scale service levels up or down to deal with changes in volumes.

It is feasible to rapidly adjust the BCL to accommodate changes, but the resulting volatility could cause two problems. Firstly, as the levy is generally factored into ticket prices, the travel industry needs to be notified of the new rates months in advance to ensure carriers can recover the correct amount from travellers (especially for cruise passengers, whose tickets may be purchased up to two years in advance).

Changes in the BCL resulting from surpluses and deficits may also create equity issues between people travelling in different levy periods, who could be charged different rates notwithstanding the fact that the same services are being provided at similar costs.

Proposal

MPI proposes to amend the Levy Order to set a levy period of *up to* 36 months. The levy period would continue to run from 1 July to 30 June. The Levy Order would be gazetted at least every 36 months.

Changing the BCL levy period from 12 to up to 36 months requires an amendment to clause 3 of the Levy Order, by amending the definition of 'levy period' to a period 'of up to 36 months'.

If progressed, the Levy Order would be amended by 1 July 2018, so that levies could be set for longer periods from 1 July 2019 onwards.

Providing for a longer levy period provides the flexibility to smooth impacts over an extended time if that is considered appropriate; in particular, it enables MPI to recover deficits or return surpluses more gradually than is possible within 12 months.

The proposal would allow MPI to reset the levy more frequently if significant surpluses or deficits accumulate within the 36 month levy period, but would also provide greater flexibility to manage the financial performance of the memorandum account over a longer period of time. This is expected to smooth out any volatility due to changes in passenger volumes or costs.

The proposal does not involve setting new BCL rates, which is done separately. Current and new BCL rates are set out below.

Table 5: Border Clearance Levy rates

$ per traveller	Current (*to 30 June 2018*)	New (*from 1 July 2018*)	Maximum rate
Non-cruise ship travellers	$8.38	$7.30	$8.80
Cruise ship travellers	$12.20	$5.34	$17.90

The process to reset the rates from 1 July 2019 will be undertaken independently of this proposals.

Other options considered

The alternative option is to retain the status quo of a 12 month levy period. This would not address the problems identified above of volatility in setting levy rates and misalignment with the Customs levy period.

Other levy periods were also considered, but MPI considers that a maximum of 36 months aligns with Customs and provides for more stable rates, while also ensuring that rates would be reviewed within a suitable timeframe (ie at least every three years).

Impact analysis

Equity will be improved because passengers travelling at different times are more likely to be charged a similar levy rate, as a 36 month levy period will enable the impact of levy changes to be smoothed over a longer period of time.

Extending the levy period to up to 36 months will make it easier for MPI to manage the impact of any surplus or deficit in the memorandum account or any changes in the cost to deliver the service.

Consultation

Responses on this proposal were received from 12 submitters, including nine in support (six conditionally), one opposed and two unclear.

Those that supported the proposal acknowledged the increased levy period would provide greater stability and certainty for industry and flexibility for MPI. For some submitters, support was conditional on a number of factors; primarily that the MPI Director-General consult with industry when the levy is reset (within the cap), and that a trigger for a review be set in advance. Some suggested that both of these requirements should be included in the Levy Order.

There was a broad concern about accumulation of surpluses, with some submitters proposing MPI's forecasts should be more closely aligned to industry's to ensure greater accuracy and avoid excessive surpluses. Some also requested that interest should be accrued on memorandum account surpluses, although this is too broad an issue (subject to Treasury requirements for memorandum accounts) to be considered here.

The opposing submitter argued for closer monitoring of financial performance to avoid excessive deficits or surpluses.

MPI's response to these submissions is discussed in the following section.

Conclusions and recommendations

This proposal provides greater flexibility to manage the financial performance of the memorandum account over a longer period of time. This should also improve equity because passengers travelling in different levy periods or at different times are more likely to be charged a similar levy rate. Moving to three yearly reviews will also align with Customs' Levy Order, improving transparency and efficiency for industry and travellers.

MPI therefore recommends proceeding with the preferred option, to amend the Levy Order to set a levy period of up to 36 months.

Some other issues raised in submissions cannot be addressed immediately but merit further examination as part of the Tranche 2 work programme, for implementation on 1 July 2019:

- whether consultation with affected parties when levy rate is reset (within the cap) should be formalised in the Levy Order
- determining triggers for a review of the rate during a levy period (such as dollar amount or percentage above and below forecast revenue)

- a process for the cruise and air travel industries to provide input into MPI traveller forecasts.

Implementation

Changing the BCL levy period from 12 to up to 36 months requires an amendment to clause 3 of the Biosecurity (Border Processing Levy) Order 2015. The proposal would amend the definition of 'levy period' to allowing for a period 'of up to 36 months'.

If progressed, the Levy Order would be amended by 1 July 2018, so that from 1 July 2019 levies could be set for a period of up to 36 months.

The proposal does not involve any direct fee update so there is no significant implementation risk.

Proposal: update Animal Products Act levies

This proposal aims to improve equity and justifiability by ensuring businesses using standards-related services under the Animal Products Act (APA) are charged full costs, by updating levies for red meat, dairy, and fish processors to recover historical and ongoing deficits.

Status quo

The Animal Products Act 1999 (APA) applies to the production and processing of animal material and products, and covers a wide range of businesses – meat processing, fish and shellfish, dairy products and a diverse group of other processors – for domestic and export markets. MPI provides a range of regulatory services under the APA that aim to minimise and manage risks to human or animal health arising from the production and processing of animal material and products. It also facilitates the entry of animal material and products into overseas markets by providing the controls and mechanisms needed to provide official assurances of compliance with foreign governments' requirements for entry into those markets.

Current cost recovery mechanisms

Part 9 (sections 113-125) of the APA provides the statutory authority for MPI to charge for services provided under the Act. Cost recovery is prescribed in the Animal Products (Fees, Charges, and Levies) Regulations 2007 and the Animal Products (Dairy Industry Fees, Charges, and Levies) Regulations 2015.

The APA, like other Acts in the food system, requires cost recovery to be aligned with the principles of equity, efficiency, justifiability, and transparency. It provides flexibility in the types of fees, charges and levies that can be applied, including allowing for direct, indirect and average costs to be recovered.

It also establishes a wide range of administrative provisions, including parameters on the recovery of historic deficits (up to 4 years after they are incurred), requirements for consultation, setting penalties, and provisions for fees to be waived. The APA and other food system Acts require a review of cost recovery to be completed every three years.

Levies collected under the APA are used to pay for the development of domestic and export standards, and to monitor compliance with the standards at an industry level. Revenue and expenditure for APA standards are accounted for through the *Standards Setting for the Food Industry* memorandum account (which also accounts for standards for the Agricultural Compounds and Veterinary Medicines Act 1997).

The APA covers a highly diverse range of businesses; as a result of this there are approximately 30 different levy categories, with a range of volume-based and annual levies and in some cases, separate rates for domestic and export production (reflecting differences between domestic and export standards). Revenues and expenditures for different levy categories are accounted for separately.

Problem definition

MPI is required to recover all costs not funded by the Crown. Under the APA, a deficit may be recovered in up to the four years after it was incurred.

The memorandum account has accumulated a significant deficit since levies were last reset from 1 July 2015, with the largest deficits related to red meat, dairy and fish processing. The levies for these industries also need to be updated to account for changes in forecast costs and volumes (in some cases, between domestic and export standards within the same industry), as discussed below.

Red meat and dairy products

There have been increases in services and associated costs in recent times because more chemical residue testing has been required by governments in export markets. In addition, more resources have been required to develop and review export food standards for dairy products. The latter is a result of the expiry of Crown funding for staff engaged as a result of the 2013 whey protein concentrate inquiry, which will now need to be funded from the levy.[7]

These costs are both historical (they have contributed to a small deficit in the memorandum account for these industries which must be recovered) and ongoing. They equate to approximately $2 million per annum for residue testing and $1 million for food safety standards, above what was budgeted when current levies were set in 2015.

Fish processing

MPI had previously built up a memorandum account surplus of approximately $540,000 in respect of fish processors prior to 30 June 2015. In the levies set from 1 July 2015, the rates for fish were set to return the surplus to the industry. As a result the surplus will be reduced to $246,000.

The impact of applying the surplus to reduce the rates is shown in Table 7.

Deer processing and other levies

Standards for deer processing are now manged as part of red meat standards, meaning that processors of deer now receive the same services as other red meat processors. It is therefore equitable for deer processors to be levied on the same basis as other red meat processors, with levies based on total costs of red meat standards, apportioned to deer using lamb equivalent conversion factors.

There are also categories under red meat covering small numbers of animals processed (horses, ostriches and emus, and potentially new species such as buffalo). Small categories present a difficulty in setting levies; namely, robust attribution of relatively low costs to relatively small processing volumes. The resulting levy rates may be highly sensitive to differences in estimates of resources applied to those groups. This means that the attribution of costs used to calculate the rates may not be fully robust, so that the rates would not meet MPI's or industry's expectations of transparency.

