Impact Summary: Prefabricated items in Schedule 2 of the Heavy Engineering Research Levy Act

Section 1: General information

Purpose
The Ministry of Business, Innovation and Employment (MBIE) is solely responsible for the analysis and advice set out in this Impact Summary, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing final decisions to proceed with a policy change to be taken by or on behalf of Cabinet.

Key Limitations or Constraints on Analysis
Evidence and quality of evidence We have high confidence in the quality of the data provided by Customs and HERA used for this analysis. However, there is a gap in the import data available to MBIE at the time of writing this assessment. This gap is from 1 June 2018 (the end of import year 2017/18) to December 1 2019. Business and import interruptions in 2020 and the unknown effect of COVID-19 on the industry going forward will also increase the error margin in our predictions of costs to importers and increases in HERA's levy revenue. While these effects have limited the presentation of some data, we still have high confidence in the main assumptions within our analysis. *Options* MBIE considers that there are three options to approach this problem: • Option 1: Status quo – no change. • Option 2: Update the Act to allow levy collection on imported prefabricated steel and iron items. • Option 3: Increase the levy rate. *Criteria* We have assessed the options against their <u>ability to fulfil the purpose of the legislation</u> at two levels: • Equitable distribution of the cost of HERA's across industry members. • Supporting the heavy engineering industry, through research and science. *Assumptions*

We have assumed that in the COVID-19 economic recovery the increasing import of prefabricated steel and iron items[1] will resume at around 23 per cent per year from 2020/2021. We have based this assumption on previous growth and used it for our forecasts on levy payment by importers and levy revenue gained by the Heavy Engineering Research Association (HERA).

We have also assumed that the levying of imported prefabricated items will proportionally increase their retail price (by importer on sellers).

Consultation limitations

Our consultation was limited by a short time period of five weeks and timing over the summer holidays. We did not mass market the consultation, but we were able to directly contact 34 of the top 50 importers of the items. This limits our analysis of the effect on importers and consumers.

The changes are proposed for Regulatory Systems Bill 3, which will go through complete parliamentary process. Industry and the wider public will therefore have further opportunity to submit on this proposal when the Regulatory Systems Bill reaches the Select Committee phase. We have informed top importers of this submission opportunity.

Responsible Manager (signature and date):

Simon Wakeman

Innovation Policy

Science, Innovation and International

Ministry of Business, Innovation and Employment

22/01/2021

To be completed by quality assurers:

Quality Assurance Reviewing Agency:
MBIE
Quality Assurance Assessment:
Reviewer Comments and Recommendations:

[1] Constructed from items levied under the Heavy Engineering Research Levy Act.

Section 2: Problem definition and objectives

2.1 What is the policy problem or opportunity?

The Heavy Engineering Research Levy Act 1978
The Heavy Engineering Research Levy Act ("the Act") legislates the collection of the Heavy Engineering Research Levy ("the levy"). Section 4 of the Act authorises the levying on all domestically manufactured and imported goods that are specified in Schedule 2 and Schedule 3 of the Act.

The levy provides around $2 million of revenue to the Heavy Engineering Research Association (HERA) each year. HERA uses this revenue to promote and conduct research and other scientific work into or relating to the heavy engineering industry (as outlined in Section 12). This includes facilitating research into advances of technology and techniques, to better inform members. HERA also uses independently sourced revenue to provide an industry network and act as an industry advocate with regulatory bodies.

Schedules 2 and 3 list the levied items by Tariff item number, in accordance with Customs Working Tariff Document[2] (the Tariff). HERA collects the levy on domestically manufactured items directly from the manufacturer (Section 6(2)). Customs collects on imported items as they enter the country then passes this on to HERA (Section 6(3)).

This Act, as with other research levies, intends to address the issue of business under-investment in research and development. The levy equitably distributes investment in HERA's services across the industry by requiring industry members to pay a research levy on the trade of items commonly used in heavy engineering practice. By applying the levy to both domestically manufactured and imported items, the Act minimises the risk of businesses free-riding HERA's services.

Problem: the levy is not currently collected from importers of prefabricated steel and iron items, which creates a levy payment inequity between domestic manufacturers and importers of prefabricated steel and iron items
The Schedules of the Act do not include prefabricated steel and iron items. We have identified four of these items, which have been increasingly used in heavy engineering practice.

