Stage 2 Cost Recovery Impact Statement

Poultry levy under the Animal Products Act 1999

Scope

The Ministry for Primary Industries (MPI) consulted on proposals to increase charges on five levies: the poultry levy, the domestic bee levy, the exporter bee levy, the dairy standards processor levy, and the dairy export levy. This Cost Recovery Impact Statement (CRIS) only covers the poultry levy.

Agency Disclosure Statement

This CRIS been prepared by the Ministry for Primary Industries. It provides an analysis of options to address a deficit that has accumulated under the poultry levy.

Cost recovery principles

Options considered in this paper have been developed in accordance with the cost recovery principles of Transparency, Justifiability, Efficiency and Equity defined in relevant legislation and MPI's cost recovery guidance.

A number of issues have been identified regarding the level of information consulted on that affects the degree to which the Transparency principle has been achieved:

- Options 2, 3 and 4 were developed following consultation taking into consideration the feedback received from submissions;
- The level of information presented in this document regarding revenue, expenditure and costs, and how the deficit had accrued was not defined to the same degree in the consultation document; and
- MPI regularly consults with industry on service levels, but this has taken place separately from consultation on proposed changes to the poultry levy.

Greater transparency, including a single avenue by which industry can consider all of MPI's services and decide the best use of levy revenue, would provide greater assurance that MPI is providing the best mix of services at lowest cost.

Despite these issues, MPI is confident it has identified the causes of increased expenditure and that the increases are justified. The two main causes are greater demand for services by industry, and increases in the cost of residue testing which MPI contracts from external providers. MPI is unable to identify the cause of the increased cost of residue testing, but the competitive tendering process should ensure that costs are efficient.

Option (1) is the most efficient option in terms of recovering costs. There is a level of uncertainty around whether Option (1) or (2) is the industry's preference and therefore best meets the Equity principle. This uncertainty has been generated by feedback received from The New Zealand Food and Grocery Council (NZFGC), and a lack of feedback from other affected parties. Therefore, the preferred option involves a level of judgement based on the level of engagement undertaken. Option (1) is a standard flat fee approach that industry will be most familiar with. Feedback received from the NZFGC stated support for an option like Option (2), but it is unclear whether this option would be supported by other affected parties.

Impact analysis

Estimates of the immediate financial impact of options on the market and at the business-level are presented. However, as the levy change is minor relative to the size of the industry, the CRIS does not contain a full analysis of the market impacts or of demand for MPI services over the longer term.

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10/06/2021

EXECUTIVE SUMMARY

As at June 2020, the poultry levy had accumulated a deficit of $73,000. Without changes the deficit is expected to grow to $299,000 by June 2025. MPI considers that demand from industry and increases in the cost of competitively-tendered contracted services are the primary drivers of the deficit.

MPI considered four options. Option (1) fully recovers costs through a single 14% increase in the levy. Option (2) fully recovers costs through a graduated levy – a 10% increase in the levy in 2021/22, and further 4% increases in 2022/23 and 2023/24. Options (3) and (4) partially or fully defer cost recovery.

The cost increases under all options are small in comparison to total industry costs and are, therefore, expected to have negligible impact on industry production.

For instance, Option (1) increases the levy from $0.00443 per bird processed to $0.00507 per bird – an increase of 0.064 cents per bird. This is 0.005% of the retail price per bird of about $13.26 per bird. The trade-offs between Option (1) and (2) are similarly negligible.

The economic inefficiency of Option (1) is only $1.85 per annum and $3.00 per annum in total across industry for Option (2). Option (1) would see a low volume processor paying $63 more per year versus, under Option (2), $42 in 2021/22 rising to $85 in 2023/24.

MPI assessed each option against the principles of Transparency, Justifiability, Efficiency and Equity.

Despite some gaps around consultation, MPI has sufficiently met the Transparency and Justifiability principles such that Options (3) and (4) should not be preferred.

Option (1) has the lowest economic inefficiency and, therefore, best meets the Efficiency principle.

Option (1) implements a flat levy on processors in each year (and is the standard approach that industry is most familiar with). Option (2) charges less in 2021/22 and more in 2023/24. The New Zealand Food & Grocery Council prefers Option (2) as it costs industry less in the immediate post-Covid period, but it is not clear that this represents a consensus view among industry.

Overall, MPI considers that Option (1) best meets the Transparency, Justifiability, and Efficiency and Equity principles and is MPI's preferred option. If the Government considers that a graduated approach is more appropriate at this time, then Option (2) could be chosen with only small efficiency costs.

STATUS QUO

The poultry industry over time

Poultry production has grown over time through increases in the number of birds farmed and through increases in yield (meat per bird) (see Figure 1). Information about prices received by farmers and processors has not been identified, but the real (consumers price index-adjusted) retail price of chicken meat has steadily declined since early 2015 (Figure 2).

Figure 1: Yearly poultry production

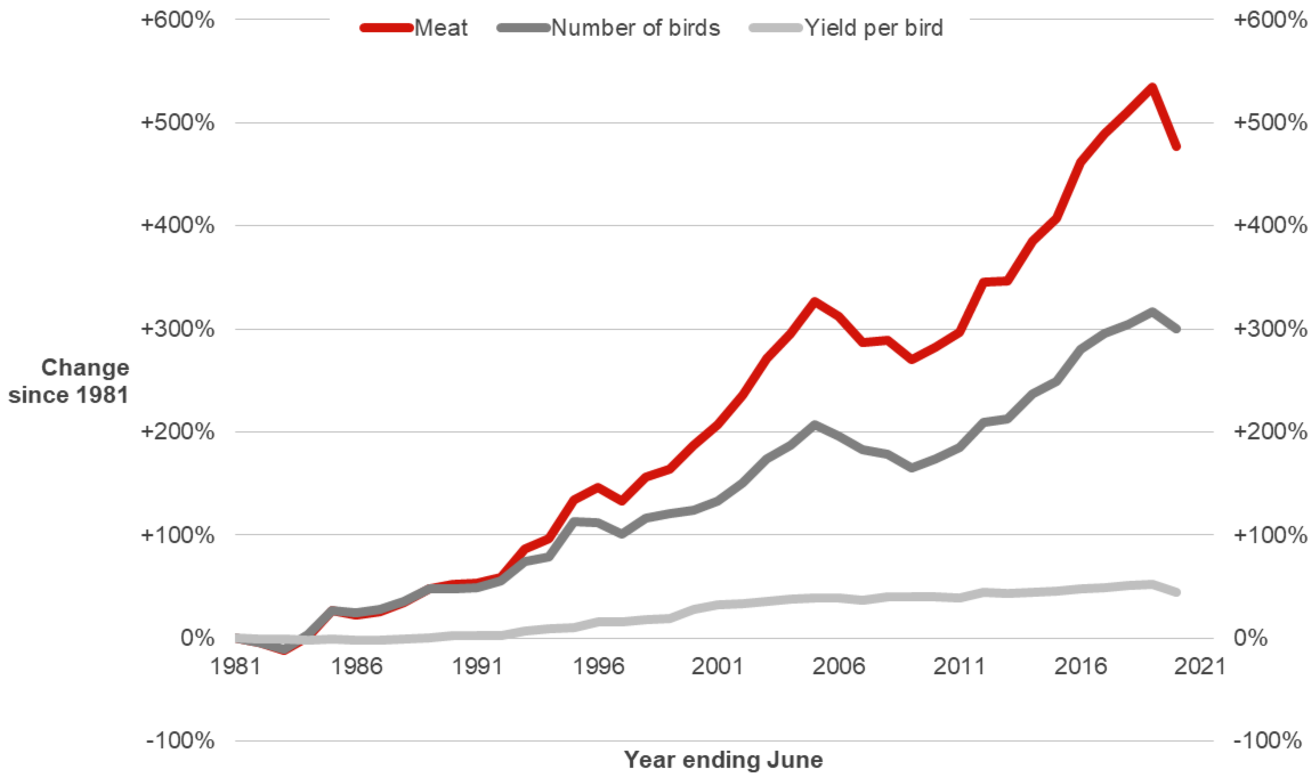
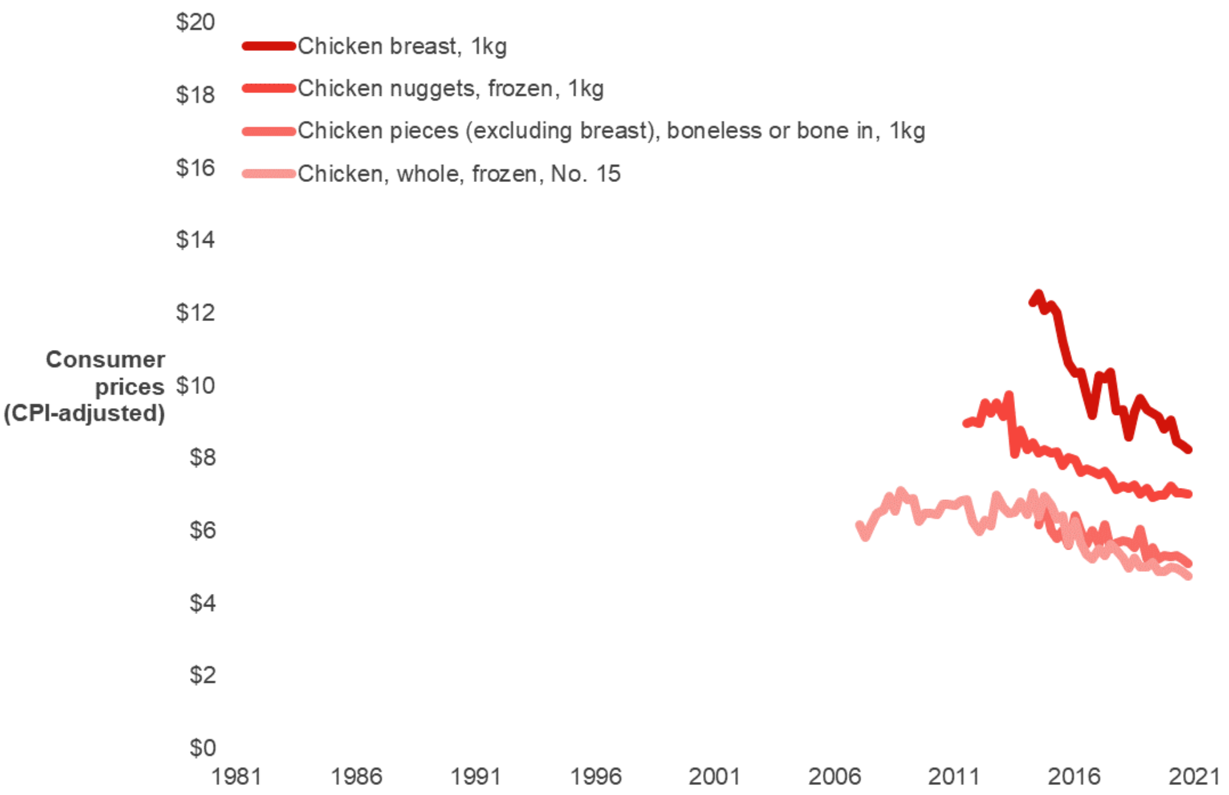