With deer moving into the red meat levy structure, and given similarities between these species, it is opportune to consolidate these rates into a single levy category.

Policy rationale

Businesses that operate under the APA benefit from having standards that provide clear statements of the requirements that they must meet in order to supply their markets, and from a well-regulated, well-functioning domestic market and the ability to export abroad.

Standards-related services are club goods, in that they are:

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[7] In 2013, there was a suspected contamination of whey protein concentrate. Testing later confirmed no products had been contaminated.

- *excludable* – MPI can restrict access to them by requiring businesses to be registered (as part of the wider regulatory system)
- *non-rival* – one business' use of the standards does not preclude or limit its use by another.

Levies are generally considered appropriate for recovering the costs of club goods as they are a way to secure a contribution towards the costs of services provided to the 'club' of businesses, in the absence of a strong link between the services and delivery to individual businesses.

APA levies are generally apportioned to 'club;' members based on production volumes (eg number of animals processed or thousand kg of dairy products exported), on the basis that each business' share of total industry volumes is a good proxy for its share of the benefits of standards-related services.

Proposal

Level of proposed levies and timing of implementation

MPI proposes to update the domestic and export levy rates for red meat, dairy, and fish processors. The following adjustments are proposed:

- to adjust red meat, dairy and fish levies under the APA to reflect the Standards memorandum account deficit relating to these levies, ongoing under-recovery of costs and re-balancing between export and domestic components
- to simplify the red meat levy by including deer in it, and consolidating deer and smaller red meat categories (horses, ostriches and emus) into a single '*Deer & other large species*' category.

This would result in the following increases in levy rates.

Table 6: Impact of alternative implementation dates for APA levy updates
(% increase unless otherwise specified)[(1)]

	Effective date(s)		
Levy category	**1 July 2018**		**1 July 2019**
Red meat (lamb equivalent)[(2)]			
export	11%		
domestic	-33%		
Dairy			
processors	43%	OR	61%
exporters	8%		15%
Fish processing			
export	124%		
domestic	12%		

Notes:

(1) Percentage changes are rounded.

(2) The levy rate for red meat is calculated on a 'per lamb' basis, then scaled up by 'lamb equivalent' conversion factors which reflect the relative processing times for other species. For example, bobby calves require the same amount of processing as lambs, and therefore are charged at the

same rate; whereas beef cattle require seven times as long as a lamb to process and attract a levy seven times larger.

(3) For some species, the export rates also include $0.025 per lamb equivalent which is collected on behalf of the Meat Industry Association, in addition to the recovery of MPI costs. The different % changes for the red meat levy are because of the inclusion of this, which it is assumed will not change. MPI cost recovery changes by equal amounts in both years.

A full list of proposed rates is shown in Table 12.

Four options for the timing of implementing changes to the levies were presented for consultation:

1. update the levies with effect from 1 July 2018. This option would address the deficit relating to the levies, under-recovery of costs and re-balancing between export and domestic components, targeting a balanced memorandum account by 30 June 2021.
2. update all levies with effect from 1 July 2019 (targeting a balanced memorandum account by 30 June 2022 for the latter). This delay means that increases when implemented would be significantly higher than under Option 1.
3. update the levies with effect from 1 January 2019. This option would address the deficit relating to the levies, under-recovery of costs and re-balancing between export and domestic components, targeting a balanced memorandum account by 30 June 2021.
4. update the levies in two equal steps, on 1 July 2018 and 1 July 2019, targeting a balanced memorandum account by 30 June 2021.

The first option, implementation from 1 July 2018 is preferred as it would:

- recover costs that have already been incurred by MPI, and prevent further accumulation of costs
- avoid financing costs to the Crown resulting from delayed revenues
- avoid larger increases when fees are ultimately raised (and risks of relitigation of fee increases at that time).

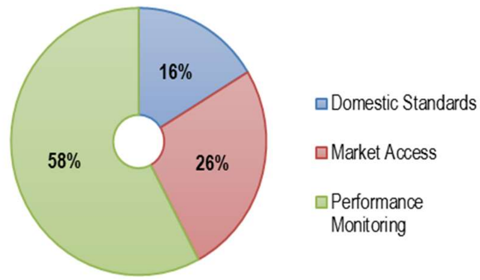
Forecast costs and revenue

APA levies are split between domestic standards, market access and performance monitoring (and for fish, separate export standards), although these are allocated differently for different levy types.

Forecast 2018/19 cost break down by activity

Red meat export levy

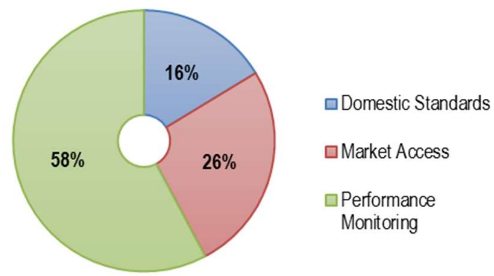
(= domestic standards + export 'top up' comprising market access and performance monitoring; applied to all stock processed at export premises)



Dairy levies

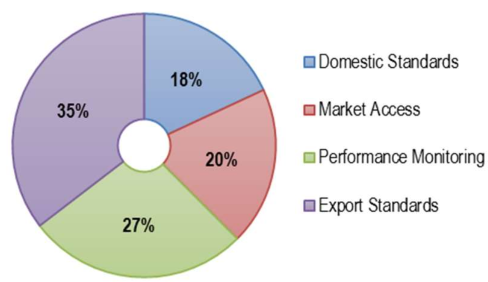
(processor levy = domestic standards plus performance monitoring; applied to volumes collected

(export levy = market access; applied to volumes exported)



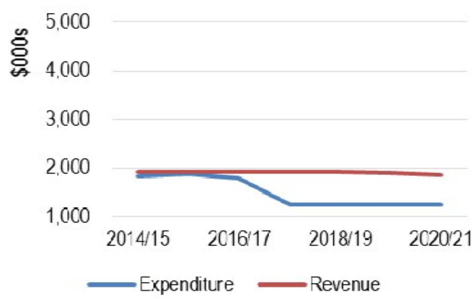
Fish export levy

(= domestic standards + export 'top up' comprising export standards, market access and performance monitoring; applied to all fish processed for export)

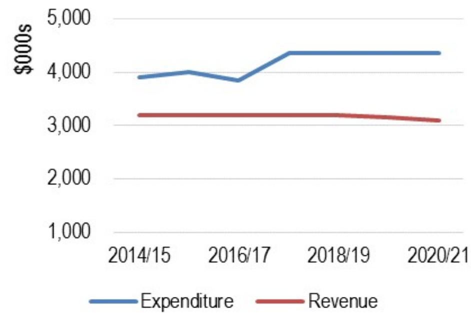


Revenue and expenditure (actuals and forecast) 2014/15 - 2020/21

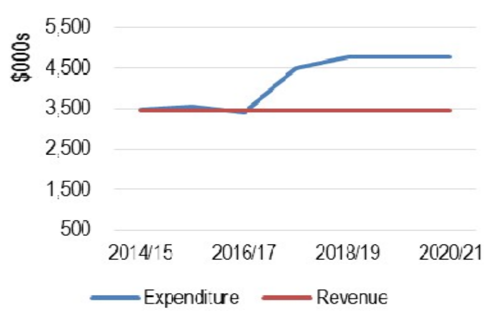
Red meat - domestic



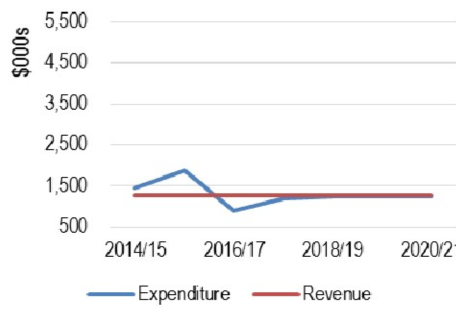
Red meat - export



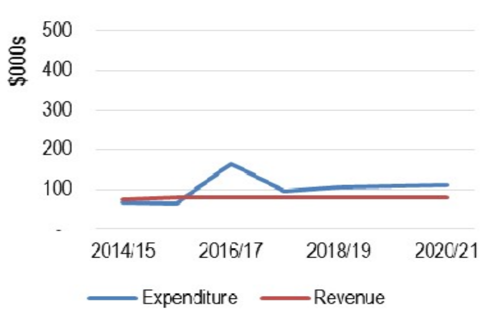
Dairy - processing



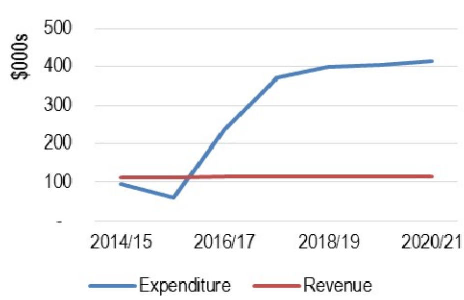
Dairy - export



Fish - domestic



Fish - export



These forecasts are based on the following assumptions:

- Increases in services and costs to be recovered primarily through red meat and dairy levies include:
  - $2 million per annum for residue testing
  - $1 million for food safety standards.
- Meat processor volumes are forecast to decrease in line with recent trends, by 0.1% in 2017/18, 1.1% in 2018/19 and 1.7% in 2019/20. In particular, cattle slaughter numbers are expected to decline as dairy prices recover and milking herds expand rather than retrench.

