Ministry for Primary Industries
Manatū Ahu Matua

Cost Recovery for Biosecurity and Food Safety

Regulatory Impact Statement

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New Zealand Government

Growing and Protecting New Zealand

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Agency Disclosure Statement

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

The cost of delivering some of the functions that the Ministry undertakes in carrying out its duties can be recovered from users where service provision is not funded by way of Parliamentary appropriation. This RIS provides an analysis of options to address the under-recovery currently occurring in the Ministry's Cost Recovery arrangements and options to improve the policy settings around some cost recovered services in the areas of biosecurity and food safety.

A key gap in this analysis is information about the number of marginal businesses in different sectors. Some sectors have expressed concern that the proposed fees will make their businesses unviable.

The Ministry has examined the impacts on sectors and considers they are not significant for most businesses. Overall, the Ministry considers costs are commensurate with the benefits that businesses receive.

The modelling that drove many of the proposed changes to fees and charges is based on financial forecasting, as well as forecasting on volumes of imports and projected demand for the Ministry's services, and estimations of assessed effort. The Ministry considers these projections to be reasonable.

Options presented under this analysis are to comply with legislative requirements that activities are cost recovered where Crown funding is not provided.

Development and consultation was constrained by the requirement to have these changes in place by 1 July 2015. This meant consultation on a long public consultation document was undertaken in five weeks, though steps were taken to ensure that consultation was robust.

Dan Bolger

Deputy Director-General, Office of the Director-General,

Ministry for Primary Industries

18 March 2015

Executive summary

The Ministry is required by legislation to recover the costs of providing services to industry and the public that are not otherwise funded by the Crown. The Ministry has forecast a cost recovery operating deficit of $5 million in 2014/15. This deficit is primarily driven by cost increases over the period since the fees were last reviewed and the associated under-recovery of these costs. The Ministry needs to revise its fees and charges to prevent further under-recovery, recoup losses (where permitted), and make allowances for future changes in demand for regulatory services.

The Ministry is proposing to amend the 254 cost recovered fees it administers, with the majority of these increasing.

The Ministry is also proposing about 60 changes to elements of cost recovery policy within the existing policy framework. Many of these are minor changes, such as correcting errors in statutory language or harmonising practice, although there is a significant change in introducing cost recovery to the wine industry.

Were the Ministry to retain fees and charges at the current levels (the status quo) it would incur significant financial deficits, or face pressure to reduce the level of service it provides. In the latter case the effectiveness of our biosecurity and food safety systems would be jeopardised, which would threaten the well-being of consumers, agricultural production systems, export revenues, New Zealand’s environment and human health.

Targeted consultation was undertaken with affected stakeholders through meetings with individuals, and sector organisations. Most feedback accepted the proposed increases, with reservations in cases where large increases were proposed. An exception was the wine industry which strongly opposed the introduction of cost recovery.

Smaller and artisan businesses submitted that they would be adversely affected by the proposed increase in fees, largely on account of their narrow operating margins. The Ministry has carefully considered this feedback and where possible modified its proposals to moderate the impacts while recognising the true costs and risks that small businesses represent.

In the case of the wine industry, the Ministry believes that the proposal to cost recover for regulatory services should proceed with minor amendments, in order to be aligned with similar industry sectors.

The Ministry is undertaking a ‘first principles’ review of its cost recovery regimes, which will consider some of the wider issues raised during consultation. This review is scheduled for completion by late 2015.

Status quo and problem definition

The Animal Products Act 1999, Animal Welfare Act 1999, Agricultural Compounds and Veterinary Medicines Act 1997, Biosecurity Act 1993, and the Wine Act 2003 require or empower the Ministry to recover from industry the costs of providing any services that are not Crown funded. Cost recovery fees are set in regulations made under those Acts and must be regularly reviewed to ensure they are accurate and correctly reflect the cost of delivering services. Periodic review of cost recovery regulations is also consistent with (and recommended under) the relevant guidelines published by the Treasury and the Office of the Auditor-General.

Review of all cost recovery for food safety, animal welfare, and biosecurity services are now overdue. Cost recovery reviews were last undertaken in 2008 for food safety and in 2010 for biosecurity. Revenue generated under the current fee levels is insufficient to meet the costs incurred by the Ministry for delivery of services in these areas.

The cost recovery reviews were due to be undertaken at the time the Ministry was created from the mergers of predecessor agencies, the Ministry of Agriculture and Forestry, the Ministry of Fisheries, and the New Zealand Food Safety Authority. The reviews were deferred to allow for the changes and financial implications of the merger to be addressed and factored into reviews. The delay also allowed the Ministry to complete redevelopment of the overhead cost allocation model for the new Ministry. At the time of the merger it was expected there would be impacts on cost recovery for the new Ministry, including beneficial impacts for third party service users.

The Ministry forecasts a deficit of $2.4 million for the 2014-15 year in providing food safety services (including the Agricultural Compounds and Veterinary Medicines, Wine, Dairy, Live Animal and Germplasm industries) and $2.6 million for biosecurity services.

The size of this deficit is due to the fact that fees have not been amended to reflect the true cost of providing these services, which has risen over the last few years because of cost pressures, improvements to services, and increased volume of demand. The deficit amount comprises the current shortfall and historic debts.

If no changes are made to cost recovery regulations at this time, industry and fee payers would benefit in the short term as there would be no increase in charges. However, this may mean larger increases in the long term or may, over time, lead to a lower than optimal level of service being provided to either industry or New Zealand, and potentially reductions in biosecurity protection, declines in food safety or loss of export access to premium markets.

Objectives

The objectives against which the options for regulatory change should be assessed are that:

- The Ministry recovers the true cost of providing services; and
- Legislative requirements[1] for cost recovery review are met:
    - ***Equity*** – Funding should generally be sourced from the user beneficiaries of a function, power, or service at a level that reflects their use or benefit.
    - ***Efficiency*** – Costs should generally be allocated and recovered in a manner that ensures maximum benefits are delivered at minimum cost.
    - ***Justifiability*** – Costs (including indirect costs) should be collected only to meet the reasonable costs for providing a function, power or service.
    - ***Transparency*** – The cost of providing a service, function, or power should be identified and allocated as closely as is practicable to the period when the service is provided.

[1] The Animal Products Act 1999 (s 113), the Agricultural Compounds and Veterinary Medicines Act 1997 (s 81) and the Wine Act 2003 (s 84) all require the principles of equity, efficiency, justifiability and transparency to be considered in cost recovery. The Biosecurity Act has equity and efficiency principles that apply to cost recovery (s 135). MPI applies all four principles to cost recovery in all areas.

The Agricultural Compounds and Veterinary Medicines Act 1997, the Animal Products Act 1999, and the Wine Act 2003 also specify the minimum frequency with which cost recovery reviews must be undertaken (every three years).

The Ministry also considered non-legislative objectives for the proposed changes, including the guidelines set out in the Treasury's Guidelines for Setting Charges in the Public Sector ('Treasury guidelines')[2] and the Office of the Auditor-General Good Practice Guide Charging fees for public sector goods and services ('Auditor-General guide').[3]

There are statutory requirements in food safety legislation that cost recovery regulations must be in place by the start of the financial year in which they take effect, in this case by 1 July 2015. The biosecurity regulatory changes are not subject to the same constraints, but there is value in aligning them with the food safety regulatory changes since many of the stakeholders overlap and it will be administratively simpler.

Options and impact analysis

Due to the large number of fee updates and policy changes proposed, this analysis first presents the overall impacts of fee changes and policy changes.

It separately analyses the impacts of the most significant proposals under both fee changes and policy changes.

Fee changes

- Overall options and impacts
- Meat industry – establishment charges component of hourly rate
- Increasing the veterinary services rate

Policy changes

- Overall options and impacts
- Wine issues – domestic and export levies
- Dairy - enhance charging approach for standards, performance monitoring, export standards, market access, and residue monitoring
- Transitional facilities

The analysis for two of the significant policy changes above, wine and dairy, are structured differently. This is to allow a more robust analysis of these issues.

Emerging from the consultation process was the concern over the impact on small businesses, such as artisan dairy producers and wineries. There is an analysis of these impacts built into the sections below.

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[2] *Guidelines for Setting Charges in the Public Sector*, The Treasury, December 2002.http://www.treasury.govt.nz/publications/guidance/finmgmt-reporting/charges

[3] *Charging Fees for Public Sector Goods and Services*. Good Practice Guide. Office of the Auditor-General, June 2008. http://www.oag.govt.nz/2008/charging-fees/

A table containing the proposed fees compared to the current fees and a complete list of policy changes proposed is published on the Ministry's website under 'Closed Consultations'.[4]

Fee Changes

Overall options and impacts

This section analyses the overall impacts of, and options for, all fee changes proposed with the exception of the proposed changes for the meat industry and veterinary services rate.