Figure 2: Poultry prices

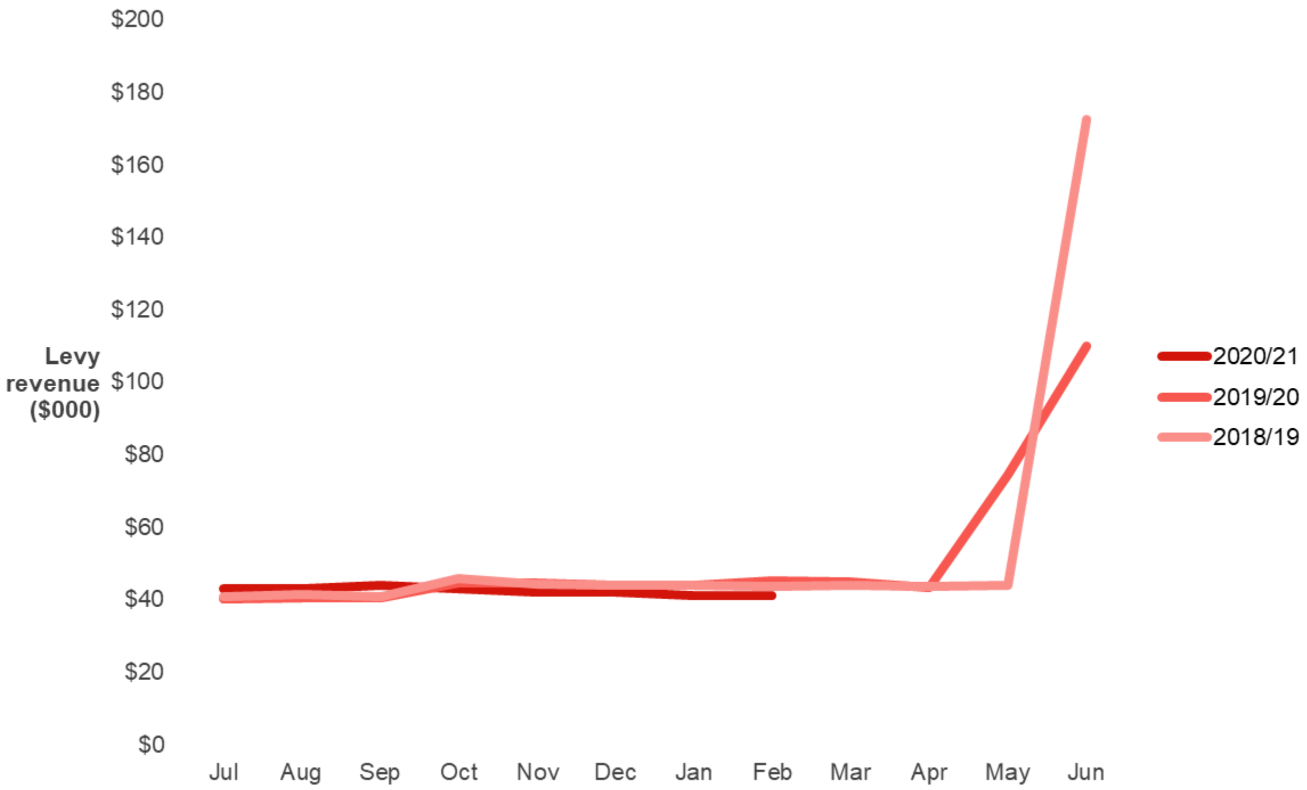


Impact of Covid-19

Levy revenue data (Figure 3) suggests that Covid-19 has not had a material impact on industry production.

However, MPI does not have timely information about the value of poultry exports or costs. A submission from The New Zealand Food & Grocery Council noted that Covid had brought extra costs in terms of processing and freight. We have not verified this for poultry in particular, but disruption and higher freight costs have been reported more generally in media, and was a common theme across industry submissions received during recent consultation on other cost recovery proposals.

Figure 3: Monthly levy revenue, July 2018 to February 2021



MPI's services, charges, and the regulatory framework

Cost recovery in general

Cost recovery funds the services that protect New Zealand from biological risks, ensure our food is safe to consume and export, and that help ensure the sustainability of our natural resources. These outcomes allow our primary sector to grow the value of its exports, which currently generate over $48 billion per annum (2019/20). Typically, approximately 30% of MPI's departmental funding comes from cost recovered revenue. With the emergence of COVID-19, this is expected to be approximately 20% ($150 million) in 2020/21, largely due to the drop in revenue for border biosecurity levies on arriving travellers.

In line with best practice guidance, MPI generally undertakes a thorough review of each cost recovery regime at least once every three years.

Additionally, MPI aims to set fees and levies at levels that ensure memorandum accounts trend towards zero over a three-year period. To achieve this, fees and levies may also be updated outside this normal three-year review cycle if a material surplus or deficit accumulates in a memorandum account.

MPI takes a principles-based approach, as set out in the 'Cost Recovery Principles and overall approach to cost recovery' section, to both its thorough reviews and its out-of-cycle reviews.

What regulated services are covered by this CRIS?

The Animal Products Act 1999 (the APA) applies to the production and processing of all animal products including but not limited to meat, fish and shellfish and dairy products. The APA influences a wide range of businesses servicing both domestic and export markets.

MPI provides a range of regulatory services under the APA that aim to minimise and manage risks to human or animal health arising from the production and processing of animal material and products. In addition, the APA covers services that facilitate the entry of animal material and products into overseas markets. These services include:

- standards development (domestic and export);
- market access services; and
- system and assurance monitoring (e.g. residue testing).

The services are club goods

A 'club good' is one where people/businesses can be excluded from services (e.g. have to join a 'club'), but once in the club, are able to use of the services without reducing the service and benefits available to other members (the benefits are 'non-rival').

The benefits of standards and market access are available to any business that chooses to operate in the domestic or export market. One business making use of the standards or access does not prevent another business from making use of the standards or access. The benefits of standards and access are, therefore, non-rival. Businesses, however, can only receive these benefits if they comply with the regulatory requirements (the service is excludable).

To encourage businesses to only demand or use services that they value highly enough it is economically efficient to, wherever possible, recover the costs of providing club goods from those who benefit from the services.

How are the levies regulated?

In general

The Animal Products Act 1999 (APA) allows MPI to recover costs in accordance with the principles of Transparency, Justifiability, Efficiency and Equity (see the 'Cost Recovery Principles and overall approach to cost recovery' section of this CRIS).

Levies are set in the Animal Products (Fees, Charges, and Levies) Regulations 2007.

Those that benefit from standards, market access and monitoring are the businesses that supply domestic and export markets, and ultimately the customers of those businesses. Economically-efficient cost recovery would see businesses pay in proportion to the benefits they receive. However, it is generally difficult to establish the precise level of benefit a business receives from a service. As a result, MPI uses an appropriate proxy (such as units produced or exported) to quantify the benefits its services provide to each business. This approach is consistent with MPI's cost recovery policy and best practice guidance from the Treasury.

Additional requirements for changes made part-way through a financial year

Any changes to the levy in 2021 will be made part-way through the financial year (1 July 2021 to 30 June 2022). The APA contains additional requirements being that the Minister is 'satisfied that those persons, or their representatives, agree or substantially agree' with the changes.

How are the levies set?

MPI calculates the total costs (direct and overheads) in the relevant business unit. The business unit is responsible for standards and market access for many products and industries.

Total costs are then divided across the total number of birds processed. This is considered a reasonable proxy for the benefit each producer receives.

Current charge

The current levy is $0.00443 per bird processed.

Cost Recovery Principles and the overall approach to cost recovery

This section summarises MPI's Cost Recovery Principles, how they relate to each other, and what this means for the overall approach to cost recovery.

MPI's Cost Recovery Principles

MPI's four Cost Recovery Principles are:

- Transparency – costs are transparent;
- Justifiability – costs are reasonable;
- Efficiency – net benefits are maximised; and
- Equity – costs are fair.

These principles are set out in MPI's cost recovery guidelines[1] and in the Animal Products Act 1999[2]

The principles build on each other with Transparency and Justifiability providing a foundation to the consideration of, and sometimes trade-offs between, Efficiency and Equity. Essentially, MPI can only cost recover if it has sufficiently met the Transparency and Justifiability principles.

Once the Transparency and Justifiability principles are met, the Efficiency and Equity principles say that the beneficiaries of services should generally pay for services. That is, beneficiaries pay 100% of costs unless there is a strong efficiency or equity reason suggesting otherwise.