- Milk solids production dropped in 2016/17 due to a lower dairy pay out for farmers. As dairy prices gradually recover it is expected that milk solids production will steadily increase. Dairy processor volumes are forecast to increase by 2.2% in 2017/18, 0.5% in 2018/19 and 2.1% in 2019/20.
- In the absence of any specific forecasts for fish processors, MPI has assumed that fish processed for domestic consumption and export remain at 2016/17 levels.

The impact of the application of the surplus to fish levy rates is shown below,

Table 7: APA fish levy rates

	$ per tonne	Domestic	Export
Prior to 1 July 2015	Actual	0.40	0.82
From 1 July 2015	Breakeven(1)	0.48	1.17
	Actual(2)	0.20	0.50
From 1 July 2018	Breakeven(1)	0.27	1.34
	Proposed(2)	0.22	1.12

(1) The ‘Breakeven’ rate is the rate required for full cost recovery prior to the application of any surplus.
(2) These rates are after application of the surplus to the breakeven rates.

Applying average annual forecast costs and hours over the three years to 30 June 2021, plus recovering the opening deficit, yields the following calculation of levy rates:

Table 8: Rate calculation – APA levies

A Forecast opening surplus/(deficit)	B Forecast annualised costs(2)	C Recoverable annualised costs(3) = B-$^{A}/_{3}$	D Forecast volumes	Break even rate = B/D	Proposed rate =C/D
Red meat – domestic (*per lamb equivalent*)					
(48,906)	1,254,000	1,270,302	47,411,000	0.0264	0.0268
Red meat - export 'top up' (*per lamb equivalent*)					
(139,194)	4,355,000	4,401,398	45,044,000	0.0970	0.0980
Dairy – large processors (*apportioned on volumes of milksolids collected*)(4)					
(464,600)	4,781,000	4,936,000	N/A		
Dairy – large exporters (*apportioned on volumes of dairy mass exported*)(4)					
(360,300)	1,235,000	1,355,100	N/A		
Fish – domestic (*per tonne*)					
53,100	109,000	91,300	406,000	0.27	0.22
Fish – export 'top up' (*per tonne*)					
193,500	406,000	341,500	383,000	1.06	0.89

Notes:

(1) These calculations assume that all changes will be effective on 1 July 2018, with full recovery of deficits by 30 June 2021.
(2) Over the three years to 30 June 2021
(3) The APA provides that a deficit from any year may be recovered (or a surplus returned) over the following four years. As rate setting is done over a three year time horizon, one-third of the opening deficit has been added to the annualised costs to be recovered.
(4) The dairy levies are based on allocation of total amounts according to shares of the prior year's volumes processed or exported, rather than actual volumes being processed or exported. Therefore no volume-based rates are calculated.

Sensitivity analysis

If the volume of red meat and fish processed is significantly different from the forecasts:

- volumes 2% higher or lower for red meat would result in increased or reduced revenue of $112,000 and a surplus or deficit in this component of the memorandum account of that amount by 30 June 2019
- volumes 2% higher or lower for fish would result in additional increased or reduced revenue of $9,000 and a surplus or deficit in this component of the memorandum account of that amount by 30 June 2019.

There are no comparable volume-related risks for dairy, as the basis of the levy is to recover a specified amount according to retrospective shares of total industry volumes.

The main risks on the cost side relate to under- or over-delivery of services, or new requirements demanded by trading partners.

Efficiency considerations

Improving efficiency is not a feasible alternative to implementing levy increases, as these increases are driven primarily by increases in levels of services required by New Zealand’s trading partners.

Other options considered

In addition to the options presented above, MPI could write off the accumulated deficits to cover the lost revenue but this would be inequitable because taxpayers would contribute towards the deficit associated with a service for which they receive no direct benefit and create no risk. This could also create an unwanted precedent where deficits accumulate in other memorandum accounts.

Impact analysis

Impact on levy payers

The impact on individual levy payers will vary considerably, depending on changes within the levy category to which they belong.

The table below shows the impact of proposed levy rates on ‘typical’ small, medium and large processors in the meat, dairy and fish industries. As a corollary, costs associated with domestic meat standards have fallen and this will enable levies for processors supplying only the domestic market to be reduced.

Table 9: Impact of levy changes on typical processors
(per annum; assuming volumes unchanged)

Processor	Current	Proposed
Red Meat processors[(1),(2)]		
Small domestic *(20,000 lamb equivalents)*	$800	$540 *-33%*
Medium domestic and export *(500,000 lamb equivalents)*	$6,750	$7,500 *11%*
Large domestic and export *(2m lamb equivalents)*	$270,000	$300,000 *11%*
Very large domestic and export *(with multiple processing plants)*	$1,600,000	$1,777,778 *11%*
Fish processors		
Small processor[(3)] *(20 tonnes export, 20 tonnes domestic)*	$77.50	$77.50 *0%*
Medium processor *(400 tonnes export, 150 tonnes domestic)*	$230	$481 *109%*
Large processor *(7,500 tonnes export, 1,500 tonnes domestic)*	$4,050	$8,730 *116%*
Large processor *(with multiple plants and vessels)*	$37,900	$84,440 *123%*
Dairy processor		
Large processor *(21m kg milksolids collected)*	$39,707	$56,941 *43%*

Notes:

(1) Most meat processors slaughter a variety of animal species, with different levy rates for each type. All levies are based on 'lamb equivalents', which are conversion factors based on processing costs for different species relative to the requirements of processing lambs. To simplify the table, we have calculated (and rounded) the 'lamb equivalents' for stock of different types slaughtered by 'typical' processors.

(2) The charges faced by different processors depend on both the domestic/export mix and the levy categories, as set out in the regulations. These calculations assume the following:

- the 'small domestic' meat processor pays only the domestic meat levy on stock processed (There are few processors supplying only the New Zealand market, and they are much smaller than export plants.)
- the 'medium', 'large' and 'very large' meat processors process some stock for export; therefore they are levied at the export rate for all stock processed, regardless of their domestic/export mix (as this is how the levy is applied, per the regulations)
- the 'small, 'medium' and 'large' fish processors pay domestic and export levies on tonnages for the domestic and export markets respectively
- the dairy processor's levy is based on its share of total milksolids processed in New Zealand in the previous year; this calculation assumes that constant volume results in an unchanged share.

(3) There is a minimum APA levy of $77.50 per annum. As the volume-based levy for this type of processor (under both current and proposed rates) is less than this, it would pay $77.50.

The tables below show the value of levy changes on export meat and dairy production relative to production and revenue on 'average' farms.

Table 10: Value of red meat levies(1) - sheep and beef farms

Farm type	Current	New	Change	Farm revenue(3)
North Island East Coast hill country	$359.56	$392.74	$33.18	$272,000
South Island Marlborough-Canterbury finishing	$309.72	$339.46	$29.75	$231,000

Notes:

(1) Export rate

(2) This table shows the levies payable on animals sent to slaughter from the most numerous classes of sheep & beef farms.

(3) The revenue estimate is based on the average payment per head for the year to September 2016 (rounded to the nearest $000) for meat only (ie excluding revenue from other products).

Source: MPI calculations from Beef + Lamb New Zealand data

Table 11: Value of dairy levies(1) - dairy farms

Herd size(2)	Current	New	Change	Farm revenue(3)
200-249	$205.95	$273.09	$67.13	$528,000
300-349	$301.50	$399.78	$98.27	$773,000
500-549	$512.80	$679.95	$167.15	$1,315,000
1500+	$1,643.08	$2,178.64	$535.56	$4,215,000

Notes:

(1) Processor and exporter levies combined; estimated as total levy amounts divided by 2016/17 production volumes.

(2) This table shows the levy payable on milk from dairy farms at the lower quartile, median and upper quartile of herd sizes, as well as on the largest farms; using production data from the 2016/17 season.

(3) The revenue estimate is based on the current Fonterra payout of $6.55 per kg (rounded to the nearest $000). Note that these estimates differ from the equivalent figures in the discussion document because of a subsequent increase in the Fonterra payout (from $6.40).

Source: MPI calculations based on data from Dairy New Zealand

The levies represent 0.02% of the average export payment for lamb and mutton[8] and 0.01% of the average export payment for beef in the year to September 2016; and 0.01% of the current dairy payout.