Viable options for cost recovery are constrained by legislative requirements that are not under or over recovering fees. An exception is an application made to Cabinet by the Ministry in extraordinary circumstances to write off debt incurred in previous years. Note all fees presented in the document are exclusive of goods and services tax.

There are two basic options for the fee change proposals:

- Option 1: Enact the proposed changes to update fees to reflect true costs. The Ministry proposes setting fees to run a temporary surplus to address the deficit that has built up in the last few years. This is provided for in the food safety and biosecurity legislation. Once the deficit is repaid, fees will be re-examined and the portion of the fee that is repaying the debt will be removed. Table 1 summarises the final impact of the proposed fees on revenue compared with expenditure.
- Option 2: Maintain the status quo (equivalent to the current year, 2014/15 in Table 1, plus any changes from volume based fees).

Table 2 below shows the cost of the Ministry's services relative to the value of exports.

Note the table is export revenue only, and so excludes domestic markets. The figures therefore overstate the Ministry's relative cost (for example over 90% of poultry is domestically consumed – 96 million chickens - compared to a little over 1 million exported).

As cost recovery is based on export figures, there is no data for intermediate operations (such as cool stores), or for import focused services such as biosecurity.

Table 1: Impact of revised fees on cost-recovered revenue and expenditure, relative to 2014/15

Area	Current 2014/15 ($million) Forecast			From 1 July 2015/16 ($million) Forecast		
	Revenue	Expenditure	Surplus/ (Deficit)	Revenue	Expenditure	Surplus/ (Deficit)
Food Safety	55.3	57.7	(2.4)	61.4	61.0	0.4
Biosecurity	30.4	33.0	(2.6)	36.4	33.8	2.6
Total	85.7	90.7	(5.0)	97.8	94.8	3.0

[4] http://www.mpi.govt.nz/news-and-resources/consultations/proposed-revisions-to-the-cost-recovery-regimes-for-biosecurity-and-food-safety/

Table 2: Total current and revised fees revenue by major sector, in NZD

Industry	*Revenue 2014/15 ($million)*	*Proposed fees revenue 2015/16 ($million*	*Change*	*Industry exports 2014 calendar year ($million)*	*Proposed Fee as % of 2014 Exports*
Meat industry	34.1	34.4	0.3	5,754	**0.60%**
Game (deer - venison)	3.3	3.3	0.0	179	**1.82%**
Shellfish	0.9	0.6	-0.3	319	**0.20%**
Wetfish/Seafood	0.9	0.89	-0.1	1,186	**0.07%**
Poultry	0.6	0.8	0.2	54	**1.47%**
Egg sector	0.2	0.3	0.1	12	**2.26%**
Honey and Bees	0.2	0.4	0.2	202 (Honey) 5 (Bees)	**0.18%**
Petfood	0.2	0.3	0.1	94	**0.36%**
Live Animals	1.8	2.6	0.8	364	**0.70%**
Dairy	5.4	6.7	1.3	16,796	**0.04%**
Wine	0.2	2.2	2.0	1,330	**0.16%**
Biosecurity	30.4	36.4	6.0	26,294	**0.12%**

Table 3: Consideration of proposals against statutory criteria:

Option	*Equitable*	*Efficient*	*Justifiable*	*Transparent*
Maintain fees at current level (status quo)	✗ Services are not wholly being sourced from the beneficiaries of the services, with some costs being recovered from those who do not receive benefit. The current level of cost recovery does not reflect the level of use (and therefore benefit) to fee payers. Due to inflation and cost pressures since fees were set, deficits are accruing.	✓ The administrative costs being recovered are minimised through direct invoicing to service users or industry bodies (as appropriate).	✗ Cost recovery fees were set based on: • hourly rates and levels of assessed effort for the Ministry's staff in 2008/09. • standard IRD mileage rates in 2008/09; and • the costs of materials in 2008/09 • cost models of MPI's predecessor agencies This method of setting fees led to justifiable rates in 2008/09, but does not recover appropriately now as the cost to MPI of providing these services has risen.	✓ MPI keeps records of service delivery metrics, to ensure that the costs of providing the service are identified and allocated to cover the period during which the service is provided. Invoices are provided in a reasonable timeframe after the completion of the service. MPI operates memorandum accounts to receive cost recovery fees. These fees are published annually to help ensure transparency. MPI considers this methodology ensures that fees collected are no higher than the reasonable costs of providing the service.

Option	Equitable	Efficient	Justifiable	Transparent
				Though, the fees are now out of date with current costs.
Update fees (preferred option)	✓ The proposed option would better source the recovery from those benefitting from the services.	✓ The administrative costs would continue to be recovered are minimised through direct invoicing to service users or industry bodies as appropriate.	✓ Proposed fees have been based on: • cost modelling of the average time and cost to MPI required to deliver the service, based on current financial data. • Up to date IRD mileage rates. As these fees have been set based on the most up to date information about current actual costs, they are more justifiable than the status quo, as they represent the actual cost to MPI.	✓ MPI keeps records to ensure that the costs of providing the service are identified and allocated to cover the period during which the service is provided. Invoices will be provided in a reasonable timeframe after the completion of the service to fee payers. MPI operates memorandum accounts to receive cost recovery fees. These fees are published annually to help ensure transparency. External auditing of this allocation process in late 2014 has shown it is fit for purpose.

MPI notes some big fees have small increases but most fees increases equal or exceed inflation in the period since the last review. There are a number of exceptions to this, including impacts on transitional and containment facilities and small and artisan businesses (discussed below). Consultation with stakeholders on these fees has shown a general level of acceptance of the fee rises, given cost pressures, improvements to services and increased demand for those services.

Note on Biosecurity fees

The overall impact of the increased fees is $6 million across the biosecurity sector, of which $2.6 million is for repayment of deficits previously incurred.

The Ministry is proposing updates to all fees under the Biosecurity Act. A full list of these changes is given in the Cabinet paper.

The Ministry proposes that the annual fee for transitional and containment facilities[5] (T&CFs) rises by $155.83, 110%, the highest proposed percentage increase across all biosecurity fees. This is to incorporate a higher level of service, as well as an overall fee increase to

[5] Transitional facilities are places where imported goods are taken for treatment before they are cleared for entry into New Zealand; containment facilities are used for live organisms that are allowed to be imported into New Zealand but never released

account for cost pressures. The increased level of service is necessary to ensure an adequate level of biosecurity protection. A broad spectrum of stakeholders have expressed significant support for the increased protections that the Ministry is proposing for T&CFs.

Animal importers will be impacted by a series of proposed fee increases. These include the rise in fee for T&CFs (as these importers operate them to bring in animals), the increased veterinary services rate (approximately a 115% increase), the increase in cost for import permits, the increased travel costs for veterinary staff and biosecurity inspectors, and the general increase to the Biosecurity System Entry Levy.

The Ministry acknowledges the cumulative impact of fee increases and their impact on animal importers. However, the services for which costs are being recovered are crucial to ensuring the appropriate level of biosecurity protection, and the cost being passed on is limited to costs the Ministry incurs in providing this service.

Note on small and artisan businesses

The Ministry received strong feedback from smaller artisan businesses, especially in cheese, wine and ornamental fish importation, that the levels of fees and charges proposed would have a significant impact on their financial viability. In addition, to comments on proposed fee increases, there was a general concern from smaller businesses on the number and cumulative burden of local and central government fees and regulatory requirements.

The fee increases have been proposed on equity and efficiency grounds. It is important to limit the extent of cross-subsidisation between large and small businesses, and ensure that businesses face the true cost of the services they receive. Nevertheless, as highlighted in the previous EGI paper (EGI Min (14) 21/6 refers), we are aware that these changes could have potentially material impacts on smaller businesses.

In response the Ministry has reviewed the proposals. As a result the Ministry has revised its proposals for artisan cheese makers. On further examination it is clear that the proposals would not have a significant impact on the majority of wine or honey producers. The proposed fees changes fall on exporters who typically larger businesses in these industries.

Increasing the Veterinary Services Rate

The current rate for veterinary services[6] is significantly under-recovering the costs of providing this service. It was set in July 2008 and based on a much lower level of assessed effort than the service actually takes.

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[6] Veterinary services include checking animals arriving at containment facilities, or certification of live animals for export purposes.

Options for addressing the veterinary services rate are:

- Option 1: Increase the rate from $88.87 to the actual cost of $186.30 (the preferred option);
- Option 2: Partial Crown funding; and
- Option 3: Status quo - no change to this fee.