Appendix 1 contains a fuller description of the principles and how they relate to each other.

Overall approach to cost recovery

The requirement to meet a level of Transparency and Justifiability and the default of beneficiary pays results in the following overall approach:

Customers/beneficiaries generally pay

Customers/beneficiaries should generally pay for the services they demand.

Charging beneficiaries encourages them to demand or use only the services that they value highly enough. If the cost is subsidised by others, then beneficiaries will demand more services (with the cost being met by others). The extra demand on services from subsidisation is an inefficiency as it results in a greater use of resources during production than people would otherwise be willing to pay for.

Charging beneficiaries helps ensure MPI service volumes or quality are not higher than is economically efficient.

When beneficiaries might not pay

Beneficiaries might not pay full costs in four situations:

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[1] https://www.mpi.govt.nz/dmsdocument/30855/direct

[2] https://www.legislation.govt.nz/act/public/1999/0093/latest/whole.html#DLM35716

Transparency and Justifiability

The first is where MPI has not sufficiently demonstrated that it is doing all it reasonably should to keep costs low (cannot meet the Transparency and Justifiability principles).

In this situation it may be appropriate for MPI to:

- change fees/levies to the level that can be justified for the time being; and
  - cover the remainder of costs; or
  - recover the deficit from a future time period after further work is undertaken;
- guarantee that prices will not exceed a certain level over the next period;
- charge fees at a fixed level, rather than variable with time, to encourage efficient service delivery.

Administration costs

The second is where the administrative costs of charging (e.g. invoicing, collection) are excessive compared the revenue raised or the efficiency gain of precisely charging beneficiaries.

Externalities

The third is where there are externalities. Externalities are positive or negative impacts on third parties from the demand and supply of a good or service. MPI primarily deals with negative externalities. An example is the risk that arises from consumers demanding, and importers supplying, overseas products. A negative externality on a third party is the biosecurity risk from pest incursions on domestic farmers. Charging importers for MPI activities to reduce the risk encourages importers to reduce the risk and, therefore, need for the service.

Equity

The fourth is where the Government determines that there are equity (fairness) reasons why the Government or some other party should contribute to costs.

PROBLEM

What is the nature of the problem?

A deficit has arisen in under the poultry levy. Deficits are an efficiency problem – either the levy is too low for a desired level of service, or expenditure is too high, or a combination of both.

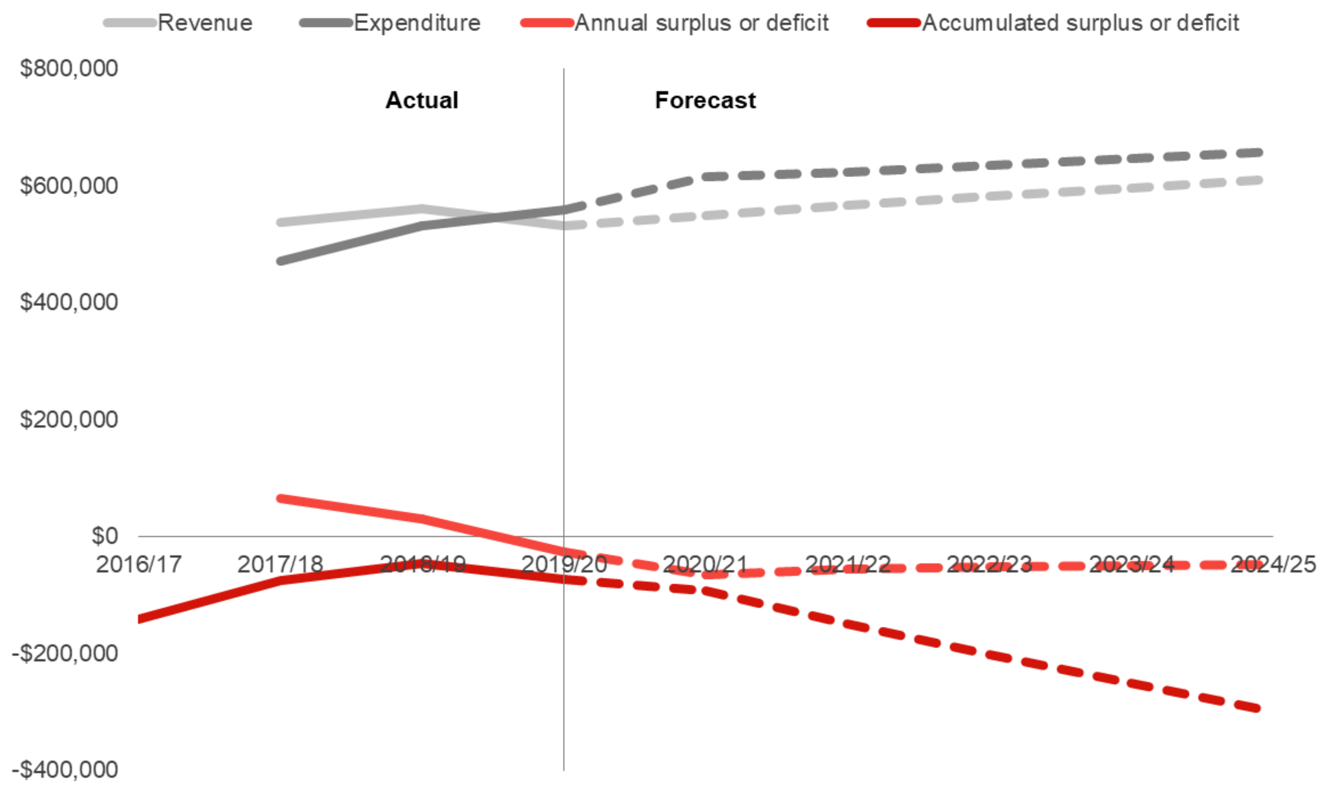
What is the size of the problem?

Historical annual deficits, including an annual deficit for the 2019/20 financial year of $27,000, have contributed to an accumulated deficit of $73,000 as at June 2020. The accumulated deficit is forecast to grow to $93,000 by June 2021 and $299,000 by June 2025.

Figure 4 shows the history of revenue, expenditure, and deficit balances through to 2019/20 and the respective forecasts through to 2024/25. The last time the levy increased was from the 2015/16 year. It appears that the accumulated deficit at that point was eliminated with the account being roughly in balance by 2018/19 (MPI aims to have accounts in balance over a three-year period). Since then, expenditure has increased further and a deficit has arisen.

Overall, between 2017/18 and 2020/21 expenditure has increased at an annualised compounding rate of 9.3% per annum.

Figure 4: Poultry levy, revenue and expenditure, 2016/17 to 2024/25



What is the cause of the problem?

To perfectly demonstrate the causes of a deficit (and why ongoing expenditure and revenue is justified), MPI would need to draw on a business case (or something similar setting out MPI's processes and the costs needed to run them) for recently developed services or, in the case of an established service, taking an old business case and accounting for changes to factors that affect revenue and costs.

In the absence of original business cases[3], the causes of the problem can still be reasonably ascertained by analysing each potential factor. These factors are the following:

(a) Lower than anticipated revenue

(b) General cost inflation

(c) MPI-specific increases in the costs of particular inputs beyond general inflation

(d) Increases in the level of resource used for a given service – whether through more effort and resources, or from cost inefficiencies

(e) Increases in the volume or quality of services

This section summarises the degree to which these factors contribute to the deficit. In doing so, it is important to consider the factors against MPI's two main groups of services[4]:

[3] Business cases won't always be produced in any case, particularly for small cost services. Poultry is a relatively small memorandum account.

[4] The expenditure across these two groups has made up about 93% of expenditure under the poultry levy between 2017/18 and 2020/21.

- standards development, e.g. reviews and implementation of the Campylobacter risk management strategy; and
- chemical and microbiological assurance – e.g. testing for residue compounds (e.g. steroids, antibiotics, pesticides).

Appendix 2 contains a fuller assessment of the problem and how each factor has contributed.

Changes in revenue – factor (a)

MPI has not located its forecasts from the last time the levy was changed in 2015, but the number of birds processed has grown at a similar (and fast) rate post the last levy change in 2015 as immediately before it (see Figure 1).

This suggests that actual revenue is unlikely to have turned out to be lower than was forecast and is unlikely to be a contributor to the deficit.

Changes in expenditure – factors (b) to (e)

While MPI's expenditure under the poultry levy has grown at a fairly consistent rate of 9.3% per annum over time, the increase is not uniform across the services that the poultry levy pays for. Expenditure is actually characterised by:

- a substantial increase in expenditure in 2018/19 on standards development, with no significant change since then; and
- a substantial increase in expenditure around 2017/18 on chemical and microbiological assurance services, followed by modest increases thereafter.

Figure 5: Expenditure by service type under the poultry levy[5]

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
Standards development	$205,509	No data		$215,832	$313,363	$286,041	$313,791
Chemical & microbiological assurance	$189,925	No data		$255,064	$218,408	$273,553	$275,503

Standards development

The increase in expenditure for standards development has come from increasing demand from industry for better domestic regulation and support (factor (e)) particularly through the development of a revised Campylobacter strategy and action plan for 2020 to 2025.

Chemical and microbiological assurance

The increase in expenditure from 2017/18 to 2020/21 is equivalent to an average compounding 2.6% increase per annum. This is not significantly different from general cost inflation (b) across MPI of about 2.1% per annum.

The precise cause of the increase in expenditure around 2017/18 for chemical and microbiological assurance has not been identified.

Increases in resource required (d) and increases in service levels (e) are not contributors. In fact, MPI has increased productivity in this area by reducing the extent of residue testing[6] in response to past results that demonstrated industry was complying with standards.

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[5] Centralised, readily accessible data on expenditure is only available from 2017/18. The 2014/15 data comes from the relevant business unit.