The final incidence of these levies – ie the extent to which they are absorbed by processors (and their shareholders) versus being passed onto suppliers through lower purchase prices - is uncertain. This depends on demand conditions in the market for supply of product to processors; the more competitive this market is, the stronger the pressures for processors to absorb levy costs

8 including skin and wool pull payments, net of processing charges

rather than pass them on to suppliers. But in many instances this distinction may not be relevant. Much meat and dairy processing is undertaken by cooperatives, where farmer-suppliers are also shareholders in the processor; so the costs of the levy are ultimately borne by the same people.

Financial impact on MPI

Overall, the adjustments to APA levy rates would increase MPI's third party revenue by approximately $3.0 million per annum. This revenue will eliminate the deficit in the *Standards Setting for the Food Industry* memorandum account and fund increasing costs relating to red meat, dairy and fish, by 30 June 2021.

Expected effects on demand for services

The increases would not have any impact on demand for MPI services, as standards-related services are delivered through what is effectively a fixed programme of work to meet the requirements of domestic and external markets. Therefore significantly higher or lower processing volumes do not affect the amount and costs of these services.

Moreover, the value of the levies is very small relative to the payments to suppliers.

International comparisons

There is no direct comparison possible with equivalent charges in other jurisdictions. For comparative purposes, MPI has looked at cost recovery systems across Australia, Canada, the UK, and the USA. Food-related services provided are similar in these countries, and in general are cost recovered; but the legislative contexts and service delivery models in each country vary considerably, to the extent that it is not possible to provide direct comparisons between costs for 'similar' services in New Zealand and elsewhere.

Consultation

The increased fees were included as one of seven proposals in a discussion document *A review of cost recovery for selected services provided by the Ministry for Primary Industries* released on 21 February 2018. Submissions were sought from affected businesses and other stakeholders.

Responses on this proposal were received from 13 submitters; 1 in support, 9 opposing and 3 whose position was not clear. Key issues included:

- transparency – cost increases were challenged, although reasons varied between industries:
  - dairy – indicated that while some increase was expected, the size of the increase was not
  - red meat - industry calculations indicated a smaller increase would be sufficient for full cost recovery; however, these calculations inly incorporated the recovery of the historic deficit and not the higher ongoing costs
- effect on small business– small dairy processors argued that the flat levy they pay is effectively much higher per kg than the volume-based levy paid by large processors (although the latter believe that they may be subsidising smaller ones).

Only one submitter[9] commented on the proposal to consolidate smaller categories within the red meat levy, supporting it.

Few submitters expressed any preference as to when the updates should be implemented. The dairy industry indicated it would prefer a later date as its budgets for the 2018/19 year have already been set.

MPI's response to these submissions is discussed in the following section.

Conclusions and recommendations

This memorandum account has an emerging deficit driven by under-recovery associated with red meat, dairy and fish processing. Consequently there is a requirement to increase levy revenues for most processors in these categories. While concerns about the increases were raised by submitters, they did not make any compelling arguments not to proceed.

Therefore MPI proposes to proceed with updating the domestic and export levy rates for red meat, dairy, and fish processors; and simplifying the red meat levy by including deer in it, and consolidating deer and similar smaller categories (horses, ostriches and emus) into a '*Deer & other large species*' category within the red meat levy structure (with a levy rate calculated in the same way as other red meat levies).

Following public consultation, the preferred implementation date is 1 July 2018.

Implementation

Changes to the relevant rates to give effect to the above proposals would be included in the Animal Products (Fees, Charges, and Levies) Regulations 2007 and the Animal Products (Dairy Industry Fees, Charges, and Levies) Regulations 2015, with effect from 1 July 2018 (or 1 July 2019 for dairy, if this option is preferred).

The proposal is a fee update with no significant implementation risk involved.

9 Deer Industry New Zealand, representing the deer industry which is most directly affected.

Table 12: Complete list of proposed APA levy rates

Levy category		Current	Proposed
Red meat levies (per head)			
Lambs, bobby calves	export[1] domestic	$0.135 $0.040	$0.150 $0.027
Sheep	export[1] domestic	$0.157 $0.040	$0.169 $0.030
Pigs	export domestic	$0.310 $0.090	$0.311 $0.067
Cattle	export [1] domestic	$0.974 $0.250	$1.047 $0.188
Goats	export domestic	$0.120 $0.040	$0.125 $0.027
Deer & other large species			
Deer[2]	export domestic	$1.38 $1.04	$0.872 $0.188
Horses	export domestic	$0.86 $0.25	$0.872 $0.188
Ostriches, emus	export domestic	$22.00 $3.50	$0.872 $0.188
Dairy levies[3]			
Milk processor *(based on milksolids collected)*		$3,441,944	$4,935,867
Dairy exporter (*based on dairy export mass)*		$1,258,824	$1,355,100
Fish levies			
Fish (per tonne)) (other than bivalve molluscan shellfish	export domestic	$0.50 $0.20	$1.12 $0.22

Notes:

(1) These rates include $0.025 per lamb equivalent collected on behalf of the Meat Industry Association, in addition to the recovery of MPI costs.

(2) Note that there is currently a partial waiver in place for deer which results in charges of $0.86 per head for export premises and $0.10 per head for domestic premises. Therefore the proposed changes will result in increases in levies for processing deer.

(3) As applied to large processors and exporters; it is not proposed to change the rates for small and medium processors and small exporters.

Proposal: introduce new charges under the Food Act 2014

This proposal aims to improve equity by ensuring businesses using MPI services under the Food Act 2014 are charged consistently for comparable services.

Status Quo

The food safety system is critical for protecting and supporting the health of New Zealanders and minimising the number of foodborne illnesses. The Food Act 2014 is one of the key pieces of legislation in the food safety system. It replaced the prescriptive 'one size fits all' approach found in the Food Act 1986 with an outcome-based approach. This provides for risk-based measures to minimise risks to public health, by setting different rules for higher- and lower- risk activities, focusing on what is most important for food safety.

The Food Act 2014 requires businesses to register plans to ensure businesses comply with legislative requirements and take responsibility for the safety and suitability of their food. This includes MPI approving businesses to operate, ensuring that risks to public health are minimised.

As the primary regulator of food safety in New Zealand, MPI provides services to approve and register food businesses under the Food Act. This ensures that businesses comply with legislative requirements and take responsibility for the safety and suitability of their food. If assessed as compliant by MPI, the business will be granted approval to operate.

Where a business is supplying 'higher risk' foods (specified in Schedule 1 of the Food Act), it is required to operate according to an approved food control plan (FCP). A business may prepare and register a custom FCP, or use one based on a template prepared by MPI (under section 39) or prepared by another party (typically an industry organisation) and approved by MPI (under section 40).

Where there is no legislative requirement for MPI to provide these services, city and district councils can also approve or register food businesses.

Current cost recovery mechanisms

Sections 193 to 214 of the Food Act provide the statutory authority to prescribe cost recovery charges along with other administrative cost recovery provisions. Cost recovery under the Act was introduced on 1 March 2016 and is prescribed in Part 2 of the Schedule of the Food (Fees and Charges) Regulations 2015.

There are a number of approval, registration, and recognition services that MPI provides to businesses operating under the Food Act which are cost recovered. However, there are some services that MPI provides or intends to provide but does not have the legal authority to charge under these regulations.

Revenue and expenditure for services under the Food Act are accounted for through the *Food Standards Assurance – Food Act 2014* memorandum account. There is a minor deficit in this memorandum account, but this is related to other existing charges and is tracking towards surplus. The next scheduled review of cost recovery arrangements under the Food Act is proposed for 2019.

Problem Definition

The Food Act requires the Minister and MPI's Director General to take all reasonable steps to ensure the costs of administering the Food Act are recovered where funding is not provided by the Crown.

Therefore, when the new Food Act was implemented on 1 March 2016, it was intended that most services provided by MPI would be cost recovered. However drafting errors in the original fee regulations mean that there is no provision for charging for some services, mostly related to registrations of FCPs. The relevant services are listed in Table 13.

Implementation has been occurring progressively since March 2016, and this will continue until the Act comes fully into force in February 2019. For this reason inability to charge for some services has not been a problem to date, as there has not yet been a requirement to provide these services. However it is expected that these services may be needed in the near future, which would mean that MPI would have to incur the costs of providing them with no ability to recover the costs.

Approvals, amendments and renewals of industry-developed templates

Some transitional Crown funding was initially provided to support implementation of the Food Act, some of which was used to develop s39 templates. MPI has since been approached by a number of industry organisations and businesses which have indicated an interest or intention to develop templates under s40. There is not sufficient transitional funding to support the development of s40 templates.

There are currently no charges for MPI to approve industry-developed templates, nor for subsequent amendments and renewals of these. The resources required by MPI to consider applications for approvals and amendments to templates could be significant, especially if it actively assists industry organisations to develop them.

MPI has the legal authority to recover these costs because they are not Crown funded. However, the absence of specific provisions in the fee regulations for approval of industry-developed templates means it cannot charge for these services.