Table 4: Consideration of proposals against statutory criteria:

<table>
<tr><th>Option</th><th>Equitable</th><th>Efficient</th><th>Justifiable</th><th>Transparent</th></tr>
<tr><td>Partial Crown funding</td><td rowspan="2">✗
The level of cost recovery under these options does not reflect the level of use (and therefore benefit) to fee payers.</td><td rowspan="2">✗
Both of these options would require invoicing, which is an established method of collection. However, it would also require arranging Crown funding, which would make this less efficient than the proposed option.</td><td rowspan="2">✗
Cost recovery fees were set based on:
• hourly rates and levels of assessed effort for the Ministry's staff in 2008/09.
• standard IRD mileage rates in 2008/09; and
• the costs of materials in 2008/09
• cost models of MPI's predecessor agencies

MPI has found through analysis of accounts that these fees are no longer up to date and do not meet the costs of providing the service.</td><td>?
MPI keeps records of service delivery metrics, to ensure that the costs of providing the service are identified and allocated to cover the period during which the service is provided.

The cost would not be allocated to the beneficiary however.</td></tr>
<tr><td>No change to the fee (Status quo)</td><td>✓
MPI keeps records of service delivery metrics, to ensure that the costs of providing the service are identified and allocated to cover the period during which the service is provided.

Invoices are provided in a reasonable timeframe after the completion of the service.</td></tr>
<tr><td>Increase rate (preferred option)</td><td>✓✓
The proposed option would best source the recovery from those benefitting from the services.</td><td>✓
The administrative costs being recovered are minimised through direct invoicing to service users.</td><td>✓
Proposed fees have been based on:
• cost modelling of the average time and cost to MPI required to deliver the service, based on current financial data.

As this fee has been set based on the most up to date information about current actual costs, it is more justifiable than the status quo, as it represents the actual cost to MPI.</td><td>✓
MPI keeps records of service delivery metrics, to ensure that the costs of providing the service are identified and allocated to cover the period during which the service is provided.

Invoices are provided in a reasonable timeframe after the completion of the service.

MPI operates memorandum accounts to receive cost recovery fees. These fees are published annually to help ensure transparency.

MPI considers this methodology ensures that fees collected are no higher than</td></tr>
</table>

Option	Equitable	Efficient	Justifiable	Transparent
			The proposed hourly rate is a realistic level given the specialist skills that this service requires and it appears competitively priced when compared to the rates charged by similar agencies in New Zealand and other jurisdictions.	the reasonable costs of providing the service. Though, the fees are now out of date with current costs.

Neither option 2 or 3 were preferred as they would incur a further deficit in providing this service. Options 2 and 3 also do not meet the legislative requirement to fully recover the costs of services that are not Crown funded nor meet expectations for equitability.

The proposed increase in the veterinary professional and specialist rate reflects cost increases since the rate was last reviewed and correctly factors in the increase in veterinary professional staff costs and overheads.

The proposed increased rate will have a significant impact on some smaller operators, particularly those who frequently require veterinary services outside of normal working hours. As an example of the maximum amount of proposed new costs (the combination of updated penal rates and the increased veterinary rate) a three-hour callout taking place between midnight and 3am would have the following costs:

Three hours at current penal rate 2.0: $410.91
Three hours at updated penal rate 2.0 with updated veterinary rate: $954.12

Meat industry – establishment charges component of hourly rate

The Ministry charges in two ways for verification services. *Circuit charges* refer to charges payable in respect of any premises where the verification functions are performed by verifiers who are not permanently based at the premises. *Establishment charges* refer to charges payable in respect of any premises where the verification functions are performed by verifiers who are permanently based at the premises.

The Ministry proposes a single combined charge for establishment and circuit verification activities. This is considered appropriate as the current allocation methodology, set in 2008, has resulted in deficits being attributed entirely to circuit businesses.

Establishment and circuit charges are veterinary charges that are distinct from the 'generic' veterinary services rate. As with the generic veterinary charge, the establishment and circuit rates are under-recovering from fee payers.

Options are:

- Option 1: Harmonise charges and raise both establishment rates and circuit charges, recouping deficits incurred over the last four years (as allowed for under the Animal Products Act) across both establishment and circuit processors;
- Option 2: Introduce new fees for circuit and establishment that do not include deficit recovery;

- Option 3: Status quo – no change to fees; and
- Option 4: Harmonise charges but add a specific element for historic deficits which is different for establishments and circuits (preferred option).

The circuit charge is set at such a level that it is recovering significantly less than the establishment rate. Raising the circuit charge to a level where it would fund the actual cost of the service and recover the deficit would be a very significant increase.

Industry generally supported the combined programme charge. The Meat Industry Association (MIA), however, strongly objected to what it considered the retrospective application of historical costs. The MIA has been working closely with the Ministry over several years and has received regular updates from the Ministry indicating moderate surpluses.

The Ministry considers the proposed cost allocation is superior and will prevent further incorrect reporting of establishment surpluses. We also appreciate that the MIA has acted in good faith on the Ministry's information and a retrospective application of fees would be unjustified. On balance, we agree that it is not fair to recoup the historical deficit given that the industry had not previously been advised that there was one.

The Ministry does not recommend recouping deficits previously attributed to circuits from establishment businesses. We therefore propose a differential programme hourly charge structure of $44.90 for circuit businesses and $41.04 for establishment businesses. This will reduce Ministry revenue by $0.922 million per annum in each of the next two financial years.

Table 5: Consideration of proposals against statutory criteria:

Option	***Equitable***	***Efficient***	***Justifiable***	***Transparent***
Continue with original proposal	✗ No one in industry knew that deficits were being incurred in relation to establishment premises. And the exact level of deficit is hard to calculate and allocate to the actual beneficiaries of the services retrospectively. So charging for them now would be unfair.	✓ From a collection perspective, none of these options presents as being particularly more efficient than any other. All options would be efficient	✗ While the proposal going forward would meet the justifiability criteria, this proposal would have elements of unjustifiability, as the exact level of deficit for establishment premises is hard to calculate.	✗ The inclusion of deficit recovery would see historic costs met by current fee payers.
Update fee without deficit recovery portion	✓ This proposal is reasonably equitable, as it ensures that in future years, the costs imposed on businesses will equate to the benefits they receive. But the Crown will be left to meet the cost of previously undercharged costs.		✓ While the proposal going forward would meet the justifiability criteria, elements of this proposal would not, as historic costs that clearly relate to circuit premises would not be recouped from them.	✓ This is a reasonably transparent option, as it recovers the current and future costs of the services in the year that they are incurred.

Option	***Equitable***	***Efficient***	***Justifiable***	***Transparent***
No update to fees (status quo)	× This proposal is not equitable as it would result in Crown funding for a club good, and ongoing cross subsidisation between establishment and circuit premises.		× This option would see an ongoing, but unclear, level of cross subsidy between circuit and establishment premises.	× This option would see an ongoing, but unclear, level of cross subsidy between circuit and establishment premises.
Harmonise programme charges but add a specific element for historic deficits which is different for establishments and circuits. (preferred option)	✓✓ This proposal is the most equitable, as it recovers the increased cost of fees as well as appropriately dealing with under-recovery of circuits costs. The beneficiaries of the services would pay for those services.		✓✓ Proposed fees have been based on: • cost modelling of the average time and cost to MPI required to deliver the service, based on current financial data. • Up to date IRD mileage rates As this fee has been set based on the most up to date information about current actual costs, it is more justifiable than the status quo, as it represents the actual cost to MPI. As this fee is indexed to the volumes of product exported as opposed to a flat fee, it will automatically adjust to the outputs created (and therefore amount of benefit received) by producers. Linking benefits to fees in this way is a more justifiable way to recover than a flat fee.	✓✓ This is the most transparent option as it recovers current and future costs in the year that they are incurred, and sees circuit premises repaying the costs they were previously undercharged for.

In response to feedback, the Ministry will not seek to recover $1.844 million over two years from establishments. The Ministry will apply to Cabinet to have a capital injection to offset this.

Policy Changes

Overall Options and Impact Analysis of Policy Changes

There are around 60 policy changes proposed for the current cost recovery review. Of these, the majority (75%) are classified as technical changes which will have either a minor or no impact on stakeholders. These are changes such as closing loopholes to allow the Ministry to charge for certain activities as allowed for in primary legislation, but never prescribed in regulations, or clarifying definitions of penal rates in regulations.

Other changes such as having standardised hourly rates or half-hour minimum charges will have a financial impact on stakeholders, the magnitude of which will depend on their use of the service in question.

The financial impact is likely to be minor. It is a small change relative to the overall size of business or is an avoidable or discretionary charge. It is also balanced against the increased efficiency to the Ministry that these changes provide. Ultimately, increased efficiency will contribute to lower increases in future cost recovery reviews. Efficiency-related changes include:

- having a standard Ministry hourly rate where appropriate;
- clarifying the ability to charge for technical support staff; and
- prescribing the ability to recover costs in regulation for certain activities (where already empowered to do so by an Act).

The alternative options are generally the status quo (i.e. not to make minor amendments to regulations). Under the status quo, ambiguity would continue because of the current legislative discrepancy and the lack of consistency across the Ministry's charging regimes. It would result in slightly lower costs to some stakeholders from those areas where the hourly charges are set at a lower rate.