The increase in expenditure on chemical and microbiological assurance might have happened earlier than 2017/18, but staff recollections are that it happened around 2018.

This leaves increases in MPI-specific costs (c) as the remaining factor. MPI contracts for these services from external organisations. MPI does not know what costs contractors face that increased around 2017/19, however the process of tendering is competitive with around half a dozen bidders, so the expenditure increase should reflect genuine cost increases incurred by contractors rather than cost inefficiencies or excess profit.

OPTIONS

Introduction

Feasible options are those that can address the problem of the poultry deficit in accordance with the Cost Recovery Principles. This section summarises the available options with a full analytical breakdown of each option available in Appendix 3.

Summary of options

Status quo:

- the levy remains at $0.00443; and
- the deficit grows over time (see Figure 4) and costs eventually written off with the cost borne by MPI.

Option (1):

- increases the levy from $0.00443 to $0.00507 (a 14% increase, equivalent to 2.3% per annum compounding); and
- eliminates the deficit and recovers future costs.

Option (2):

- has graduated increases the levy of, compared to the current levy, 10% and then two further increases of 4%: $0.00485 in 2021/22; $0.00506 in 2022/23; $0.00523 in 2023/24. The levy at the end of three years is 19% higher than currently;
- eliminates the deficit and recovers future costs.

A graduated increase was proposed by The New Zealand Food & Grocery Council as part of their submission to ease the burden on industry during the immediate post-Covid period.[7] It charges businesses less than Option (1) in the first year and more in the third year.

Option (3):

- increases the levy from $0.00443 to $0.00483 (a 9% increase); and
- maintains the deficit at its current level by recovering future costs only until MPI has a better understanding of expenditure and revenue.

Option (4):

- defers changes to the levy for a year; with
- changes being set from 2022/23 once MPI has a better understanding of expenditure and revenue.

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[6] Residue testing decreased form 100 samples per year to 75 samples per year from 2017/18.

[7] The New Zealand Food & Grocery Council provided steps (an initial 10% increase, followed by 5% to 7% increases to 2025/26) but this was based on incorrect figures provided by MPI in the discussion document – see the ‘Transparency’ section in ‘Assessment against the principles’. The actual amount of cost recovery required is about half of what was consulted on and, to reach balance within three years, would need to be recovered in about half the time proposed by The New Zealand Food & Grocery Council. Overall, the lower cost recovery required and shorter time period roughly offset each other, meaning that The New Zealand Food & Grocery Council’s proposed increases are very close to what would be needed according to MPI’s forecasts.

There is no write-off risk to MPI associated with any of the options.

Options (2), (3) and (4) did not appear in the consultation document and have been developed taking feedback received into consideration.

Discarded options

Options to change the level of service were not explicitly considered through the discussion document. MPI's relevant business units undertake regular consultation with industry on service levels. Further consideration of service levels is inherent in Options (3) and (4) which fully recover costs after MPI better understands expenditure and revenue.

Estimated financial and economic impacts

Introduction

This section sets out the immediate financial impact of options on the market and at the business-level, and then considers how the financial impact feeds through to changes in prices and volumes over the medium- to long-term.

Appendix 4 shows expenditure, revenue and deficits/surpluses over time under the status quo and Option (1).

Immediate market-level impacts

Figure 6 shows the immediate financial impact on industry and MPI under each option.

Figure 6: Immediate market-level impact

Option	Impact on MPI	Impact on industry
Status quo	The deficit accumulates and is progressively written off over time. No deficit is written off in 2021/22.	None. (This assessment of impact on MPI and industry assumes expenditure levels continue as forecast in Figure 4. In reality, MPI would likely look to reduce expenditure.)
Option (1) – 14% increase	The deficit is eliminated and forecast expenditure is fully recovered.	+$84,000 per annum in cost from between 2021/22 and 2023/24.
Option (2) – graduated increase	The deficit is eliminated and forecast expenditure is fully recovered.	+$84,000 per annum in average cost from 2021/22. Actual cost increase in a year is graduated – $54,000 in 2021/22, $83,000 in 2022/23, $113,000 in 2023/24.
Option (3) – 9% increase	The deficit is maintained through recovering forecast expenditure only. No deficit is written off in 2021/22.	+$53,000 per annum in cost in 2021. Cost to industry from 2022/23 depends on decisions subsequently taken.
Option (4) – defer changes by one year	The deficit accumulates further. No deficit is written off in 2021/22.	No cost change in 2021/22. Cost to industry from 2022/23 depends on decisions subsequently taken.

Immediate business-level impacts

Figure 7 indicates the impact on a representative low volume processor with about 100,000 birds and a representative high volume processor with 20 million birds. About 99% of production by volume is by high volume processor.

Figure 7: Annual financial cost to representative processor

Option	Low volume processor	High volume processor
Status quo	None.	None.
Option (1) – 14% increase	+$63 per annum in cost from 2021/22.	+$13,000 per annum in cost from 2021/22.
Option (2) – graduated increase	+$63 per annum in average cost from 2021. Actual cost increase in a year is graduated – $42 in 2021/22, $63 in 2022/23, $85 in 2023/24.	+$13,000 per annum in average cost from 2021. Actual cost increase in a year is graduated – $8,000 in 2021/22, $13,000 in 2022/23, $17,000 in 2023/24.
Option (3) – 9% increase	+$40 per annum in cost in 2021/22. Cost from 2022/23 depends on decisions subsequently taken.	+$8,000 per annum in cost in 2021/22. Cost from 2022/23 depends on decisions subsequently taken.
Option (4) – defer changes by one year	No cost change in 2021/22. Cost from 2022/23 depends on decisions subsequently taken.	No cost change in 2021/22. Cost from 2022/23 depends on decisions subsequently taken.

Medium- to long-term market-level impacts

Changes in cost recovery charges are changes in business costs. This feeds through to business margins and, over the medium- to longer-term, to market prices and quantities. Competition means that changes in costs for processes will feed through to changes in prices throughout the value chain, including at the farmgate (i.e. costs changes are at least partially passed through).

When prices rise/fall, the quantity demanded for New Zealand production including exports falls/rises. This causes a decrease/increase in production at an industry level. Businesses will, on average, sell less/more. The business-level impact can range from all businesses producing less/more, or some businesses exiting the market and remaining businesses producing the same.

The scale of the impact depends on the size of the cost (price) increase and the elasticity of demand (how price sensitive customers are) and supply (how easily the industry can scale up and scale down production over the long term).

This cost changes considered in this CRIS are small in the context of total industry costs, and therefore will have a negligible impact on volumes and prices.

For example, Option (1) increases costs by $84,000 per annum. This compares to estimated retail revenue of about $1.6 billion.[8] If all of the cost reduction was passed through to export prices, the reduction would be 0.005%. As this is a negligible impact, the wider market impacts are not analysed further.

Assessment against the principles

This section assesses the options against MPI's Cost Recovery Principles using the approach set out in the 'Overall approach to cost recovery' section. In doing so, this section also draws on and responds to submissions received.

[8] This figure was estimated using the latest prices retail prices from the consumers price index (see Figure 2), purchase weights in the consumers price index, volumes of birds processed reported by Statistics New Zealand (see Figure 1).

Transparency and Justifiability

Summary

Overall, MPI considers that the Transparency and Justifiability principles have been sufficiently met under Options (1) and (2). Some information gaps were identified which may have had some impact on industry's ability to make informed submissions. These gaps will be addressed for future cost recovery proposals.

Transparency

A number of information gaps were identified with the proposed poultry levy option consulted on. These gaps related to the analysis, transparency of revenue, expenditure and associated services, and costs.

MPI considers that these gaps are sufficiently mitigated by ongoing regular consultation with the poultry sector that includes consultation on the proposed extent of residue testing on an annual basis, and on standards development work on an as-needed basis. However, it should be noted that additional consultation through these avenues does not fully address all of the information gaps in the consultation document. MPI will continue to improve the quality of information provided to industry during future consultation on levy settings so that industry are better able to judge the impact of levy adjustments, and consider via a single avenue all of MPI's services to decide the best use of levy revenue.

Further detail about the identified information gaps is outlined in Appendix 5.

Justifiability

Justifiability requires that costs be reasonable. From the analysis in the 'What is the cause of the problem?' section, MPI considers that it has sufficiently met this principle.

Competitive tendering in chemical and microbiological assurance services will keep costs low, and the reduction in the extent of testing is evidence of productivity improvements.

For standards development, while there has been demand for more services by industry, the gaps in transparency around costs means there is less confidence that costs are reasonable.

Considering the options in light of the Transparency and Justifiability principles

This CRIS considers that, despite information gaps, the Transparency and Justifiability principles have been sufficiently met by both Options (1) and (2), with Option (1) MPI's preferred option. As these principles have been met, implementing Options (3) and (4) which partially or fully defer levy increases based on limitations with the available information is not recommended.

However, should the Government prefer to defer implementing change under Options (3) or (4), the information gaps to meet the Transparency and Justifiabillity principles under these options are not large. Option (3) would appear to be more reasonable than Option (4), however Option (4) could be more administratively straight-forward. Neither option would create a cost write off.

Efficiency and Equity

Efficiency

Options (1) and (2) both recover all costs over the three-year period and eliminate the deficit. Option (1) does this by charging a flat levy over the three years. Option (2) does this by charging a graduated levy.

Both options recover future costs and accumulated deficit. As such, the levies charge future customers more than it costs to provide the services they receive. This reduces demand, even if negligibly, for

MPI services compared to if MPI only recovered future costs. This creates an economic inefficiency (deadweight loss).[9]

The degree of economic inefficiency depends on how much revenue is raised in each year within the three-year period compared to how much should be raised to pay for services in each year. Figure 8 sets out how much revenue would be raised if MPI only recovered future costs i.e. how much revenue would be raised under Options (1) and (2). Figure 8 also identifies the approximate share of revenue that would minimise inefficiency (with recovered future costs plus 5% to recover the deficit in each year).