A priori, not charging for these services appears inequitable as they create private or club benefits, and the applicant is the primary beneficiary (along with template users, who will typically be members of the industry organisation). Therefore the applicant should be charged for the service.

Registrations and renewals of FCPs based on templates

There are currently no provisions in the fee regulations for MPI to charge businesses that apply to register FCPs based on industry-developed templates nor when those registrations are renewed. Without these provisions, businesses that choose to register an FCP under an industry-developed template cannot be charged, even though those that register FCPs under MPI-developed templates would be.

The number of businesses that might seek to register this type of FCP is uncertain; however, up to 5,000 registrations is considered possible.

In addition, while there are provisions to charge for registration and renewals of an FCP based on an MPI-developed template, there are none to charge for amendments or for voluntary suspension to this type of FCP.

These omissions are inequitable as similar services are provided by MPI in both instances (and for all registration-related services for custom FCPs). It is also potentially inefficient as it may incentivise businesses to choose a particular approach to meeting Food Act requirements on the basis of whether or not they will be charged by MPI. In addition, charging for these services may improve efficiency by incentivising applicants to provide all the required information to minimise the time required by MPI to process applications.

Other approvals

There are four other services (listed in Table 13) that do not currently have charges prescribed in regulations, notwithstanding the fact that they are very similar to services for which charges have been prescribed. Not charging for these services is inconsistent with MPI's cost recovery for other approvals under the Food Act and other legislation.

This is inequitable as some businesses could be charged for certain MPI services while others using comparable services would not be charged.

Policy Rationale

Approvals, registrations, and recognitions provide direct benefits to the applicant as they enable them to operate their business. These services are private goods as they create benefits that are 'excludable', as applicants must be approved to operate, and 'rival' as an approval is specific to the applicant. Therefore, in general it is appropriate to charge the applicant directly for these services.

The principle that is most relevant to the proposal is equity. The primary beneficiaries of approvals, registrations, and recognitions are the applicant and therefore it would not be equitable for the taxpayer to fund these services.

In addition, the costs of providing the service can be fully attributed to the applicant as the sole beneficiary of the output of the service. Direct charging via fees is appropriate because MPI can efficiently identify and charge the direct user of the service.

Moreover, there is direct comparability between some of these services and others for which MPI already has authority to charge; therefore, not charging could be inequitable and/or inefficient (through incentivising businesses to choose less-preferred options to avoid MPI fees).

Recovering costs directly from applicants via an hourly rate allows the actual costs of MPI delivering these services to be recovered from the applicant. In some cases the processes and time necessary to consider an application are standardised, short and predictable; a fixed fee is appropriate for these, possibly with some recourse to additional charging for unusual or time-consuming applications.

However, the requirements on MPI for approving industry-developed templates are expected to be more substantial and less predictable. For these, payment according to an hourly rate limits the risk of under- or over-recovery, which might happen if fixed fees were used.

Proposal

Level of Proposed Fees

MPI proposes to prescribe charges for the approval, registration, and recognition services discussed in the previous section as set out in the table below. The proposed charges shown below are based on a rate of $155 per hour, which is used for existing charges for comparable services under the Food Act.

MPI will undertake a more extensive review of charges under the Food Act as part of a wider review of food system fees and levies, which is intended to be one of a series of “rolling reviews” of MPI charges which will commence from 2019.

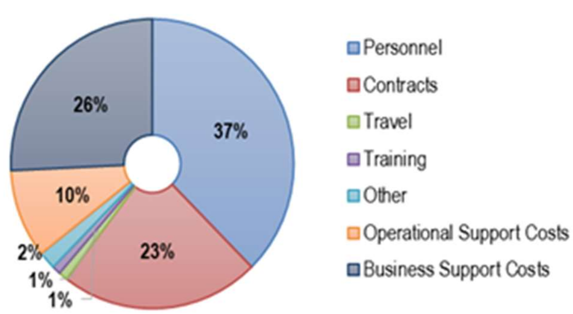
Table 13: Proposed rates for services under the Food Act 2014

Service	Proposed Fee
Miscellaneous provisions	
Renewals of laboratory approvals and amendments between renewals of the details of laboratory approvals	$77.50 per application, plus $155 per hour after the first 30 minutes
Amendments between renewals of the details of recognition of agency, person or class of persons	$77.50 per application, plus $155 per hour after the first 30 minutes
Waivers under section 53(3)(b) from the requirement for a custom food control plan to be evaluated	$348.75 per application, plus $155 per hour after the first 2 hours and 15 minutes
Approvals under section 291 to meet a requirement of the Act (except laboratory approvals) and renewal and amendments between renewals of the details of section 291 approvals	$77.50 per application, plus $155 per hour after the first 30 minutes
Template and FCP provisions	
Approval, amendments and renewals of a section 40 template	$155 per hour
Amendments and voluntary suspensions of a food control plan based on a section 39 template	$77.50 per application, plus $155 per hour after the first 30 minutes
Registration of a food control plan based on a section 40 template	$193.75 per application, plus $155 per hour after the first 1 hour and 15 minutes
Renewal of registration of a food control plan based on a section 40 template	$77.50 per application, plus $155 per hour after the first 30 minutes

The costs of approval services are made up as follows:

Forecast 2018/19 cost breakdown by MPI cost type

- The majority of costs are for personnel (37%) and contracts (23%).
- Business support costs (26%) are slightly higher than in other areas of MPI.



Revenue and expenditure

MPI is currently working with three industry organisations on the development of templates and expects more to be developed in future.

It is expected that more than 5,000 applications will be lodged for FCP approvals under these three industry-developed templates. If that number of applications were received, this would generate costs to MPI of approximately $1 million; therefore the proposed charges will increase MPI's cost recovery by that amount.

Cost recovery after the initial year is likely to be lower as the number of new registrations of FCPs using industry-developed templates would be fewer. Existing approvals would need to be renewed but costs are lower because renewals are significantly less time-consuming than approvals (half an hour versus 1 hour 15 minutes).

These are all new services, and as such, it is difficult to make accurate estimates of volumes and costs. However, as the services are driven by demand, revenue and expenditure for MPI should still align even if volumes differ from those estimated.

The volume of activity and revenue from the other approval services is expected to be minimal, up to $5,000 per annum.

Other options considered

MPI anticipates costs of up to $1 million per annum to provide these services. If the status quo is retained, these costs would need Crown funding. This would be inequitable as the taxpayer would be paying for a service that provides direct commercial benefit to the applicant, who also creates the risk that the services are designed to manage.

It would also be inequitable as there are other comparable approval, registration, and recognition services under the Food Act that are currently cost recovered.

Impact analysis

Impacts on fee payers

MPI anticipates that the costs of approvals, amendments and renewals of industry-developed templates will vary for each application, depending on the requirements set out in the Food Act for the particular industry. The time and costs to organisations developing templates could vary, especially as MPI expects to work with the organisations during the development process.

Individual registrations and renewals of FCPs based on industry-developed templates would be charged at the same rate as similar approvals under MPI-developed templates. Generally, the assessment of registration of an FCP takes 1 hour and 15 minutes, which means that the majority of applicants for FCPs would incur a one-off cost of $193.75, with subsequent renewals and amendments generally charged at $77.50. MPI expects up to 5,000 applications for new FCPs may be lodged, although not all in a single year.

More complex applications can attract higher charges, at an hourly rate of $155 (after the first 1 hour and 15 minutes); however, these are expected to be infrequent (by definition, the standardisation of information in a template is intended to simplify what is needed to complete it) and the additional MPI time may be a result of factors the applicant can control, eg provision of accurate information.

For the other approval services, it is expected there may be approximately 50 to 100 applications per year, so this would only affect a small number of fee payers.

Comparisons and impacts on demand

Approvals, renewals and amendments of industry-developed templates

At this stage it is not known what MPI resources will be required for these processes, and therefore the size and impacts of MPI charges. No feedback on this point was received from the consultation.

Registrations, renewals and amendments of FCPs based on templates

For comparative purposes, MPI compared the proposed charges against those for a sample of city and district councils across New Zealand, below. MPI's charges generally compare favourably, with only one council in the sample (Wellington City) having lower charges, and another (Tasman District) in line with what MPI proposes.

Table 14: Comparison of MPI and council charges for FCPs

	MPI	Auckland Council	Wellington City Council	Christchurch City Council	Tasman District Council	Southland District Council
Registration	$193.75 + $155 per hour after the first 1 hour and 15 minutes	$283.83	$134.78	$373.91	$196.52	$317.39
Renewal	$77.50 + $155 per hour after the first 30 minutes	$141.91	$67.39	$291.30	$79.13	$126.96

As it is a legal requirement for businesses to register a FCP, and there is limited scope for them to choose with which authority it is registered, [10] MPI does not expect that the introduction of charges for registrations and renewals of FCPs to have any significant impact on demand for its services.

Other approvals

The demand for the other approvals is expected to be minimal, increasing revenue by approximately $5,000. MPI does not expect that the proposed charges will have any significant impact on demand or the provision of these services.