The remaining changes are new policies or substantial changes. These are analysed below.

Wine Policy Issues – Background

There are two major Ministry services and corresponding proposed new charges in the wine industry: a proposed **levy on domestic production** to fund standard setting and compliance; and a proposed **export levy** to fund overseas market activities.

Export and market access services have historically not been cost recovered. The rationale of a previous Cabinet decision (EXG Min (06) 1/6 and CAB Min (06) 23/2)[7,8] was that the small amounts of costs to be recovered by the industry may not be worth recovering. Now that the industry has matured and volumes have risen substantially, it is seen as appropriate to recover the costs of providing these services.

Other factors affecting the industry

The wine industry also pays an 'excise' tax, designed to modify consumption of alcohol in order to reduce personal and social harm. The Ministry is not involved with setting or administering this tax, and its proceeds do not pay for any of the costs it accrues when providing services to the industry.

The Ministry currently issues rebates on laboratory testing of wine. The Ministry will no longer offer these rebates as the industry participants are now in a position to pay these costs themselves. Cessation of the rebate from the Ministry for laboratory testing will reduce Crown expenditure by $800,000 per annum.

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[7] Cabinet Committee on Government Expenditure and Administration

[8] Appendix 6 shows the original funding decision.

The Ministry is aware of the cumulative effects of government taxes and the cessation of rebates, but still notes the requirement to recover costs of providing services from those who benefit and/or use them.

Options and impact analysis - Domestic Levy on NZ Winegrowers to fund Standards and Compliance

The Ministry performs a range of functions for the domestic wine sector, including provision of a New Zealand standard setting programme and a compliance programme. These functions are club or industry goods, and principally relate to the making and processing of wine and wine products.

These services are projected to cost the Ministry $320,000 in 2015. The proposal is to collect this from the industry body, New Zealand Winegrowers (NZ Winegrowers).

New Zealand Winegrowers currently makes a voluntary payment to the Ministry of $151,000 per annum towards the cost of the New Zealand standards programme. Compliance programme costs for the industry are currently Crown-funded. Prosecutions and investigations will remain Crown funded, as this is typically considered a public good.

The options are:

- Option 1: Continue voluntary payments, updated to $320,000, from NZ Winegrowers ; and
- Option 2: Impose a levy on NZ Winegrowers to recover the costs of these services

Option 1, continuing to receive voluntary payments from New Zealand Winegrowers through a memorandum of understanding, would be administratively simple and effective at recovering the costs of the New Zealand standards programme and compliance programme. However, without a statutory mandate it creates a risk that funding could be withdrawn by New Zealand Winegrowers in future.

Option 2 would cost NZ Winegrowers an extra $169,000 in 2015, the same as the preferred option. If it elected to pass this cost on to its members, it would be an average of $256.00 additionally paid per winery to NZ Winegrowers in 2015. NZ Winegrowers currently voluntarily pays the Ministry $151,000 towards its costs, and levies $5.9 million from its members.

Though the options will deliver the same financial outcome, the Ministry notes there is significant value in the certainty that an imposed levy offers. However, the Ministry also notes there is value in allowing the industry body flexibility to determine whether it passes costs down to individual producers. As such, there is no clear preferred option and Ministers will make the final decision. Further analysis is provided in Table 6 below.

Table 6: Consideration of proposals against statutory criteria:

Option	***Equity***	***Efficiency***	***Justifiability***	***Transparency***
Continue voluntary payments, updated (modified status quo)	✓ For both options, funding would be sourced from the major beneficiaries of the service indirectly through NZ Winegrowers.	✓ For both options, collecting the annual fee from the industry association as a centralised contact is efficient and helps deliver minimum administrative cost.	✓ For both options, the costs are only proposed at the level that it costs the Ministry to provide the services.	✓ Both options are transparent in that they allocate the cost of a service to a beneficiary, and both would be done on a similar timeframe relative to when the benefits are received.
Impose a levy				

Options and impact analysis - Export Levy on Winegrowers

The Ministry performs a range of functions for the export wine sector, including:

- the export standard setting programme;
- certification system for export shipments;
- the market access programme; and
- compliance and systems audit activities related to export.

There are two groups of beneficiaries from the services – wine businesses and overseas consumers. In line with considering cost recovery from the wine industry, the Ministry considered four options for funding these services:

- Option 1: The Ministry continues to pay for the costs of overseas market access (status quo);
- Option 2: Impose a flat levy on all wine exporters; and
- Option 3: Impose a levy on each litre of a wine business exports over 10,000 litres (preferred option).

The approach under Option 1 would mean the Crown would continue funding this service for industry, which in the absence of the original justification would be inequitable for other industries as well as in conflict with legislation requiring that MPI recovers costs

The approach under Option 2 would not be equitable as it would not reflect the value of the benefits received. It would result in small exporters paying a disproportionately large share, while large exporters pay a disproportionately small share. This option would be administratively efficient as the Ministry can identify and invoice all wine exporters.

Option 3 is administratively efficient as the Ministry can efficiently identify and invoice all wine businesses. Wine businesses already provide returns to the Ministry and the New Zealand Customs Service, so providing additional information to the Ministry would add minimal cost.

MPI's preferred option is Option 3: to impose a levy on each litre of wine exported, in the form of an annual levy of approximately $0.01 per litre, excluding the first 10,000 L. The total revenue that would be raised by this levy from industry is approximately $1.8 million.

The levy would be imposed on applicants for export consignment approval. This means that wine businesses whose product is exported would be liable to pay the levy. Wine businesses that make applications on behalf of third parties wishing to export their wine would need to make a commercial decision as to whether, and how, to pass on that cost.

Table 7: Consideration of proposals against statutory criteria:

Option	***Equity***	***Efficiency***	***Justifiability***	***Transparency***
The Ministry pays (status quo)	✗ Services are not being sourced from the beneficiaries of the services, with costs being recovered indirectly through taxes. The current lack of cost recovery does not reflect the benefit to fee payers.	✓✓ The Crown continuing to fund this service would remove the need to invoice a service user.	✗ Not collecting any levies to meet MPI's costs would be in contravention of statutory requirements.	✓ MPI keeps records of service delivery metrics, to ensure that the costs of providing the service are identified and allocated to cover the period during which the service is provided.
Flat levy on wine exporters	✓ A flat fee to the industry is more equitable than the Ministry paying for this, but it is less equitable than option 3 as it does not account for the volumes exported (and therefore amount of benefit received) by individuals.	✓ The administrative costs being recovered are minimised through direct invoicing to service users.	✓ A flat fee to a service receiver is justifiable, but not indexing the fee to the benefit received makes this less justifiable than option 3.	✓ MPI keeps records to ensure that the costs of providing the service are identified and allocated to cover the period during which the service is provided. Invoices will be provided in a reasonable timeframe after the completion of the service to fee payers. MPI operates memorandum accounts to receive cost recovery fees. These fees are published annually to help ensure transparency. External auditing of this allocation process in late 2014 has shown it is fit for purpose.
A levy per litre over 10000 litres exported (preferred option)	✓✓ The proposed option would better source the cost recovery from those benefitting from the services.	✓ The administrative costs being recovered are minimised through direct invoicing to service users.	✓ Proposed fees have been based on: • cost modelling of the average time and cost to MPI required to deliver the service, based on current financial data. • Up to date IRD mileage rates As this fee has been set based on the most up to date information about current actual costs, it is more justifiable than the status quo, as it represents the actual cost to MPI.	

Option	Equity	Efficiency	Justifiability	Transparency
			As this fee is indexed to the volumes of product exported as opposed to a flat fee, it will automatically adjust to the outputs created (and therefore amount of benefit received) by producers. Linking benefits to fees in this way is a more justifiable way to recover than a flat fee.	

Total impact on the Sector

The following table gives illustrative information about the cost of the preferred option on wine exporters and relates that to the value of the quantity of wine exported by the selected businesses.

The following information is approximate as it is based on data obtained from the E-cert database[9] for a four month period that has been annualised. It is illustrative, based on some exporters only, and does not represent the actual effect on all exporters.

Table 8: Examples of levy costs to wine exporters according to size of export business

Export volume range (litres)	*Number of exporters*	*Impacts ($)*
< 10,000	183	0
10,000 – 200,000	171	0- 2,000
200,000 – 400,000	25	2,000 – 4,000
> 400,000	52	4,000 +

In 2014, NZ Winegrowers reported that the total value of wine exported was $1.3 billion resulting from the export of a total of 186.9 million litres of wine.

For a domestic winery, the additional costs of the proposals would be the amount that NZ Winegrowers decides to directly pass on, up to an additional of $256 per winery when averaged over the industry, for a total contribution of $472 on average per winery.