Figure 8: Revenue by option

Year	Only future costs	Lowest economic inefficiency	Option (1)	Option (2)
2021/22	$624,000	$654,000	$649,000	$622,000
2022/23	$634,000	$665,000	$666,000	$666,000
2023/24	$647,000	$678,000	$683,000	$711,000
Total	$1,905,000	$1,998,000	$1,998,000	$1,998,000

Under Option (2), the revenue raised in 2021/22 ($622,000) is very similar to recovering only costs in that year ($624,000) and, so, will have little economic inefficiency. In 2023/24, the revenue raised is much higher than costs ($711,000 to $647,000) and will have very high economic inefficiency. Under Option (1), the revenue raised in 2021/22 and in 2023/24 is modestly different from only recovering future costs and the economic inefficiency will be modest.

While the economic inefficiency involved with both options will be negligible (as the levy makes up a negligible of total industry costs and will only negligibly affect production), Option (1) is the most efficient option. Option (2) is estimated to generate about 60% more economic inefficiency than Option (1).

The revenue raised under Option (1) in each year is very close to the revenue raised under an approach that would minimise economic inefficiency.[10]

Covid and the timing of changes

The Equity issue raised by the New Zealand Food and Grocery Council is whether it is fair that the Government increases the cost of services during the immediate post-Covid period, as it is highly likely that profit margins are temporarily lower due to supply chain disruptions.

The Government has so far preferred to deal with the impacts on businesses through central supports such as the Small Business Cashflow (Loan) Scheme and the Business Finance Guarantee (Loan) Scheme.

[9] Overall, no matter who pays, the existence of an accumulated deficit means there's an economic inefficiency. If the Crown pays, there's an inefficiency from higher-than-necessary taxes or lower-than-desired spending elsewhere. If industry pays, they are paying a higher charge to cover services delivered to past processors. Provided that MPI has sufficiently met the Transparency and Justifiability principles, future industry participants bearing the costs or benefits of past deficits or surpluses is the established and accepted approach. Charging the Crown would only potentially be considered more efficient if expenditure was not sufficiently justified or if there was significant turnover in industry participation such that future customers had minimal input into past decisions that led to the deficit or surplus.

This concept is somewhat complicated with club goods as the benefits of market access established in previous years are available to future processors, but the general concept is correct.

[10] The most efficient approach has not been formally set out as its own option because of how similar Option (1) is. Option (1)'s levy is $0.00507. An option around the efficient approach would have levies of $0.00503, $0.00506 and $0.00511 over the three years (increasing at less than 1% per year to 2022/23 and 2023/24).

However, The New Zealand Food & Grocery Council is not asking that the Crown contribute to the cost. The proposal is for industry as a whole to pay full costs, just at different points over time. If this was a consensus view across industry, Option (2) could be deemed Equitable.

The poultry levy is levied on poultry processors. However, the costs of the levy and the benefits of services would be shared throughout the value chain: from farmers, to processors, to retailers, to consumers.

The New Zealand Food & Grocery Council say they represent 'the major manufacturers and suppliers of food, beverage and grocery products in New Zealand'. The New Zealand Food & Grocery Council membership includes retailers (such as supermarkets) and some major processors (such as Tegel and Ingham's).

The Poultry Industry Association, who say they represent 'the interests of more than 99% of poultry meat producers in New Zealand[11]', did not make a submission or respond to follow-up contact from MPI to test their preferred option.

It is therefore undetermined that the submission received from the New Zealand Food & Grocery Council represents the views of the poultry industry or that the industry shares its concerns. On the basis that industry is generally familiar and accepting of flat changes to cost recovery levies and that a consensus alternative view has not been clearly established, MPI's preferred approach is to implement Option (1).

If the Government has further concerns about the cost to businesses and considers that the feedback from The New Zealand Food & Grocery Council represents a consensus view of industry, then shifting costs to later years via Option (2) might be favoured.

Magnitude of Efficiency and Equity trade-offs

Option (1) has the highest economic inefficiency, and it is unclear which option is the most equitable.

However, the financial impacts of both options are negligible. For instance, Option (1) increases the levy from $0.00443 per bird processed to $0.00507 per bird – an increase of 0.064 cents per bird. This is 0.005% of the retail price per bird of about $13.26 per bird.

The trade-offs between Option (1) and (2) are similarly negligible (in dollar values[12]). The economic inefficiency of Option (1) is only $1.85 per annum and $3.00 per annum for Option (2). Option (1) would see a low volume processor paying $63 more per year versus, under Option (2), $42 in 2021/22 rising to $85 in 2023/24 (see Figure 7).

CONSULTATION

Avenues of consultation

As covered in the discussion of the Transparency principle, MPI consulted through three channels: 1) via a consultation document published online and sent directly to industry groups including the Poultry Industry Association and The New Zealand Food & Grocery Council; 2) through regular consultation around chemical and microbiological assurance; and 3) through consultation as-needed on standards development.

Summary of industry feedback

Despite limitations of the information consultated on outlined earlier, industry is generally supportive of matters under the poultry levy.

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[11] Tegel and Inghams are members of both the New Zealand Food & Grocery Council and the Poultry Industry Association. Together these two companies make up 75% of poultry processors by production.

[12] Proportionally, Option (2) is estimated to generate about 60% more economic inefficiency than Option (1).

MPI regularly consults with industry on an as-needed basis on standards development work, and routinely on chemical and microbiological assurance.

During the consultation on the proposed poultry levy increase, only one submission was received from The New Zealand Food & Grocery Council. Poultry is a relatively small industry and the Poultry Industry Association is a relatively small organisation. They appear to target their consultation engagement to the areas of biggest impact, such as the review of the Campylobacter strategy. Industry is heavily engaged in designing and approving standards development work, particularly the Campylobacter strategy which is the biggest service. Industry approves of services in these areas. No feedback was received on the latest annual consultation on the extent of residue testing held in June 2020.

The poultry levy is levied on poultry processors. The costs of the levy, and the benefits of services, will, however, be shared throughout the value chain: from farmers, to processors, to retailers, to consumers. The New Zealand Food & Grocery Council's[13] submission noted gaps in information in the consultation document. It also preferred a graduated increase in the levy to mitigate the impacts of Covid on industry.

MPI's response

The New Zealand Food & Grocery Council noted that better information could have been provided. These information gaps are identified in Appendix 5. MPI will improve the information consulted on in future. These gaps may have inhibited industry from testing MPI's expenditure and the contributors to the deficit. MPI has confidence (see the 'What is the cause of the problem?' section) that it has subsequently sufficiently identified the contributors to the deficit and that they are justified, but greater ability for industry to test this would have been desirable.

MPI's assessment of Option (2) are covered more fully in the 'Efficiency and Equity' section above. Option (1) is the most Efficient option. On Equity, MPI considers that there has been insufficient feedback from industry to demonstrate consensus that Option (2), rather than Option (1), is the most equitable option.

Additional requirements for changes made part-way through a financial year

As noted in the 'How are the levies regulated?' section of the 'Status Quo' section, there is an additional requirement for changes made part-way through a financial year. This requirement is that the Minister needs to be 'satisfied that those persons, or their representatives, agree or substantially agree' with the changes.

This CRIS does not say whether the Minister should be satisfied or not, however this section summarises some information relevant to that decision:

- The consultation document had some information gaps, these are been mitigated by the consultation that MPI regularly undertakes with industry. However, some expenditure information remains unclear
- Industry has demanded increased service levels in MPI's standard developments work
- Industry has not submitted on changes to the extent of residue testing under the chemical and microbiological assurance work
- The New Zealand Food & Grocery Council, which represents some affected parties, favoured Option (2) rather than Option (1). Option (2) was proposed by The New Zealand Food & Grocery Council and was not consulted on subsequently with other parts of industry.

[13] The New Zealand Food & Grocery Council say they represent 'the major manufacturers and suppliers of food, beverage and grocery products in New Zealand'. The New Zealand Food & Grocery Council includes poultry retailers (supermarkets).

- Option (1) is a standard approach to recovering costs that industry is most likely to understand and expect. The Poultry Industry Association which claims to represent 99% of poultry meat producers in New Zealand, did not provide feedback on Option (1) despite attempts from MPI to seek feedback.

Conclusions and recommendations

MPI's preferred option

MPI considered four options.

Options (1) and (2) fully cost recover costs. Option (1) recovers costs through a flat levy. Option (2) recovers costs through a graduated levy.

Options (3) and (4) partially or fully defer cost recovery.

MPI considers it has sufficiently justified its expenditure and consulted with industry. Therefore, deferring cost recovery through Options (3) or (4) is not recommended.

Option (1) is MPI's preferred option. A flat levy is the standard approach which industry is familiar with. Option (1) also has the lowest economic inefficiency.

While The New Zealand Food & Grocery Council submitted a preference for a graduated approach captured as Option (2), it is unclear that this option is the consensus view of the poultry industry.

Overall, MPI considers that Option (1) best meets the Transparency, Justifiability, and Efficiency and Equity principles, but that there uncertainty and judgement involved around the Equity principle. If the Government considers that a graduated approach is more Equitable and reflective of industry's position, then Option (2) could be chosen with only small efficiency costs.

The cost increases under all options are small in comparison to total industry costs and are, therefore, expected to have negligible impact on industry production. For instance, Option (1) increases the levy from $0.00443 per bird processed to $0.00507 per bird – an increase of 0.064 cents per bird. This is 0.005% of the retail price per bird of about $13.26 per bird.

The trade-offs between Option (1) and (2) are similarly small. Option (1) would see a low volume processor paying $63 more per year, versus $42 under Option (2) in 2021/22 rising to $85 in 2023/24 (see Figure 7).