Consultation

Responses on this proposal were received from ten (10) submitters; four were generally supportive, four opposed and two did not provide a clear position.

[10] Custom FCPs must be registered with MPI. Template FCPs are generally registered with local councils, unless the business is operating in several locations across more than one council area; in this situation they are able to register a single multi-site FCP with MPI rather than multiple FCPs with each council.

Supporters of the proposal did so on the basis that the charges would target applicants as the primary beneficiaries of the services. The main basis for opposing the proposals were with increasing costs of compliance, which submitters considered would place a burden on their businesses. MPI will undertake work to identify opportunities to make compliance easier for small food business in terms of time, effort and money while maintaining food safety standards.

One submitter opposed charging for the approval of industry-developed templates as it felt MPI should encourage industry to develop and adopt templates.

MPI's response to these submissions is discussed in the following sections.

Conclusions and recommendations

This proposal would introduce new direct charges for application and registration services under the Food Act as set out above. The charges for these services would be based on the hourly rate of $155 which is used for other application and registration services under the Food Act.

MPI generally recovers costs attributable to the service outputs. In the case of approvals, recognitions, and registrations, the applicant is a clear beneficiary of the output of the service. It is therefore equitable to recover the costs from the applicant rather than from the taxpayer, who does not receive any direct benefits from the output of this service.

While there were some concerns raised during consultation about increased compliance costs, no compelling reason was presented against introducing charges for these services. MPI's proposed fees appear generally to be in line with those of territorial authorities or lower; therefore MPI does not believe that the costs of compliance are unreasonable for the service provided.

For these reasons MPI recommends proceeding with the changes as proposed.

Implementation

Provisions to enable the proposed changes and will be included in the Food (Fees and Charges) Regulations 2015, with effect from 1 July 2018. This will require adding line items to the Schedule to enable recovery for the approval, recognition, and registration services.

MPI will continue to apply the existing processes to provide approval, recognition, and registration services. However, MPI will notify fee payers of the new rates that will apply from 1 July 2018 and update its application forms to include the appropriate rates.

Proposal: update rates for circuit verifications

This proposal aims to improve equity and justifiability by ensuring businesses using MPI circuit verification services are charged at rates that fully recover historical deficits and ongoing costs.

Status quo

Circuit verifications are undertaken by MPI staff travelling between meat, dairy, fish/shellfish and other premises (i.e. on a 'circuit'). They verify that the businesses are operating internal systems (and some aspects of external supply chains) consistently with legal requirements and risk management plans registered under the Animal Products Act 1999 (APA).[11]

The object of the APA (under Section 2) is to -

(a) minimise and manage risks to human or animal health arising from the production and processing of animal material and products by instituting measures that ensure so far as is practicable that all traded animal products are fit for their intended purpose

(b) facilitate the entry of animal material and products into overseas markets by providing the controls and mechanisms needed to give and to safeguard official assurances for entry into those markets.

The key instrument for achieving this is a *risk management plan* (RMP) which all businesses operating under the APA must draw up and register with MPI. Each RMP specifies how the business will conduct its operations in order for its products to comply with New Zealand and export market standards.

The purpose of verification is monitoring the systems used by the business in order to confirm – ie to verify - that it is compliant with its RMP. Therefore verification is essential to achieve the objects of the APA.

Provision of APA circuit verification services is in a contestable market[12] where MPI Verification Services covers approximately 850 premises (out of a total of 1,344 requiring verification), with AsureQuality New Zealand and Eurofins New Zealand servicing the remainder.

In some cases the private verifiers are unable or unwilling to provide the service to businesses, so MPI does so as 'verifier of last resort'. However there is no explicit statutory requirement for MPI to undertake this function.

In other sectors (eg seafood), while there is no formal requirement for a government agency to undertake verification, this is preferred over private verification as it is perceived to be more robust and helps maintain New Zealand's reputation for high food safety standards.

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11 APA circuit verifications differ from verifications of:

- export meat processors, where there are 'establishment' verifiers located permanently on-site and charged under a different fee regime
- premises under the Wine and (especially) Food Acts, which are generally not verified by MPI; services are provided by private verifiers (eg accounting firms for wine verification) and local authorities (under the Food Act 2014).

12 For some sectors (eg meat processing) verification services are not contestable, and are done by MPI because it is a requirement of foreign governments that official assurance of exports is done by a government department.

MPI tends to verify remote, high risk end emerging businesses (eg non-animal product proteins). Consequently verification services provided by MPI are not directly comparable with those provided by the private verifiers. This makes cost comparisons difficult.

Current cost recovery mechanisms

Circuit verification fees are charged under Part 9 (sections 113-125) of the APA, and are set out in:

- part 7 of Schedule 1 to the Animal Products (Fees, Charges, and Levies) Regulations 2007
- part 7 of the Schedule to the Animal Products (Dairy Industry Fees, Charges, and Levies) Regulations 2015.

The current charge comprises two components:

- a programme charge[13] which recovers the costs of providing support services ($44.90 per hour)
- a verifier charge to recover the direct costs of the verifier's time ($120.10 per hour).

Both components are charged to MPI clients for the hours required for verification, except that:

- the programme charge is limited to the first 40 hours per week of the verifier's time
- there are overtime and penal rate provisions for the verifier charges, which are applicable when verification is provided at times that require payment of these rates (under verifiers' employment contracts).

In practice there is little overtime worked on the circuit, so most hours are charged at $165.00 per hour. Similar rules apply for establishment verifiers, although their hourly rate is lower ($70.30 per hour) and there are substantial differences in working arrangements that affect cost recovery (see below).

Problem definition

MPI is required to recover all costs not funded by the Crown. Under the APA, a deficit may be recovered in up to the four years after it was incurred.

The costs of circuit verifications have been under-recovered for some time. The last increase in charges (on 1 July 2015) was not sufficient to fully recover costs, so a deficit relating to circuit verifications has been accumulating in the memorandum account since that time. This deficit is estimated to be $1.3 million by 30 June 2018 (after deficits of $3.9 million have been written off since 2013/14).

The key factor contributing to the deficit was the decision at the time of the previous fee reset to apply the same rates for the programme charge for establishment and circuit verifiers ($44.90 per hour). However, there are significant differences in the working and charging arrangements for the two.

- establishment verifiers are based full-time on their sites and the fee regulations are structured to ensure that establishments charged for all of the hours they work; therefore the programme charge fully recovers their support costs

13 described as a 'basic charge' in the regulations.

- circuit verifiers work for multiple clients and a range of factors – eg travel time, seasonal variations in work volumes – mean that the number of hours for which they are able to charge is significantly less than hours worked; while their direct costs are fully recovered, the shortfall in chargeable hours results in a significant under-recovery of support costs from the programme charge.

Recognising these differences in chargeable hours (and a review of relevant costs) suggests that a substantial rebalancing is needed in circuit verification fees, with higher programme charge partially offset by a lower hourly verifier rate.

Overall, these charges need to be increased substantially to recover the historic deficit and fully recover the ongoing costs of providing these services.

In addition, prior to 1 July 2015 there was an annual fee paid by coolstores and other storage premises, and processors of fish,[14] to recover a fixed portion of MPI's costs. MPI intended to move from this arrangement to charging them the hourly programme charge from 1 July 2015; but, because of an error in drafting the regulations, this did not occur until 1 July 2016. Consequently these businesses made no payment towards these costs in the 2015/16 financial year.

Changes implemented from 1 July 2016 mean that the programme charge is now applied to storage premises and processors of fish, but the costs incurred in the 2015/16 financial year have yet to be recovered from these businesses. Foregone revenue for that year is calculated as $996,000.[15]

These businesses were made aware of the error at the time it occurred, and of MPI's intention to recover the shortfall.

As noted above, under the APA there is a four year time limit within which any deficit may be recovered. Therefore the unrecovered programme charge from the year ended 30 June 2016 must be recovered by 30 June 2020.

Policy Rationale

Verification services provide direct benefits to the operator of the processing facility, as verification confirms compliance with New Zealand and export standards and enables operators to supply overseas markets.

The outputs of verification services are private goods, in that they are:

- *excludable* (MPI can decline to provide the service, including if the operator does not pay)
- *rival* (verification is specific to the relevant premises or products, and not transferable to or usable by others).

This means that this service is appropriately cost recovered by direct charging.

The principle that is most relevant is to the proposal is *equity*. As the primary beneficiaries of verification services are the businesses that are verified, it is equitable that they be expected to meet the full costs of the services. As a corollary, it would be inequitable for taxpayers or other businesses to meet any of the costs of the services.

Direct charging via an hourly rate means that each business pays the actual costs of MPI providing verification services. Hourly charges are appropriate for verification services as the length of time

[14] including both wetfish and shellfish.

[15] assuming the basic hourly charge had been charged to all verifiers' time.

taken depends on the size and complexity of the processes being verified. In particular, the amount of time required and the frequency of verification depends in part on the efficiency of the business' processes, so this element of verification costs depends on factors that the business can control.