For an exporting winery, the additional costs would be the domestic standard setting cost (of however much NZ Winegrowers elects to pass on) plus approximately $0.01 per litre exported.

[9] "E-cert" is the electronic certification system used by wine exporters. It is significantly more efficient that the previous paper-based certification system.

Dairy - Enhance charging approach for NZ standards, performance monitoring, export standards, market access standards, and residue monitoring

Status quo for large and small processors

The Ministry charges processors for the development and maintenance of New Zealand standards and export standards, as well as performance monitoring,[10] through:

- quarterly specified fees to five dairy processing businesses receiving more than 316,000 kilograms of raw milk solids or more (i.e. **"large processors"**); and
- an annual flat fee to each registered manufacturing premises receiving less than 316,000 kilograms of raw milk solids (i.e. **"small processors"**).

The quarterly specified fees to large processors is based on a business' share of total raw milk solids received, using data available at the time the regulations were set. Market shares for raw milk solids serve as a proxy for the individual benefits derived from New Zealand and export standards and performance monitoring.

The annual flat fee to small processors is based on attributing a small share of costs to them (higher than their share of total milk solids received at the time the regulations were set) and dividing by the number of these premises.

Status quo for large and small exporters

The Ministry charges exporters for market access activities and dairy residue monitoring/National Chemical Contaminants Programme (NCCP) through:

- a quarterly specified fee to Fonterra as the largest dairy exporter (i.e. **"large exporter(s)"**; and
- a small annual flat fee to all other registered dairy exporters (i.e. **"small exporters"**)

The share of costs paid by Fonterra for each service is based on estimates of the benefits to Fonterra from market access functions and the NCCP at the time the regulations were set respectively. The small annual flat fees to small exporters is based on dividing the remaining share of costs amongst them.

Proposed Changes

This section analyses the three major changes proposed for how to charge for these services, and then presents the overall impacts of the changes.

The three proposed major changes are:

1. Change who pays for export levies;
2. Change who pays for the NCCP; and
3. Changes to the way levies[11] are charged to processors and exporters and introduce a new medium processors category (there are four main components to this major change)

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[10] Performance monitoring refers to systems performance monitoring and management and excludes approvals and verification inspection and audit fees.

[11] In the current dairy regulations, the charges for domestic and export standards, performance monitoring, dairy residue monitoring and market access standards are referred to as fees. In the new dairy regulations, the charges will be referred to levies. There will be no difference in economic terms given the levies proposed are still specific

1. Changes to who pays for export levies

Problem definition

Export standards and New Zealand standards are currently being charged as a single expense to dairy processors. This has efficiency benefits, but there is an equity trade-off as charges are not necessarily targeted to businesses that benefit from the different services. Domestic-only processors are being charged for export standards, whereas dairy exporters who import their milk ingredients or dairy products do not face any costs for export standards. The Ministry is seeking to find a better balance between efficiency and equity for the cost recovery of export standards.

Options analysis

The options are:

- Option 1: Export standards and New Zealand standards are levied to dairy processors (status quo); and
- Option 2: The service of New Zealand standards development is levied to dairy processors and the service of developing and maintaining export standards is levied to dairy exporters (preferred option).

Table 9: Consideration of proposals against statutory criteria:

Option	***Equitable***	***Efficient***	***Justifiable***	***Transparent***
Maintain current charging method (Status Quo)	✗ Not all beneficiaries of export standards are being charged for the service i.e. dairy exporters who import their milk ingredients or dairy products. Some parties being charged for export standards do not benefit from the service i.e. domestic-only processors.	✓✓ Levying dairy processors for both export standards and New Zealand standards minimises costs of recovery as the levies can be directly invoiced together dairy processors.	✗ The fees set in 2007 are now out of date. They do not appropriately reflect the costs to MPI of providing New Zealand standards and export standards in total or the costs of providing the services to the particular businesses specified.	✓ MPI keeps detailed records of the respective costs of New Zealand standards and export standards, so that the costs of providing these services are identified and allocated for the period of the cost recovery regulations.
NZ standards levied to processors, export standards to	✓✓ The proposed option would levy	✓✓ Levying dairy exporters for export standards also keeps costs of	✓ Costs for New Zealand standards and export standards would be based on the	

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total charges (as opposed to a per unit levy). The change to levies is in accordance with the 2008 Office of the Auditor General guidelines on Charging Fees for Public Sector Goods and Services. According to the guidelines, charges should be imposed through a levy when charges will apply to a certain group such as industry participants for carrying out a particular function.

Option	Equitable	Efficient	Justifiable	Transparent
exporters (preferred option)	all beneficiaries of export standards.	recovery low as dairy exporters are already charged for market access standards, so these levies can be directly invoiced together to dairy exporters.	most up to date assessment of full-time equivalent effort by the Ministry's staff and other actual costs. It is possible costs may change in future years due to unexpected events.	

Option 2 is preferred as it scores better than or the same as the Status Quo against the criteria.

2. Changes to who pays for the NCCP

Problem definition

The dairy residue programme (or NCCP) is currently charged to Fonterra as the primary exporter, and to other smaller exporters. However, the programme has benefits for both export and domestic market participants that use New Zealand milk.

A small proportion of costs and activities of the NCCP are specifically focused on export product requirements, namely an independent verification programme and testing for radionuclides. However, there are spill-over benefits to domestic producers as the levels of radionuclides in milk are a marker of quality and used across the entire dairy industry.

Options analysis

The options are:

- Option 1: The dairy residue programme (or NCCP) is charged to exporters only (status quo); and
- Option 2: The dairy residue monitoring service is charged to all dairy processors instead of dairy exporters (preferred option).

Table 10: Consideration of proposals against statutory criteria:

Option	Equitable	Efficient	Justifiable	Transparent
Charge NCCP to exporters (status quo)	× The NCCP is not being wholly recovered from the beneficiaries of the service as domestic-only processors and domestic customers are not bearing costs.	✓ Both options minimise the administrative costs of recovery as both exporters and processors are invoiced directly for other dairy services.	× The fees set in 2007 are now out of date. They do not appropriately reflect the costs to MPI of providing the NCCP in total or the costs of providing the services to the particular businesses	✓ MPI keeps detailed records of the costs of the NCCP, so that the costs of providing these services are identified and allocated closely to the period of the cost recovery regulations.

Option	Equitable	Efficient	Justifiable	Transparent
			specified. The costs of providing these services has risen significantly with an increase in service provision.	
Charge NCCP to all processors (preferred option)	✓✓ Levying processors would better source recovery from those benefitting from the NCCP. By levying processors, the costs for the NCCP will likely flow through to domestic customers as well as exporters and their customers, as processors pass costs downstream.		✓ Costs for the NCCP would be based primarily on the most up to date costs of contracts with independent service providers to sample raw milk, colostrum and dairy products. It is possible costs may change in future years due to unexpected events.	

Option 2 is preferred as it scores better than or the same as the Status Quo against the criteria.

3. Changes to the way levies are charged to processors and exporters

There are two parts involved in calculating levies for each processor and exporter: defining the levy categories i.e. what levy should apply to each business; and determining the method of calculating the levy.

This section is split into four changes: defining the levy categories for processors; defining the levy categories for exporters; calculating levies for large processors and exporters; and calculating levies for small processors and exporters and medium processors.

In terms of the total costs for New Zealand standards development, performance monitoring, the NCCP, export standards and market access standards, the level of costs is justifiable. The costs of New Zealand standards, performance monitoring and market access and exports standards are based primarily the most up to date assessment of full-time equivalent effort by the Ministry's staff and the costs for the NCCP are based primarily on the costs of contracts with independent service providers to sample raw milk, colostrum and dairy products. The costs for each service are fully allocated (direct costs of the service and a fair allocation of business support costs) and adjusted, where appropriate to do so, for prior year/s over or under-recoveries. The discussion of justifiability for the following changes relates to that particular proposal.

Problem definition for processor definitions

The current definition for processors (registered manufacturing premises) means that dairy processors manufacturing under a food safety programme rather than a risk management programme are not charged for New Zealand standards, performance monitoring and dairy residue monitoring, although they benefit from these services.

There is also a need to have reliable data sources to inform which processors are "large" and to inform the calculation of levies to large dairy processors. To date, charges have been based on publicly available information that is incomplete and not always up-to-date.

Options analysis

The options are:

- Option 1: Updated status quo i.e. large processors would be registered manufacturing premises receiving more than 491,000[12] kg of raw milk solids. Small processors would be all other registered manufacturing premises. No medium processors category; and

- Option 2: Large processors would be defined as persons with a farm dairy risk management programme that are collection agents, and who collected more than 491,000 kilograms of milk solids from dairy farmers directly (that is, not through another collection agent) in the previous financial year.

  Medium processors would be defined as collection agents that collected greater than 16,500 kg and less than or equal to 491,000 kg of raw milk solids directly (not through another collection agent) in the previous financial year and would be charged an annual levy like small processors.