Additional requirements for changes made part-way through a financial year

If the Government prefers any of Options (1) to (3), the Minister needs to be 'satisfied that those persons, or their representatives, agree or substantially agree' with the proposed changes. Information to inform that consideration is outlined in the 'Additional requirements for changes made part-way through a financial year' section above.

Implementation plan

If changes to the levy are agreed, amendments will be made to the Animal Product (Fees, Charges, and Levies) Regulations 2017, which will then be publicly notified in the New Zealand Gazette. Implementation will apply from 1 October 2021 and MPI will notify fee payers of the new rates that will apply prior to this. In addition, MPI will update its application forms and other material to include the appropriate rates.

Levies are collected from processors rather than from other parts of the supply chain to minimise administration costs of collecting revenue. Administrative costs of changes to levies are expected to be negligible on the part of MPI and industry.

MPI understands that industry would prefer to have as early an indication of fee changes as possible so they can build them into contracts with customers. MPI will be endeavouring to progress cost recovery changes more efficiently in future.

Monitoring and evaluation of services

MPI recognises that performance reporting is a critical component in providing transparency to industry and other interested parties, as well as ensuring ongoing system efficiency. This is explicitly acknowledged in the policies and guidance on our Principles.

To improve transparency, MPI has worked with industry to create a framework for reporting on the performance of cost-recovered services for all sectors. This has involved publishing annual reports about MPI's performance for the primary sectors. Performance reporting is an area for ongoing development for MPI – the annual reports currently focus on transparency around financial data and there is scope to use them to report against performance metrics (once developed).

Review of cost recovery settings

MPI monitors the financial performance of all cost recovered systems it administers on an ongoing basis throughout the year. In line with best practice guidance, we generally undertake a thorough review of each cost recovery regime at least once every three years. This ensures that cost recovery regulatory settings remain appropriate. Reviews consider both cost recovery policy settings (who should pay for services, and how) and the rates of fees and levies.

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

A wider refresh of MPI's principles, policies and processes is underway. Work done to date has informed this CRIS including in the definition and application of the cost recovery principles and the analysis and identification of gaps that has flowed from that. The identified gaps will be referred to the refresh project for consideration as the refresh continues to roll out over the coming years, and addressed in future cost recovery regulatory impact analysis as appropriate.

Appendix 1: MPI's cost recovery principles

MPI's four Cost Recovery Principles are:

- Transparency – costs are transparent
- Justifiability – costs are reasonable
- Efficiency – net benefits are maximised
- Equity – costs are fair

These four principles appear in the Animal Products Act 1999 and the Wine Act 2003.[14]

The legislative definitions and interpretation of these are set out under each of the four principles below.

Transparency

Legislation

'Costs should be identified and allocated as closely as practicable in relation to tangible service provision for the recovery period in which the service is provided.'

Interpretation

'Transparency' means providing adequate information to people such that they can understand charges and have an opportunity to input into their calculation and setting.

'Identified and allocated…' means presenting the costs in a way that people can see what services generate what costs and when. 'Allocated' does not mean 'charged'. How costs are charged is a result of consideration of all the principles.

Justifiability

Legislation

'Costs should be collected only to meet the reasonable costs (including indirect costs) for the provision or exercise of the relevant function, power, or service.'

Interpretation

'Reasonable costs' are those necessary to deliver the service at the demanded quantity and quality.

Efficiency

Legislation

'Costs should generally be allocated and recovered in order to ensure that maximum benefits are delivered at minimum cost.'

Interpretation

Efficiency is made up of several elements:

(1) Costs should be the lowest necessary to meet customer demand. Customers can include businesses, members of the public, and the Government including other agencies. Meeting customer demand might involve treating different customers differently.

(2) Costs should be charged to:

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[14] https://www.legislation.govt.nz/act/public/1999/0093/latest/whole.html#DLM35716
https://legislation.govt.nz/act/public/2003/0114/latest/DLM223236.html

(a) Who benefits from the service – If the customer pays, they have the incentive to demand only those services that provide them benefit compared to other things they might purchase. If parties other than the beneficiary pays, then the beneficiary will demand more services than otherwise.

(b) Whose behaviour can reduce the need and cost of the service – Typically both the supplier (MPI) and the customer will be able to do things to reduce the need and cost of the service. For example, MPI could adopt innovative technologies to reduce labour costs, while businesses might locate in urban, rather than rural, areas to reduce distance from market (including MPI's services).

If MPI has transparently justified its costs, it will not normally be appropriate for MPI to contribute to the costs.

Where there are externalities, it may be efficient to charge the third party as well, or instead of, charging the customer/beneficiary.

(3) Charges should account for administrative costs – sometimes it will be administratively prohibitive to charge according to (2)(a) or (2)(b) so a simplified approach is warranted.

(4) Charges should be competitive neutral – MPI should not use any dominant market position to charge inflated prices and make more than a fair economic return.

Equity

Legislation

'Funding for a particular function, power, or service, or a particular class of functions, powers, or services, should generally, and to the extent practicable, be sourced from the users or beneficiaries of the relevant function, power, or service at a level commensurate with their use or benefit from the function, power, or service.'

Interpretation

The Government will usually deem it fair that beneficiaries pay.

On other occasions, the Government will determine that other fairness considerations mean that another party contributes to the costs. For example, sometimes industry will be happy to support parts of its industry. Other times, Governments will want to provide additional support.

Relationship between the Cost Recovery Principles

The principles build on each other with Transparency and Justifiability providing a foundation to the consideration of Efficiency and Equity. Figure 9 summarises the relationship between the principles.

Transparency and Justifiability come before considering Efficiency and Equity

The APA says about Justifiability that MPI can only recover reasonable costs.

While the Transparency principle itself doesn't have a similarly strong statement, the very next clause says that costs should not be recovered unless there's been adequate consultation with affected parties including 'sufficient time and information to make an informed contribution'. Adequate consultation can only happen if MPI has been transparent.

With language of 'should not' and 'only', Transparency and Justifiability require[15] some minimum standard to be met. In contrast, Efficiency and Equity are to be achieved 'generally'.

This sequential approach to the principles, rather than considering the principles simultaneously, makes sense. It is not possible to be confident that the efficient way of cost recovering has been

[15] The Animal Products Act 1999 and Wine Act 2003, however, also say that failure to consult sufficiently does not affect the validity of cost recovery charges.

identified if costs have not been sufficiently justified, or affected parties have not had a reasonable opportunity to test the costs.

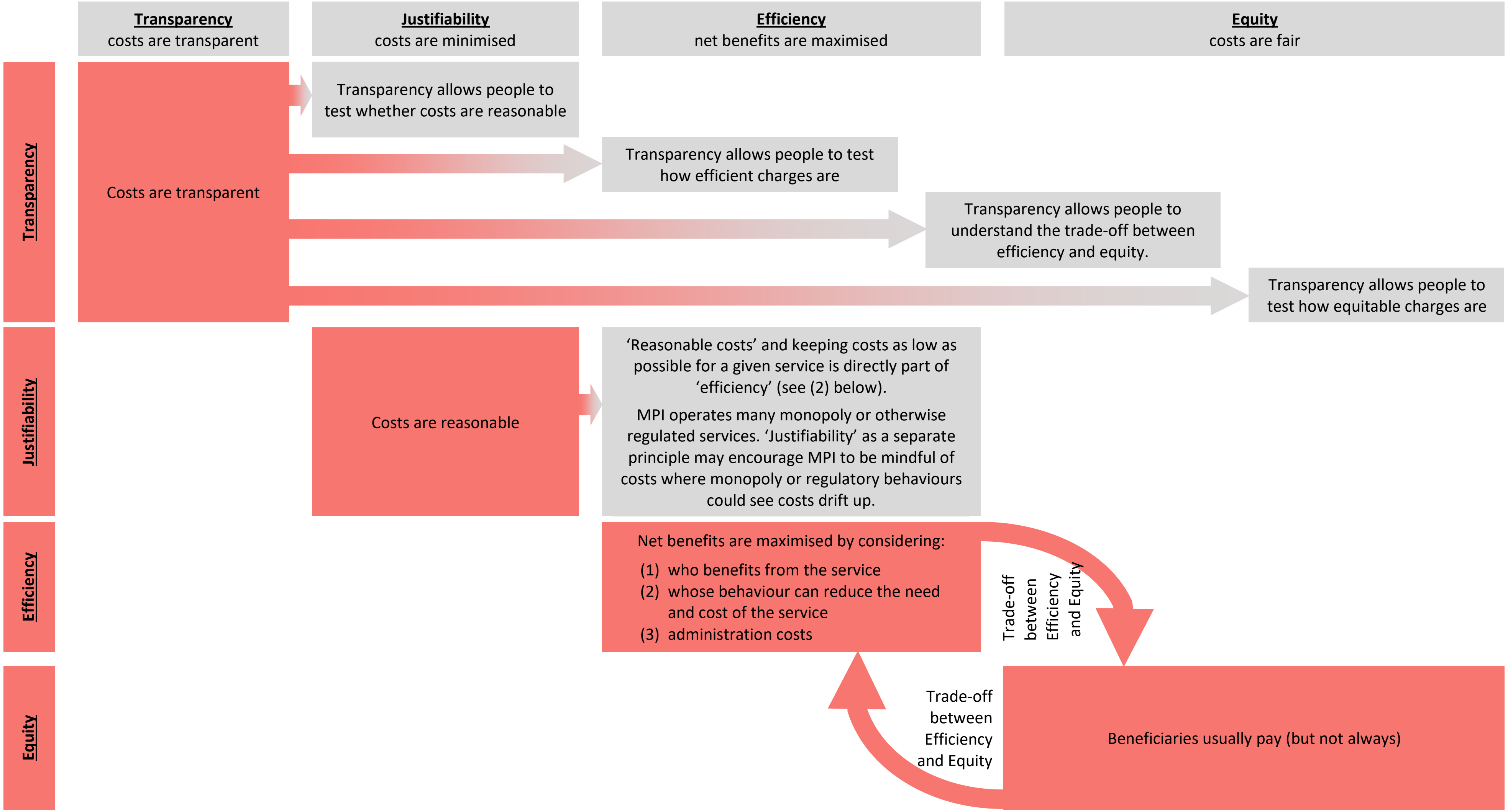
There will sometimes be trade-offs between Efficiency and Equity

The ‘generally’ in the Equity principle means that a Government might decide to charge someone other than the beneficiary. The ‘generally’ in the Efficiency principle means that cost recovery settings will not always maximise benefits and minimise costs.