With respect to the historical non-recovery of the programme charge from storage premises and processors of fish, this is clearly inequitable; they have in effect been charged significantly less for MPI services than other businesses. If (as proposed below) this non-recovery is recouped, these businesses will still have realised some significant cash flow benefits, equivalent to 2-3 years' interest savings on what they would have paid at the time.

There may be some misalignment in the charges for individual businesses between what should have been paid in 2015/16 and what is proposed to charge for in 2018/19 and 2019/20. This would occur for any that have entered or left the industry, or scaled their operations up or down substantially since that time. This means that recouping historical deficits in this manner is not completely equitable. However, this is an inherent problem with historical cost recovery through memorandum accounts, and does not invalidate the rationale for doing so.

In this case, storage premises and fish processers are mostly medium-large and large entities; as such they generally have high capital costs and the population of these business is relatively stable with few entering or exiting the industry. Therefore it is expected that businesses facing this cost will be predominantly the same ones that would have would have incurred the costs originally (and have benefited from the delay in collection).

Proposal

Level of proposed charges

The proposed charges are as follows:

Table 15: Proposed hourly charges – circuit verifications

$ per hour	Current	Proposed	Change
Programme charge	44.90	99.29	121%
Verifier charge	120.10	105.27	-12%
Total	165.00	204.56	24%

A complete list of all current and proposed circuit charges, including penal and after-hours call-out rates, is shown in Table 20.

With respect to the historical under-recovery from storage premises, and processors of fish, MPI proposes to recoup the costs incurred in 2015/16 in the two financial years commencing on 1 July 2018 and 1 July 2019 (in order to meet the requirements in the APA to recover these costs by 30 June 2020). It is proposed to do this through a rate targeted to these businesses of $23.60 per hour for those two years only. This targeted rate is in addition to the proposed rate increase above, resulting in the following charges.

Table 16: Proposed hourly charges – circuit verification targeted rate

$ per hour	Current	Proposed	Change
Programme charge	44.90	99.29	121%
Verifier charge	120.10	105.27	-12%
Additional targeted rate		23.60	
Total	165.00	228.16	38%

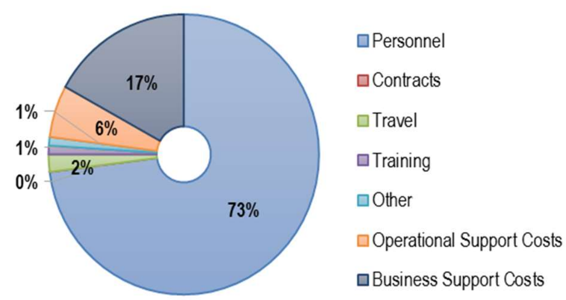
From 1 July 2020, the targeted rate would no longer be applicable and the charges for these businesses would revert to the rates set out in Table 15.

Forecast costs and revenue

The costs of circuit verification services are made up as follows:

Forecast 2018/19 cost breakdown by MPI cost type

- The majority of costs (73%) are for personnel, which is to be expected given the highly skilled and specialised requirements of the verifier role.
- Business support costs are slightly lower than in other areas of MPI at 17%.
- Due to the requirements to visit client premises (many of which are outside main centres), travel costs are much higher than across the rest of MPI, at 6%.



Current revenue is forecast to be $8.1 million in the year to 30 June 2018. Under the proposed charges it is estimated to be $10.2m in the 2018/19 year, rising by 2% per annum to $10.4m in 2019/20 and $10.7 in 2020/21.

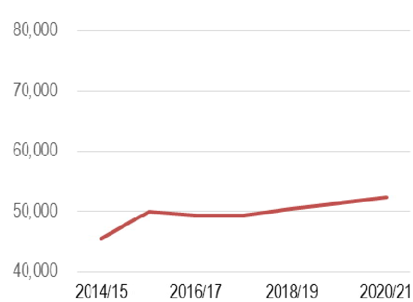
These forecasts are based on the following assumptions:

Hours of circuit verifications (actuals and forecast) 2014/15 – 2020-21

Circuit hours have been increasing due to new areas of work and a growing number of operators. 2015/16 growth is considered an outlier.

Forecast assumptions:

Future chargeable hours are forecast to increase by 2% pa.

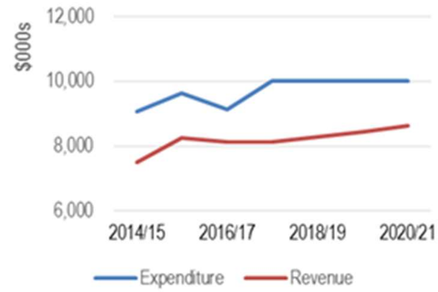


Revenue and expenditure (actuals and forecast) 2014/15 – 2020/21

Circuit costs have increased by $0.9m since 2015/16 on the basis of an analysis of operational support to circuit and establishment verifications, which indicates an under-recovery of costs from circuits.

Forecast assumptions:

Costs are forecast to remain at 2017/18 levels due to an intent to deliver efficiency gains to offset any future cost pressures.



Applying average annual forecast costs and hours over the three years to 30 June 2021, plus recovering the opening deficit, yields the following calculation of hourly rates:

Table 17: Rate calculation – circuit verification fees

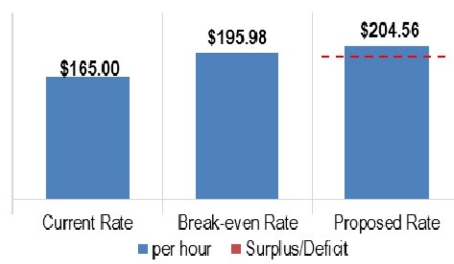
A Forecast opening surplus/(deficit)	B Forecast annualised costs(1)	C Recoverable annualised costs(3) = B-$^A/_3$	D Forecast volumes	Break even rate = B/D	Proposed rate =C/D
(1,318,700)	10,015,000	10,454,600	51,400	195.98	204.56

Notes:

(1) Over the three years to 30 June 2021

(2) The APA provides that a deficit from any year may be recovered (or a surplus returned) over the following four years. As rate setting is done over a three year time horizon, one-third of the opening deficit has been added to the annualised costs to be recovered.

At forecast expenditure and volumes, circuit verifications would break even at $195.98 per hour. However, this rate needs to be set $8.58 higher to recover the opening deficit in the memorandum account (shown in red on the third column in the graph on the right).



If the volume of hours is significantly different from the forecasts, volumes 2% higher or lower would result in increased or reduced revenue of $210,000 and a surplus or deficit of that amount in this component of the memorandum account by 30 June 2019.

These forecasts depend on two key assumptions:

- MPI will be able to hold its costs at levels forecast for 2017/18, with any cost increases in the three subsequent years offset by efficiency gains
- volumes of MPI verification services (hours of verifiers' time) are forecast to increase by 2% per annum, in line with recent trends; notwithstanding the fact that they are provided in a market with a certain degree of contestability, and substantial increases in the rates are proposed (24-38%).

The risk for both of these assumptions is likely to be negative – ie that increased costs cannot be offset by efficiency gains and/or volumes will be materially lower than forecast because of reduced use of MPI verification services as a result of higher fees. Either of these outcomes would result in under-recovery of costs and this component of the memorandum account remaining in deficit.

Other options considered

Circuit verification rate

MPI considered retaining the status quo and delaying implementation of the higher hourly charges until 1 July 2019; however this would require a larger increase to $210.96 (28%) when the rate is eventually raised. It would also result in $0.2 million in unrecoverable deficits being written off.

MPI also considered recovering only the ongoing costs of providing circuit verification services, but not recovering the deficit in the memorandum account. This would have resulted in an increase to $195.98 per hour (19%). This would be less equitable because the 'write off' of the historical deficit means that taxpayers would contribute towards the costs of a service from which they receive no direct benefit and create no risk.

Targeted rate

With respect to the unrecovered programme charge from 2015/16, it is appropriate that the foregone revenues be recovered; but given other businesses have already paid the basic charge, it would be inequitable to attempt to do so through a general charge applying to all APA businesses. Therefore the charge should be targeted towards storage premises and processors of fish.

MPI also considered the option of delaying implementation of the targeted rate for another year. However, this would require doubling the increase to $47.20 per hour.

Alternatively, MPI could write off the deficit. This would be less equitable because taxpayers would contribute towards the deficit arising from a service for which they receive no direct benefit and create no risk.

Efficiency and productivity improvements

As noted above, in estimating breakeven costs MPI has committed to holding its costs at 2107/18 levels for the following three years, with any cost increases over this period to be offset by efficiency gains. A specific example is that of the proposed circuit verification training budget for the 2018/19 financial year, which has been reduced from $150,000 to $88,880 (which equates to a cost of $1,367 per employee). MPI considers that this can be implemented without risking the integrity or quality of verification services.