  Small processors would be defined as persons with farm dairy risk management programmes who are not collection agents (do not buy milk solids from a dairy farmer) or collection agents that collected less than or equal to 16,500 kg of raw milk solids directly (not through another collection agent) in the previous financial year (preferred option); and

- Option 3: As Option 2, but would be based on expected collection of raw milk solids in the financial year, rather than in the previous financial year.

Table 11: Consideration of proposals against statutory criteria:

Option	***Equitable***	***Efficient***	***Justifiable***	***Transparent***
Maintain current definition with updated threshold (status quo)	✗ Dairy services are not being wholly sourced from the beneficiaries of the services as only processors who	✓ Would require large processors to provide data to the Ministry on an annual basis, creating additional	✗ The fees set in 2007 are now out of date. They do not appropriately reflect the costs to MPI of providing New	✓ MPI keeps detailed records of the respective costs of dairy services, so that the costs of providing these

[12] Determined by dividing the medium processors' levy amount by the total amount to collect from processors and multiplying it by the total milk solids collection in 2013/14.

<table>
<tr><th>Option</th><th>Equitable</th><th>Efficient</th><th>Justifiable</th><th>Transparent</th></tr>
<tr><td></td><td>operate under a manufacturing risk management programme are levied while some dairy processors operate under a food safety programme.

Costs for individual small processors could be seen as unfair by the smaller processors within this group given the wide range in the size of small processors.</td><td>administrative costs.</td><td>Zealand standards, performance monitoring and residue monitoring in total or the costs of providing the services to the particular businesses specified. The costs to MPI of providing these services in total has risen.</td><td>services are identified and allocated to cover the period of the cost recovery regulations. Large dairy processors are invoiced quarterly and small processors are invoiced annually.</td></tr>
<tr><td>Large processors: collected > 491,000kg in previous financial year; medium: 16,500 kg < ‘x’ kg ≤ 491,000kg; small: not collection agents or collected ≤ 16,500 kg (Preferred Option, Option 2)</td><td rowspan="2">✓✓
This option would better source recovery from those benefitting from the services as it imposes the levy on all who collect raw milk for processing and hence costs will be passed onto all dairy processors.

Levying individual businesses based on their share of raw milk solids collected recognises additional premises do not generally increase costs for these services because information is transferable within the business.</td><td>✓✓
Can use DairyNZ data, which has less administrative cost than processors providing data to the Ministry.</td><td rowspan="2">✓
Costs for New Zealand standards and export standards would be based on the most up to date assessment of full-time equivalent effort by the Ministry’s staff and other actual costs. Costs for the NCCP would be based primarily on the costs of contracts with independent service providers to sample raw milk, colostrum and dairy products. It is possible costs may change in future years due to unexpected events.</td><td>✓
As above. Annual costs would be allocated closely to annual service provision in the previous year.</td></tr>
<tr><td>Large processors: expected to collect > 491,000 kg in the financial year; medium: 16,500 kg < ‘x’ kg ≤ 491,000kg; small: not collection agents or ≤ 16,500 kg (Option 3)</td><td>×
Relatively high administrative costs as large processors would need to provide data to the Ministry on their expected collection and the Ministry would need to do reconciliations at the end of each year between expected collection and actual collection.</td><td>✓
As above. Annual costs would be allocated to the expected annual service provision in the year.</td></tr>
</table>

Option	Equitable	Efficient	Justifiable	Transparent
	Introduction of a medium processors category better targets levy amounts to the size of processors and hence how much they benefit from, and impose costs on MPI's services.			

Option 2 is preferred as it scores better than or the same as the other options against all the criteria.

Problem definition for exporter definitions

The definitions for exporters need to be updated to reflect the changes in market shares for dairy exporters since the last cost recovery review to ensure equity and competitive neutrality.

There is also a need to have reliable data sources to inform which large exporters and to inform the calculation of levies to these exporters. To date, charges have been based on publicly available information that is incomplete and not always up-to-date.

Options analysis

The options are:

- Option 1: Status quo - Fonterra would continue to be the only large exporter (i.e. the only exporter with a specified quarterly levy). Small exporters would be all registered exporters other than Fonterra and would be charged an annual levy;
- Option 2: Large exporters would be defined as registered exporters and other persons who exported more than 636,000 kilograms[13] of dairy products in the previous financial year. Small exporters would be all other registered exporters (preferred option);
- Option 3: Large exporters would be defined as export processors that collected more than a certain threshold of raw milk solids to be processed primarily for the export market in the previous financial year. Small exporters would be all other registered exporters; and
- Option 4: Large exporters would be defined as registered exporters and other persons who exported more than a monetary threshold of dairy products in the previous financial year. Small exporters would be all other registered exporters.

[13] The threshold for exporters was determined by dividing the small exporters' levy amount by the total amount to collect from exporters and multiplying it by the total export mass of dairy products in 2013/14.

Table 12: Consideration of proposals against statutory criteria:

Option	*Equitable*	*Efficient*	*Justifiable*	*Transparent*
Fonterra as the only large exporter. Small exporters are all other exporters. (Status Quo)	✗ Lacks equity as there are many large exporters that should be paying a higher amount than the small exporters levy based on their relatively large share of the export market, which is a proxy for their benefit from the services. Costs to small exporters could be seen as unfair by the smaller exporters within this group given their share of costs would be affected by the market shares of many relatively large exporters.	✓✓ Only one large exporter to calculate and invoice specific levies to reduces administrative costs.	✗ The fees set in 2007 are now out of date. They do not appropriately reflect the costs to MPI of providing market access standards and export standards in total or the costs of providing the services to the particular businesses specified. The costs to MPI of providing these services in total has risen.	✓ MPI keeps detailed records of the respective costs of dairy services, so that the costs of providing these services are identified and allocated to cover the period of the cost recovery regulations. Large exporters are invoiced quarterly and small exporters are invoiced annually.
Large exporters exported more than to 636,000 kg in previous financial year. Small exporters are all other exporters. (Preferred Option, Option 2)	✓✓ Individual exporters would be levied for market access and export standards at a level more commensurate with their benefits from these services. The benefits of market access and export standards is more related to the quantity of product exported than to the financial returns from exports. Using export mass is also consistent with wine cost recovery.	✓ Additional administrative costs from invoicing specific levies to multiple large exporters. The use of Customs data to determine whether exporters are large or small would help to minimise administrative costs. Some conversions of quantity exported into one unit of measurement (litres into kg) would be needed.	✓ Costs for market access standards and export standards would be based on the most up to date assessment of full-time equivalent effort by the Ministry's staff and other actual costs. It is possible costs may change in future years due to unexpected events.	✓ As above. Annual costs would be allocated closely to annual service provision in the previous year.

Option	Equitable	Efficient	Justifiable	Transparent
Large exporters would have collected more than a certain threshold of raw milk solids for the export market in previous financial year. Small exporters are all other exporters. (Option 3)	× Lacks equity as the levy to large exporters would be partly based on their production for the domestic market, which does not benefit from market and export standards development.	× Additional administrative costs from invoicing specific levies to multiple large exporters. Relatively high administrative costs due to the need to determine which processors are export orientated.		✓ As above. Annual costs would be allocated closely to annual service provision in the previous year.
Large exporters exported more than a certain monetary threshold in previous financial year. Small exporters are all other exporters. (Option 4)	✓ Returns from exports are not as close a proxy for the benefits from market access and export standards as export mass because many other factors affect export returns to each company, such as the level of value-adding by company. Market access is typically provided generically, rather than by the value of the product.	✓ Additional administrative costs from invoicing specific levies to multiple large exporters. The use of Customs data to determine whether exporters are large or small would help to minimise administrative costs. Some conversions of quantity exported into one unit of measurement (litres into kg).		✓ As above. Annual costs would be allocated closely to the expected annual service provision in the year.

On balance, Option 2 is preferred as it scores best overall against the four criteria. While it is less efficient than the Status Quo, it is still an efficient option.

Method of calculating levies for large processors and exporters

Problem definition

Prescribed levies that are specific to individual businesses become less transparent and equitable between cost recovery reviews as actual market shares change. With changes in market shares, the levies no longer reflect the benefits received from services delivered. In addition, if there are any changes to the list of businesses that operate as large processors between cost recovery reviews, the Ministry is required to seek an ad hoc change to the regulations to incorporate these.

Options analysis

The Ministry has considered the following options:

- Option 1: Specified levies for each large processor and exporter in the regulations, updated for their current market shares (status quo);
- Option 2: The regulations would set out a single formula to annually determine the amount for each large processor and exporter to pay for all services respectively. Under-recoveries or over-recoveries resulting from changes in industry structure would be dealt with through annual adjustments within the Ministry (preferred option); and
- Option 3: An annual levy rate. For large processors, the levy would be a set rate per kilogram of raw milk solids collected, based on forecast milk solids production. For large exporters, the levy would be a set rate per kilogram or litre of dairy product exports, based on forecast dairy exports.