This also makes sense. If the Government determines that it is more equitable pay for a service through Crown funding rather charging beneficiaries or those whose behaviour can reduce the need for the service (see (2)(a) and (2)(b)), then the cost recovery setting will not be maximising net benefits.

The two ‘generally’s allow for trade-offs to be made between Efficiency and Equity.

Figure 9: Relationship between the Cost Recovery Principles



APPENDIX 2: ASSESSMENT OF FACTORS CONTRIBUTING TO THE DEFICIT

Potential contributing factors to deficits (and surpluses), why they are important, and what MPI knows about them in relation to the services covered by this CRIS are set out in Figure 10.

Figure 10: Contributing factors

Factor	How important is this factor?	What do we know about this factor?
(a) Higher or lower than anticipated (or needed) volumes	MPI has negligible control over this factor. Volumes are a result of demand for product and producers' ability to supply it. In the case of levies, higher volumes generate more revenue, and reduce the average costs of the club good. It is important to be transparent so that the contribution of volumes versus other factors is understood, and so that industry can plan for the future using timely information about how revenue is tracking against cost (and thus the likelihood of future levy changes). So long as MPI makes best endeavours in forecasting and collecting revenue, MPI has negligible control and this factor is not significant to questions about whether costs should be 100% recovered.	<u>Comparison with forecast</u> MPI has not located its forecasts from the last time the levy was changed in 2015, but the number of birds processed has grown at a similar (and fast) rate post the last levy change in 2015 as immediately before it (see Figure 1). This suggests that actual revenue is unlikely to have turned out to be lower than was forecast. <u>Contribution of volume changes to costs and expenditure</u> The services are club goods with fixed costs. Changes in volumes do not, by themselves, change the total level of expenditure as there are no variable costs. It is useful to understand the impact of volume changes on costs per bird (average costs), however, as this the levy is charged on the number of birds. Average volumes for 2018/19 to 2019/20 are about 12% higher than the average for 2014/15 to 2015/16, with average compounding growth of 2.7% between 2014/15 and 2019/20. Since 2017/18 (from when MPI has financial information), volumes have been variable with 121,000,000, 124,60,000, and 119,640,000 birds processed in 2017/18, 2018/19, and 2019/20 respectively. Because of the variability, it is not appropriate to report the change as a compounding rate of change. An average of 2018/19 and 2020/21 compared to 2017/18. The average volume for 2018/19 to 2019/20 is 0.8% higher than for 2017/18. This reduces the average cost of a given level of service by 0.7%.

(b) Cost inflation	Inflation is the general increase in costs over time. The control MPI has over this factor is negligible. It is important to be transparent so that the contribution of cost inflation versus other factors is understood, and so that industry can plan for the future using timely information about how revenue is tracking against cost (and thus the likelihood of future levy changes). Because MPI has negligible control, this factor is not significant to questions about whether costs should be 100% recovered.	Using an MPI cost-index[16], MPI's overall cost inflation has been running at about 2.1% per annum since June 2015. The true inflation rate for any particular service will differ from this. This compares to expected average annual increases in expenditure of 9.3% per annum through to 2020/21 and 4.3% to 2024/25. As the memorandum account didn't reach balance following the last increase in charges, this CRIS places a greater weight on the short-term figure of 9.3%, rather than the longer term figure of 4.3%.
(c) MPI-specific increases in the costs of particular inputs beyond inflation	It is more important, compared to (b), that MPI be transparent about these costs. This information is likely to be held by MPI, rather than be in the public arena like general information, and MPI is likely to have greater levels of control from time to time in the level of cost (e.g. wage settlements). If MPI is not transparent, there is a risk that hard choices and questions about whether costs should be 100% recovered will be obscured.	<u>Specific cost increases</u> *Chemical & microbiological assurance* It is likely that there was a significant increase (about $50,000) in the costs of residue testing in 2017/18 or earlier. A lack of information from the time means the cause of the increase cannot be fully ascertained. Some of the increase will be due to the inclusion of travel costs (including travel time) by testers to premises being included which were previously incorrectly omitted from costs, however this appears to only explain a small part of the cost increases. While there is a lack of information, if the tendering at the time was competitive, then cost increases will be genuine cost increases faced by entities MPI contracts with rather than cost inefficiencies. Current tenders, which are competitive (receiving around half a dozen bidders), have resulted in similar levels of expenditure and provide further evidence that historical expenditure was reasonable. *Standards development and market access* No specific cost increases have been identified that go beyond general inflation, though these have not been recorded. <u>Cost breakdown across all expenditure under the levy</u> Figure 11 sets out the forecast breakdown of costs for the poultry levy for 2020/21. MPI has not benchmarked these, including the balance of

[16] An index that indicates inflation in MPI costs. It is based on cost indexes produced by Statistics NZ and the costs in MPI's 2019/20 annual report.

direct costs and overheads, against similar services in the public or private sector.

Figure 11: Costs by type[17]

Cost type	Share of costs
Personnel	35%
Contracts	18%
Business support costs	16%
Operational support costs	10%
Travel	2%
Other	19%

(d) Level of resource required for a given service	While MPI has little and some control over (b) and (c) respectively, it has complete control over (d). It is very important that MPI is transparent about the level of effort/resource required to deliver services, including different ways of delivering the same outcome. For example, while export requirements are set by overseas countries, careful design can reduce regulatory costs. If MPI is not transparent, risks of cost inefficiencies or missed productivity improvements arise and questions about whether costs should be 100% recovered cannot be raised.	*Chemical & microbiological assurance* Since 2017/18, MPI has reduced the number of tests it typically conducts from 100 samples per year (20 per type of compound) to 75 samples per year (15 per type of compound). In testing for compounds (e.g. steroids, antibiotics, pesticides), samples return an average of 100 results. This reduction was likely due to previous years returning zero cases of results being higher than the regulated standard. As industry was demonstrating its compliance, the need for testing reduced. *Standards development and market access* No specific changes in the level of input required to deliver services has been identified.
(e) Service levels	It is very important that MPI is transparent about choices around service levels. While export requirements are set by overseas countries, the actual countries New Zealand ends up having agreements with is a matter of choice. MPI and industry have significant control	*Chemical & microbiological assurance* There has been no material change in the level of assurance MPI and industry wants to achieve. The reduction in the degree of testing was about ensuring a sufficient level of testing to maintain assurance.

[17] Business support costs include information technology, finance, human resources and other overheads. Operational support costs include management and administrative support.

	here. There is even more control for domestic standards, where the design of the standard is more within MPI’s control (in consultation with industry). If MPI is not transparent, costs might not be as low as they can be, and service levels might be too high and legitimate questions about whether costs should be 100% recovered could be raised.	*Standards development and market access* There has been increasing demand from industry for better domestic regulation and support, particularly through the development of a new Campylobacter strategy and action plan for 2020 to 2025. Service levels are agreed with industry at the time levels are set.

Appendix 3: Identifying options

This Appendix contains more description of the options and, by running through each element of the 'Overall approach to cost recovery' section above and the Cost Recovery Principles, how they were identified:

- that beneficiaries pay, unless:
  - MPI has not or cannot sufficiently met the Transparency and Justifiability principles
  - administration costs are prohibitive
  - there are externalities such that someone other than the beneficiary should pay
  - or there are equity reasons.

This Appendix contains sufficient information about the above to identify options. A full assessment of options is in 'Assessment against the principles' section.

How the options were identified

Beneficiaries pay

'Beneficiaries pay' means paying for the costs of their services and only the costs of their services. On the condition that MPI has sufficiently met the Transparency and Justifiability principles, this is Option (1) which fully recovers the deficit and future costs.

Transparency and Justifiability

The Animal Products Act 1999 says that costs should not be recovered unless there's been adequate consultation with affected parties including 'sufficient time and information to make an informed contribution'.

MPI consulted with industry through a consultation document. The consultation document said that the deficit was caused by 'increasing personnel and contract costs'. The consultation document did not demonstrate this, nor demonstrate the factors that had contributed to these costs (see Appendix 2 for the current consideration of factors). The consultation document also did not identify the unexplained revenue loss.

The gaps in consultation mean that options that do not fully cost recover should be considered. These are Options (3) and (4).

Administration costs

MPI's cost recovery regime operates, with industry approval, on a basis of frequent reviews to ensure significant surpluses and deficits do not arise or are addressed quickly when they do.

It is administratively easy for MPI to change the levels of the charge and to set different charges for different categories for the purposes of raising revenue. It is expected to be administratively easy for businesses to change their accounting settings too. The minor administration costs of frequent changes are already factored into MPI's approach of frequent reviews and changes.

No other administration cost issues have been identified.

No options are required to address administration costs.

Externalities

Market access provides industry and their customers with club good benefits. MPI considers that there are no positive or negative externalities.

No options are required to address externalities.

Equity

The upheaval of Covid including higher business costs means producers are looking for cost savings. While the Government has so far preferred to deal with the impacts on businesses through central supports such as the wage subsidy and through supports to banks (to then support bank customers), arguments could be made for deferring cost increases of Government services.