MPI continually reviews its operations to find ways to improve efficiency. Most recently, on 1 December 2017 it moved to nationally-focussed business oversight of verification services (from being managed regionally). This will improve financial transparency, prevent cross subsidisation and is the building block on which efficiencies in training, resourcing and utilisation of new technologies will be achieved.

Impact analysis

Impact on fee payers

The impact of the proposed increases on a range of 'average' businesses is illustrated below, which shows the median average[16] number of hours charged annually for different types of processors, and the resulting impacts. The processors have been grouped according to MPI's assessment of the size of a 'typical' business in each industry.

Table 18: Impact of verification charges on 'average' businesses

	Hourly charge	*$165.00*	*$204.56*	
Processor category	**Median number of hours pa**	**Current charges**	**Proposed charges**	***Increase***
Industries with small processors				
Bee products	10.0	$1,650	$2,046	$396
Dual operator butchers(2)	5.0	$825	$1,023	$198
Eggs	5.5	$908	$1,125	$218
Hides & wool	4.0	$660	$818	$158
Industries with medium processors				
Petfood manufacturers	30.75	$5,074	$6,290	$1,216
Pharmaceutical products	23.0	$3,795	$4,705	$910
Industries with large processors				
Poultry	75.25	$12,416	$15,393	$2,977
Secondary Processors(3)	76.5	$12,623	$15,649	$3,026

Notes:

(1) All calculations are rounded to the nearest dollar. The "Increase" figures may differ slightly from simple subtraction because of rounding.

(2) 'Dual operator butchers' are retail butcheries that supply the domestic market and also process home kill or recreational catch animals at the same premises.

(3) 'Secondary processors' are businesses processing animal products beyond the primary stages (which include slaughter and dressing).

The equivalent impacts for storage premises and processors of fish are shown below, distinguishing the impacts of the general increase and the targeted rate.

[16] The median average is the value of the middle observation in an ordered sequence of observations - exactly half the values in the sequence are smaller and half are larger. A median value is regarded as representative of a 'typical' member of the relevant population; in particular, it does not get skewed by very large or very small values as can happen with a mean average (total values divided by the number of observations).

Table 19: Impact of verification charges on storage premises and processors of fish

Hourly charge		$165.00	$204.56	$23.60	$228.16
			Proposed charges		
Processor category	Median number of hours pa	Current charges	General increase	Targeted rate	Combined
Coldstore	69.75	$11,509	$14,268	$1,646	$15,914
Increase			*$2,759*	*$1,646*	*$4,405*
Drystore	22.5	$3,713	$4,603	$531	$5,134
Increase			*$890*	*$531*	*$1,421*
Wetfish	44.25	$7,301	$9,052	$1,044	$10,096
Increase			*$1,751*	*$1,044*	*$2,795*
Shellfish	37.75	$6,229	$7,722	$891	$8,613
Increase			*$1,493*	*$891*	*$2,384*

Notes:

(1) All calculations are rounded to the nearest dollar. The "Increase" figures may differ slightly from simple subtraction because of rounding.

(2) MPI's assessment is that shellfish processors are generally medium-sized businesses, and the other types are medium-large.

Cost comparisons with other verification agencies and expected effects on demand for services'

There is a risk of movement of clients from MPI to other verifiers. Submissions indicated that at the proposed hourly rates of $204.56 per hour, MPI's charges would be higher than those of other providers of verification services. However, they did not provide any evidence of the price differential nor any indication of whether they would be likely to change provider as a result.

MPI is competing with AsureQuality (AQ) and Eurofins NZ Ltd for verifications in a contestable market. As noted previously, direct comparisons between its charges and those of its 'competitors' are very difficult, for a number of reasons:

- the other two organisations charge on a contractual rather than an hourly basis, and APA verification is frequently 'bundled' with other related services (eg verification against private standards)
- MPI's role of 'verifier of last resort' may mean that its clients are expensive to service and unattractive to private providers (eg small remote businesses or those with significant performance issues)
- the development of new food products and technologies may necessitate investment in new verification capabilities – primarily training for specialist verifiers – and the private providers do not appear interested in making this investment
- some overseas market verification requirements may add time and costs to the processes; for example, MPI is investigating options to deliver some types of verification remotely, but overseas market requirements are that they be done on-site, which adds travel time to the costs.

Consultation

Responses on the proposal for a general increase in circuit verification rates were received from 20 submitters, with 12 opposing, four generally supporting and four not providing a clear position.

Those opposing the proposal generally considered the cost increase would have a negative impact on their businesses because they would have to either absorb the cost or pass it on to customers.

Several submitters acknowledged that it might be possible to reduce costs by managing business processes so as to meet requirements with fewer verifier hours. However, they submitted that most businesses are already operating efficiently and minimising verification requirements, so cannot mitigate cost increases in this way.

A number of submitters considered that MPI has not provided sufficient evidence about how the proposed increase is calculated, and questioned whether MPI was simply increasing charges rather than seeking ways to deliver the service more efficiently.

Eight submitters expressed concern over the inconsistent delivery of circuit verification services by MPI and proposed changes to the service delivery model. Several noted that at the proposed rates MPI would be more expensive than private providers; one suggested that the private providers will increase their prices to match MPI.

Seven submitters also commented on the proposal for a targeted rate, with five opposed and two unclear.

The seafood industry expressed concerns about the cost increases resulting from the combination of the general increase and the targeted rate, and indicated that these costs would be difficult to recover in international markets.

Other issues raised were:

- a preference for the deficit to be recovered over three years rather than two (which is not possible under the relevant provisions in the APA)
- opposition to the recovery of an historic deficit that was attributable to a drafting error.

MPI's response to these submissions is discussed below.

Conclusions and recommendations

Verification services provide direct benefits to the operator of the processing facility as verification confirms compliance with both New Zealand and export standards and enables operators to supply their markets. Charging as an hourly rate is appropriate as the length of time taken will vary depending on the size and complexity of the processes being verified.

MPI acknowledges that the proposed hourly rate will increase costs for businesses that receive circuit verification services. However there has been under-recovery for circuit verification services for some years, and there have already been significant write-offs of memorandum account deficits.

Although some stakeholders may consider there is insufficient transparency about the basis of costings for circuit verification services, MPI is confident that the methodology used to determine the proposed hourly rate is robust, and consistent with that used to determine costs for all MPI services.

MPI is conscious of the impact of increased charges on business and is committed to holding costs at current levels to mitigate the size of the increase. There are several work programmes underway across MPI to ensure effective delivery of services is maintained and improved.

Therefore MPI proposes to proceed with the increase to circuit verification charges as proposed.

Implementation plan

Changes to the relevant rates to give effect to the above proposals would be included in the Animal Products (Fees, Charges, and Levies) Regulations 2007 and the Animal Products (Dairy Industry Fees, Charges, and Levies) Regulations 2015, with effect from 1 July 2018.

Table 20: Complete list of proposed circuit verification charges

$ per hour	Current	Proposed	Change
Basic hourly charge	44.90	99.29	121%
Non-penal charges			
Per hour	120.10	105.27	-12%
Per hour at 1½ time	180.10	157.91	-12%
Per hour at double time	240.10	210.54	-12%
Penal charges			
Time worked at penal rate 0.5	60.10	52.64	-12%
Time worked at penal rate 1.0	120.10	105.27	-12%
Time worked at penal rate 2.0	240.10	210.54	-12%
After-hours callout charge(1)			
Minimum charge	3 hours at the relevant hourly rate		
Flat breakfast shift charge (if applicable)	8.70	N/A	-100%
Per hour	75.00	105.27	40%
Per hour at 1½ time	125.00	157.91	26%
Per hour at double time	150.00	210.54	40%

(1) These proposed charges apply only to callouts of circuit verifiers.

Monitoring and evaluation

MPI will continue to monitor the impact these charges will have on the relevant memorandum accounts to ensure that surpluses and deficits are managed appropriately, and that costs are being fully recovered but not over-recovered.

Ongoing industry reporting

As part of the First Principles Review, MPI identified opportunities to improve reporting to businesses and other stakeholders that pay the fees and levies. MPI recognises that industry reporting is a critical component of providing transparency to interested parties, as well as ensuring ongoing system efficiency.

MPI will improve transparency by publishing reports on cost recovered services that it provides. MPI is undertaking work to develop an approach to this, and will continue to work with industry to ensure that information provided is meaningful. MPI aims to have completed the reporting framework by 1 July 2018.

Review

MPI will undertake an ongoing programme of “rolling reviews” across all of its cost recovered systems, through which each cost recovery regime will generally be reviewed once every three years. This will ensure that cost recovery regulatory settings remain appropriate, including preventing any significant deficits or surpluses from accumulating. Reviews will consider both the policy setting and the actual fee and levy rates.

Fees and levies may also be updated outside the review cycle if a material surplus or deficit accumulates in a memorandum account. However, MPI aims to set fees and levies at a level that ensures memorandum accounts trend towards zero over a three-year period.