Table 13: Consideration of proposals against statutory criteria:

Option	***Equitable***	***Efficient***	***Justifiable***	***Transparent***
Specified levies for each large processor and exporter in the regulations. (Status Quo)	× Setting a levy for several years based on a point in time means that businesses whose market shares and hence benefits change during these years are not levied in relation to their benefits.	✓ Having the same levies set for several years minimises administration costs, but additional administration costs if the Ministry has to seek ad hoc changes to the regulations if there were changes to which businesses are large processors or exporters.	× The fees set in 2007 are now out of date. They do not appropriately reflect the costs to MPI of providing the dairy services in total or the costs of providing the services to the particular businesses specified. The costs to MPI of providing these services in total has risen.	✓ MPI keeps detailed records of the respective costs of dairy services, so that the costs of providing these services are identified and allocated to cover the period of the cost recovery regulations. Large processors and exporters are invoiced quarterly.
Levy formula (Preferred Option, Option 2)	✓ Setting a levy based on market share and hence benefits businesses received in the previous year to the year of provision is a good proxy for benefits received in the year of provision.	✓✓ A single levy for all services calculated minimises administration costs. Annual updates to which businesses pay for the levies would mean there	✓ Costs for the dairy services in total and by business would be based on the most up to date assessment of full-time equivalent effort by the Ministry's staff and other actual costs. It is possible	✓ As above, but annual levies could become more closely allocated to the period of service provision if the Director-General set total levy amounts by Annual Notice; this is subject to

Option	Equitable	Efficient	Justifiable	Transparent
		is less chance of under-recovery, which reduces benefits from this method increases administration costs.	costs may change in future years due to unexpected events. Annual levies could become more in line with annual costs by the Director-General setting total levy amounts by Annual Notice; this is subject to Parliamentary Counsel Office advice or amendments to the Animal Products Act 1999.	Parliamentary Counsel Office advice or amendments to the Animal Products Act 1999.
Annual levy rate (Option 3)	✓✓ Each processor would be charged the same rate per kilogram for milk solids collected in the year of provision, which is a strong proxy for the benefit from services received in the year of provision.	✗ The Ministry could be under-resourced if actual milk solids production is less than forecast. If the Ministry invoiced on the basis of quarterly production, there would be uneven payments throughout the year given variances in milk production. Both of these would decrease the benefits from this method and increase administration costs.		✓ As above, but annual levies could become more closely allocated to the period of service provision if the Director-General set total levy amounts by Annual Notice; this is subject to Parliamentary Counsel Office advice or amendments to the Animal Products Act 1999.

On balance, Option 2 is preferred as it scores best overall against the four criteria and in particular, it scores well on the efficiency criterion.

Method of calculating levies for small processors and exporters and medium processors

Problem definition

Setting charges to small processors and exporters based on a fixed share of total costs for services is not easily maintainable. The Ministry would have to change the share of total costs to small processors and exporters over time if there are changes in the numbers of small processors and exporters and/or in the size of total costs to ensure the levy amounts to small processors and exporters would not change markedly.

Options analysis

The Ministry has considered the following options:

- Option 1: Levies based on a set percentage of total costs for small processors and exporters per service, divided among the number of small processors and exporters respectively. The set percentage would be above the actual share of raw milk solids collected by small processors and above the mass of exported dairy products by small exporters (updated status quo);

- Option 2: Levies based on the actual share of total raw milk solids collected by small processors and the actual share of total dairy products exported by small exporters, divided by the number of small processors and small exporters respectively. There would be a combined levy to cover New Zealand standard setting, performance monitoring and residue monitoring for small processors, and a combined levy for market access and export standards for small exporters; and

- Option 3: Levies based on a time-benefit basis. There would be a combined levy to cover New Zealand standard setting, performance monitoring and residue monitoring for small processors and a combined levy for market access and export standards for small exporters. Based on the standard Ministry food safety hourly rate of $155, each small processor would pay $465 a year in total for New Zealand standards development, performance monitoring and residue monitoring services, equal to one hour of time for each service. Similarly, each small exporter would pay $310 a year in total for market access and export standards development services, with one hour for market access and one hour for export standards. Medium processors would be levied $930 per annum, equivalent to six hours of time (preferred option).

  Based on operational experience, the Ministry considers these time periods to be reasonable estimates of the time spent delivering New Zealand standards development, performance monitoring and residue monitoring to small processors, small exporters and medium processors respectively.

Table 14: Consideration of proposals against statutory criteria:

Option	***Equitable***	***Efficient***	***Justifiable***	***Transparent***
Set percentage of costs above share of total raw milk solids and dairy exports (Updated Status Quo)	✓ Small and medium processors and exporters should be levied according to their benefit from the services. They receive benefits and impose higher costs than levies based on their small share of raw milk solids and export mass respectively.	✓ Dollar amount of levies sufficient to collect. Relatively high administration costs at each review as MPI would have to recalculate the percentage share used if total costs for services, or the number of small and medium processors or exporters changed significantly, so that levies to small and medium processors and exporters remain justifiable.	✗ Costs to small processors and exporters based on proportion of total costs could be become unrelated to the actual and reasonable costs incurred by the Ministry of providing the relevant services given changes in the numbers of small processors and exporters and/or in the size of total costs.	✓ MPI keeps detailed records of the respective costs of dairy services, so that the costs of providing these services are identified and allocated to cover the period of the cost recovery regulations. Small processors and exporters are invoiced annually. All levies are set for the period of the cost recovery regulations, but if there are significant changes

Option	***Equitable***	***Efficient***	***Justifiable***	***Transparent***
Actual share of total raw milk solids and share of dairy exports (Option 2)	✗ Lacks equity as small and medium processors and exporters receive greater benefits and impose higher costs than their small share of raw milk solids and export mass respectively, so should be levied greater amounts.	✗ Inefficient to administer and collect these levies due to their small dollar amount per processor and exporter.	✗ Costs are not reasonable as the costs of provision are higher than the levies charged.	in processors or exporters' market shares they will move to the medium or large processor categories or large exporter category respectively.
Time-benefit basis (Preferred Option, Option 3)	✓ The levies are linked to an estimate of the average hours of service provision to small and medium processors and small exporters respectively.	✓✓ Dollar amount of levies sufficient to collect. Administration costs would be minimised in future reviews as each levy could be updated by linking it to the increase in the standard hourly Ministry food safety rate.	✓ Based on operational experience, three hours of service per small processor, six hours per medium processor, and two hours for small exporters are considered to be conservative estimates of benefits to them from services provided. The proposed levies for small processors and exporters are lower than their current levies. The food safety hourly rate compares favourably to similar services in New Zealand and abroad (for example, they are up to $241 at the Civil Aviation Authority).	

Option 3 is preferred as it scores better than or the same as the other options against the criteria.

Impacts of the proposals

Overall impacts

In total, cost recovery for New Zealand standards development, market access and export standards development, dairy residue monitoring and performance monitoring is proposed to increase by 26 percent over charges for 2014/15. Costs to processors would increase by 87 percent given the proposal to shift the cost of dairy residue monitoring from dairy exporters to dairy processors and given increases in service provision for dairy residue monitoring and performance monitoring.

Overall *direct* costs to exporters would decrease by 29 percent as the cost of dairy residue monitoring is proposed to be shifted from them to dairy processors and there is a small decrease in the costs for export standards development.

Small and medium processors

The levies proposed for small processors, $465 per annum, are five percent lower than current charges of $488 per annum. The decrease for small processors reflects the Ministry's efforts to better distinguish between the benefits received, and costs imposed, by small processors and medium processors.

The levies proposed for medium processors are significantly higher than current charges to small processors. The additional cost is primarily due to their new contribution to dairy residue monitoring, which is the most costly of the four major Ministry services charged to the industry. The estimated increase in total costs to medium processors is in the order of $442 a year, which is significant in terms of percentage growth (91 percent increase).

Small exporters

These parties would pay less *directly* as their levy for dairy residue monitoring is shifted to dairy processors, although costs are likely to flow through to them from dairy processors. The estimated decrease in total costs to small exporters is in the order of $358 a year, which is significant in terms of a percentage change to the cost (a decrease of 54 percent).

Large processors

Large processors would be required to pay more, as their overall contributions to residue monitoring, performance monitoring and New Zealand standards are brought in line with their current market shares, as they begin to contribute to dairy residue monitoring, and given increases in service provision for residue monitoring and performance monitoring.

Large exporters

Some large exporters would be required to pay more as their overall contributions to market access and export standards are brought into line with their market shares, although some other large exporters will pay less as total costs to exporters decrease.