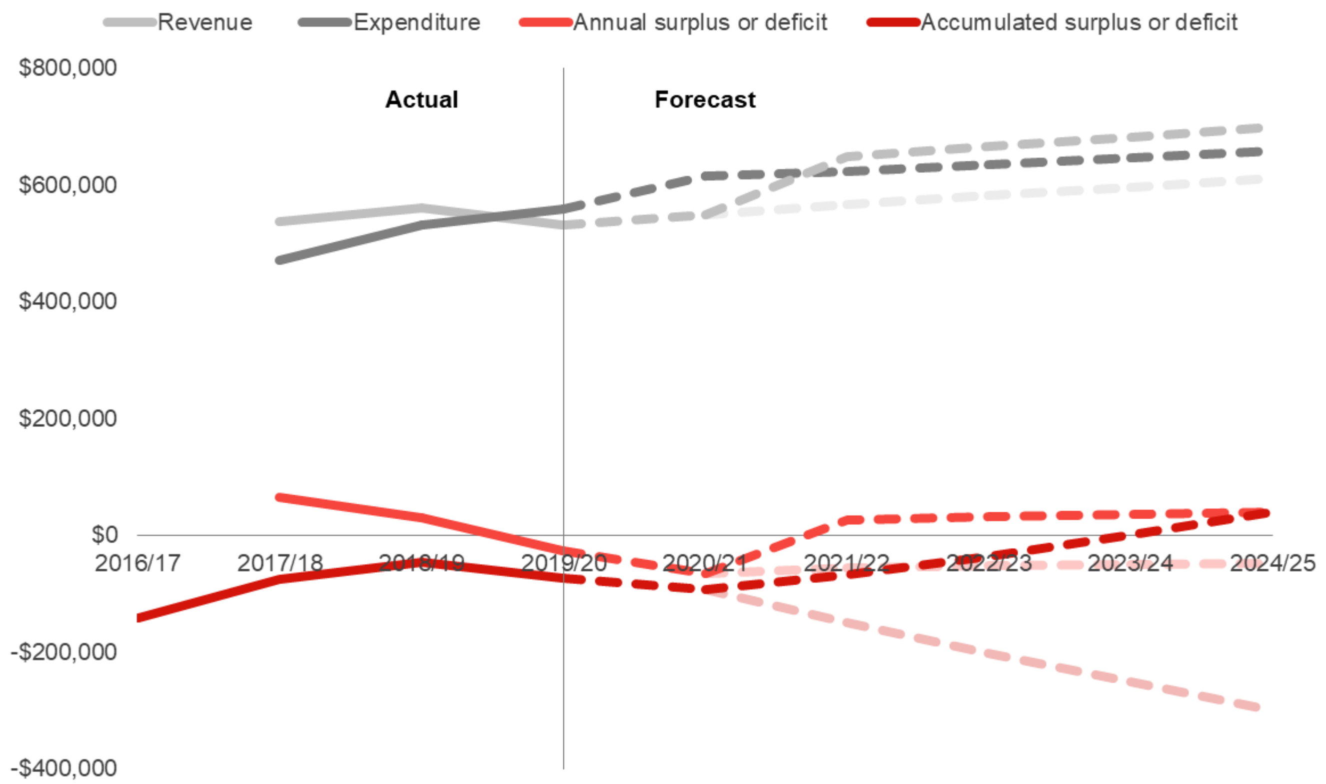
Options (2), (3) and (4) partially or fully defer costs.

Appendix 4: Actual and forecast revenue and expenditure

Figure 12: Poultry levy[18]

	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
Status quo								
Opening balance	-142	-76	-46	-73	-93	-150	-202	-251
Revenue	537	562	532	549	567	582	597	612
Expenditure	471	532	559	615	624	634	647	659
Ending balance	-76	-46	-73	-93	-150	-202	-251	-299
Option (1)								
Opening balance	-142	-76	-46	-73	-93	-150	-202	-251
Revenue	537	562	532	549	649	666	683	700
Expenditure	471	532	559	615	624	634	647	659
Ending balance	-76	-46	-73	-93	-68	-36	-0	41

Figure 13: Change in revenue and deficit under Option (1)



[18] The ending balance for 2020/21 includes $43,000 being written off as unrecoverable.

Appendix 5: Transparency

Consultation obligations on MPI

The Animal Products Act 1999 says that costs should not be recovered unless there's been adequate consultation with affected parties including 'sufficient time and information to make an informed contribution'.

Treasury's *Guidelines for Setting Charges in the Public Sector*[19] provides further guidance with reference to a Court of Appeal decision. Treasury says that:

> *as a minimum:*
>
> - *there should be sufficient time for genuine and considered feedback to be developed by the stakeholders*
> - *the information provided in a consultation process should be appropriate to the audience*
> - *the material used in consultation processes should include enough underlying cost data and accompanying analysis to enable stakeholders to understand the rationale for the proposed levels for charges, and*
> - *entities should genuinely consider how the feedback provided through the consultation process could change its advice.*

MPI considers that there are not major issues around the first, second and fourth of these points in relation to the consultation document:

- MPI provided four weeks for submissions. MPI considers that this is sufficient time for considered feedback to be provided. Considered feedback was received from The New Zealand & Grocery Council on the poultry proposals (and from many other submitters on other proposals of a similar size consulted on at the same time for other industries).
- This CRIS sets out how feedback has been considered. MPI considers that this is genuine consideration.
- While some financial information was not provided in an easily understandable form, of the information that MPI did provide, most appears to be understandable and accessible for broad audiences.

Due to incomplete information there were some issues with the sufficiency of data and analysis – however.

Gaps in consultation

This CRIS considers that insufficient information around data and analysis was provided in the consultation document but that this has been sufficiently mitigated through ongoing consultation with industry through other channels.

The gaps in the consultation document and mitigation through other channels are discussed in in Figure 8.

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[19] https://www.treasury.govt.nz/publications/guide/guidelines-setting-charges-public-sector-2017-html#child-26

Figure 14: Gaps in consultation

Information gaps in the consultation document	Potential size of impact on parties	Discussion and mitigation
Raw information		
A lack of data about revenue, expenditure and costs over time	Moderate	This would have prevented parties from assessing the degree to which expenditure and revenue has changed over time. This constrains the ability to test whether the change in expenditure is reasonable, including in comparison to the change in revenue. This also constrains parties from judging whether MPI has addressed the deficit quickly enough. This was noted by The New Zealand Food & Grocery Council in its submission. This gap is partially mitigated through ongoing consultation MPI has with industry. Consultation on chemical and microbiological assurance occurs regularly every year and covers the proposed amount of testing (service levels). Cost information is not provided, however. Consultation on standards development occurs typically whenever industry proposes new services. The lack of a regular single round of consultation where all services, costs and revenue are presented to industry would limit industry's ability to demand greater or lower levels of service, and to test costs. However, the extent of industry involvement in such a round of consultation might be limited. The Poultry Industry Association did not submit on the consultation document and the only submission was from The New Zealand Food & Grocery Council. Poultry is a relatively small industry and the Poultry Industry Association is a relatively small organisation. They appear to target their consultation engagement to the areas of biggest impact, such as the review of the Campylobacter strategy.
Two values for the levy were included under Option (1) – one which had a 27% increase (appearing in main text including the 'Overview' section), and one which had a 20% increase (appearing in numerical tables and charts)	Small	Two values would have created confusion or given inaccurate information on which industry would have formed views. Based on MPI's understanding of expenditure and revenue at the time[20], the correct figure should have been 20%. It appears that The New Zealand Food & Grocery Council understood 27% to be the correct number. The New Zealand Food & Grocery's council focussed on the lack of information and on deferring increases in charges through a graduated approach. It seems likely that this submission would not have materially changed, though the graduated charges proposed by The New Zealand Food & Grocery Council would have been lower.
No information about service quantity and quality	Small	The consultation document contained no information about service levels. This may have constrained parties' ability to judge whether expenditure delivers value for money and to propose higher or lower service quantity or quality, however service levels are consulted with industry through ongoing consultation.
Justification and analysis		

[20] Correcting for an error in the revenue figures, and the correct figure should have been 14%.

Information gaps in the consultation document	Potential size of impact on parties	Discussion and mitigation
Limited information about, and inaccurate application of, the cost recovery principles	Small	Some information about MPI’s cost recover principles was provided, but the assessment that was provided in the consultation document was incorrect. Consultation documents do not need to get everything correct, but some statements were inaccurate. These statements included that: • the discussion document had provided data about historical costs and revenue • the discussion document had provided data about the causes of deficits • that charging beneficiaries (assuming costs were Justified) did not help in achieving the Efficiency principle. It is difficult to judge what impact this might have had on parties as the statements clearly appeared to be inaccurate.
Minimal discussion of why expenditure had increased and a deficit arisen	Moderate	The consultation document included only this statement justifying expenditure increases: ‘The under-recovery has been primarily caused by increasing personnel and contract costs.’ In addition to containing no demonstration of why personnel and contract costs had increased and why this was justified, the consultation document contained no consideration of any other factor that might have contributed to higher expenditure. As such, the consultation document did not demonstrate the extent to which factors (a) to (e) from the ‘Problem’ section were important. The lack of information would have the impact of significantly constraining parties from understanding, and testing MPI’s analysis of, why expenditure had increased and the deficit arisen, whether those reasons provided justification. Mitigating this is the consultation MPI does through other channels particularly around service levels and where it is spending its effort.
No consideration of alternative options	Moderate	Consideration of alternative options improves confidence that the preferred option best meets the cost recovery principles by demonstrating how the preferred option better achieves the principles. Absent alternative options, parties would have had to create their own without the benefits of financial data and modelling. The New Zealand Food & Grocery Council set out an alternative option, but had to speculate as to the appropriate settings and impacts on MPI and industry. Mitigating this is the consultation MPI does through other channels. Alternative options are not considered during consultation on chemical and microbiological assurance testing levels, but a mix of options was considered, for example, during the review of the Campylobacter strategy.