Consultation

The Ministry undertook consultation between 19 January and 20 February 2015. The consultation process included 21 public regional meetings and several targeted, sector-specific meetings in addition to a publicly released consultation document. Notification of the meetings was through email, hard copy letters, and newspaper advertisements.

Around 270 people attended the meetings and the Ministry received 247 submissions. Of these, the majority (181, 80%) were from the wine industry.

The most significant stakeholder concerns were:

- The wine industry's view that it should not pay additional fees for regulatory services because it already pays excise duty.
- The meat industry's opposition to the proposal to recover deficits in the verification of food regulatory programme memorandum account through increased charges.
- The cost to importers and exporters from the increase in the veterinary and specialist staff hourly rate.
- The significant increase in the per head levy for slaughtered deer.
- The significant increase in the annual levy on processors of egg products.
- The cumulative impact of costs (and administrative burden) of government regulations and charges on small and artisan businesses, e.g. wine, dairy, honey, bees and ornamental fish.

Of these, the majority of submissions were received on the proposed levies on the wine industry.

There was general acceptance by stakeholders that an increase in fees and charges was inevitable given the length of time since they were last reviewed. Importers acknowledged the importance of robust biosecurity regulation and accepted the need to set fees appropriately. Some stakeholders (agricultural medicines and compounds suppliers, and larger importers) proposed increasing fees further with a view to expediting the delivery of services. The Ministry is working with industry to investigate this option.

The dairy industry accepted the proposed change to charging mechanisms. Dairy Companies Association of New Zealand (DCANZ) noted that a component of the cost increase for dairy was associated with improvements to the NCCP and was supportive of the Ministry's work to ensure this programme is fit for purpose and maintaining pace with international changes. DCANZ suggested that future revisions are made on a more regular basis to avoid the scale of adjustment required under the current proposals.

Established operators in the biosecurity sector (e.g. assessment and quarantine facilities of imported goods) welcomed the revised rules and charging around the operation of transitional and containment facilities. Operators also accepted fee increases for services, provided there was demonstrable value for money. Consistent with previous feedback, cargo and freight operators sought more equitable attribution of costs between cargo, freight and passenger pathways. The latter issue is one that the Ministry will consider further with other agencies as part of its biosecurity policy programme.

An outstanding concern within the biosecurity sector was the impact of the cost of quarantine inspections on ornamental fish and invertebrate importation, due to the proposed increase in the veterinary professional/inspector rate from $88.87 to $186.30. Importers indicated that it was likely to affect the viability of their businesses and limit consumer access to ornamental fish. Other stakeholders, across a range of import and export sectors, also expressed their concern over the proposed increase to the veterinary rate and questioned whether it was justifiable or transparent.

The Ministry considers the veterinarian services rate proposal is now set at a rate that will appropriately cover the costs of providing this service, and notes that the rate compares favourably to professional rates for other New Zealand agencies (e.g., up to $241 for the Civil Aviation Authority) and also with agricultural verification rates in Australia (between $132 and $306 AUD).

The wine industry stakeholders, led by their industry representative body (New Zealand Winegrowers), objected to all aspects of cost recovery. The key reason was that the domestic wine industry already contributes $206m (2013/14 year) in excise duty on New Zealand consumed wine and the industry should not therefore be expected to carry the additional costs of regulation.

The Meat Industry Association (MIA), however, strongly objected to what it considered the retrospective application of historical costs, through the recouping of circuit verification services through increased charges for establishment verification services. The MIA has been working closely with the Ministry over several years and has received regular updates from the Ministry indicating moderate surpluses.

The Ministry appreciates that the MIA has acted in good faith on the Ministry's information and a retrospective application of fees would be unjustified. On balance, we agree that it is not fair to recoup the historical deficit given that the industry had not previously been advised that there were any.

Small-scale and artisan stakeholders objected to the level of fee increases, and the cumulative impact of government fees and charges. Artisan cheesemakers proposed an alternative, tiered, charging mechanism that would see lower levels of cost recovery from smaller producers than proposed.

The pet food industry welcomed the positive impacts that regulation has brought their industry and accepted that fees increase were inevitable given the increase in input costs.

Submissions of a more generic nature included proposals to improve the value for money of services, improve the level of service delivery and increase the transparency of regulatory costs. These issues will be considered as part of a first principles review of cost recovery across the Ministry, which is scheduled for completion in 2015. Many industry stakeholders expressed a keen interest in being involved in such a review.

MPI is considering the best way to engage with industry during the review.

Conclusions and recommendations

Having carefully considered stakeholder submissions and the impacts of different options, the Ministry recommends the proposals be implemented the proposals as presented in the public consultation document, with a number of the substantive sector-specific revisions and minor amendments.

The substantive revisions are:

- a recommendation not to recoup all the historic deficits in the verification of food regulatory programme memorandum account;

- a re-definition and decrease in the small dairy processor levy (to approximately current levels) and the creation of the new levy category of ‘medium dairy processor’.
- the adoption of a single (export and domestic) levy for poultry production;
- alignment of the minimum hourly rate charge at the equivalent of half an hour;
- New Zealand Winegrowers making a voluntary annual payment to the Ministry for maintaining standards and compliance services, rather than being subject to levy;
- all wine exporters will be exempt from paying an export levy on the first 10,000 L of wine exported; and
- decreasing wine domestic standards by $10,000 to remove the cost of standards development for non-grape wines.

For the wine industry, the Ministry considers that the case is insufficient to exempt the wine industry from cost recovery for the reasons stated above under the Wine Policy Issues section.

Implementation plan

Changes to fee rates and policy will be empowered through regulatory amendments by an Order in Council. New fees will be implemented through amending internal charging processes. There are no transitional arrangements needed or foreseen implementation risks to mitigate.

The Ministry does not expect compliance costs to be affected as there will be no changes to practice required. In the case of the proposed cost recovery for the Wine industry, the method of collection will remain as it currently is, incurring no further compliance costs.

While most regulations proposed to be amended are required for the regime to function, some redundant regulations under the Wine Act will be removed.

Monitoring, evaluation and review

Monitoring of the charges relative to costs will be undertaken through financial analysis of the memorandum accounts and checking the activity against assessed levels and comparing this to the Ministry’s costs.

Monitoring of the regime as a whole will be undertaken through both the first principles review, as well as periodic reviews of cost recovery fees and policy settings that support them. This examination will allow for evaluation of the previous years’ fees and examination of the assessed levels of effort (compared to actual) that many of the current fees were derived from.

The main performance indicators of the annual review will be the Ministry’s income compared to costs for each memorandum account, on a monthly basis. Data will be collected by the Ministry’s Corporate Services branch and analysed as part of the first principles review of cost recovery, as well as being used to evaluate and monitor the current changes. Table 15 below describes indicators the Ministry will monitor to ensure that the statutory criteria are met.

The review and evaluation process will be centred on whether the goals of the cost recovery project are being met. These goals are that the regime is equitable, efficient, transparent and justifiable. After this first review of cost recovery as the Ministry for Primary Industries, the regime and fees will be reviewed more regularly.

Table 15: Monitoring, evaluation and review

Objectives	Indicator(s) to monitor	Info / Data Source(s)	When and how to (Monitor, Review, Evaluate), Who and Product of this
		Equitable	
Charges being fairly distributed across industry	Stakeholder feedback, costs compared to actual effort and expenditure on different sectors	Financial memorandum accounts, reports from Finance (currently monthly)	The cost recovery team will monitor this feedback and financial indicators supplied by Finance
Charges recovering underlying costs	Memorandum account activity	Financial memorandum accounts	Financial analysis of memorandum accounts, analysed monthly by Finance Any irregularities flagged and SLT/cost recovery team notified.
		Efficient	
Costs being minimised to deliver the expected service standards	Internal cost reporting, through Finance External audits conducted show good tracking against best practice		The Ministry’s cost recovery team being established will monitor this feedback and financial indicators supplied by the Finance department. The Assurance and Evaluation branch will provide support.
Effective and efficient roll-out of new cost-recovery	Stakeholder feedback, internal accounts management, feedback from public-facing staff	Feedback from stakeholders, feedback from the teams directly involved	

Transparent			
Objectives	**Indicator(s) to monitor**	**Info / Data Source(s)**	**When and how to (Monitor, Review, Evaluate), Who and Product of this**
Memorandum accounts are operated correctly	Stakeholder feedback, internal monitoring	Stakeholder feedback, financial examination of the accounts	External auditors, Finance, Cost Recovery team
Stakeholders can see that the costs they pay are the costs of services, and that those services are being delivered as efficiently as possible	Memorandum accounts are open and operated properly	Time recording tools are deployed and data collected	
Justifiable			
External review/audit bodies are satisfied that fees are appropriate	Results of external auditing	Reports from auditors	Late 2015 – First principles review, then annually, to be done by the Policy Capability & Regulatory Systems team and the cost recovery team.
Regime as a whole	Accounting for above indicators, data sources and what these are telling us.		