The four Tariff item numbers fall under Tariff category 73.08:

- 73.08: *Structures (excluding prefabricated buildings of heading 94.06) and parts of structures (for example, bridges and bridge-sections, lock-gates, towers, lattice masts, roofs, roofing frame-works, doors and windows and their frames and thresholds for doors, shutters, balustrades, pillars and columns), of iron or steel; plates, rods, angles, shapes, sections, tubes and the like, prepared for use in structures, or iron or steel.*

The four tariff codes specify subcategories of goods within that grouping:

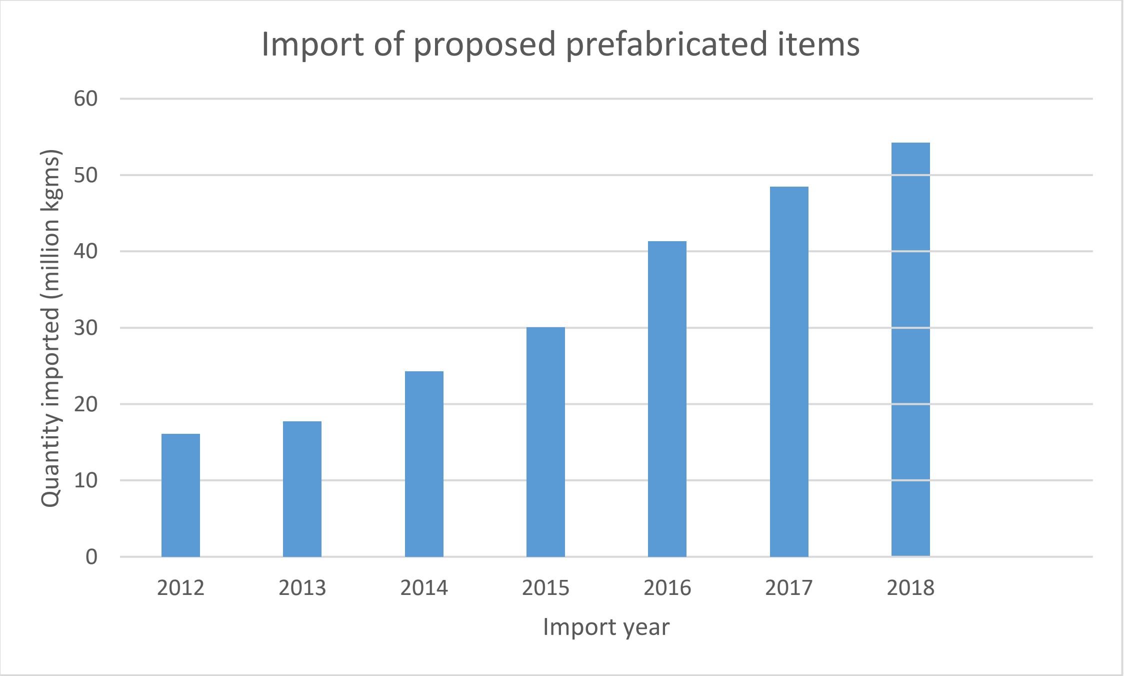
- 73.08.10.00 (00H): *Bridges and bridge sections*

[2] A document owned by the New Zealand Customs Service, listing the Tariff item numbers for all items imported at significant quantities.

- 73.08.90.90 (10C): *Other – Channels, joists, girders, beams and columns*
- 73.08.90.90 (15D): *Other – Tubes and the like, prepared for use in structures*
- 73.08.90.90 (29D): *Other – Other.*

The nature of the Act means that locally manufactured items are already levied (through the levy on the component steel items), but the imported items are not. It is not currently possible to collect the levy on the component items of imported prefabricated steel items. This is because Customs levy collection is restricted to collecting based on the Tariff item number an item is imported under.

Market changes, i.e. the increased use of prefabricated items in heavy engineering practice, have created this problem. These tariff codes were not originally included in the Act because the Tariff item numbers were not introduced to the Working Tariff Document (the Tariff) until 2010 and then 2012. This suggests that purchase of prefabricated heavy engineering items was not envisaged when the Act was passed. MBIE last updated the items listed in Schedule 2 in 2005. This also predates the introduction of these four prefabricated items to the Tariff. The chart below shows the increasing import of the four prefabricated items we propose to include in Schedule 2 of the Act.



Source: Customs import data for Tariff items 73.08.10.00 (00H), 73.08.90.90 (10C), 73.08.90.90 (15D) and 73.08.90.90 (29D).

The inability to collect the levy on these items is a problem because the exclusion of these items causes inequitable levy payment between importers and domestic manufacturers. The Act intends to treat all commonly used heavy engineering items equally, independent of origin (Section 4(2)). As locally manufactured items use materials that have already been levied, whereas imported prefabricated items do not, this has generated an unequal treatment of these products.

MBIE acknowledges that some imported items may have already been subject to a research levy in their country of manufacture. This does not affect our impact analysis.

How the situation will develop
If we do not address this issue, the levy payment inequity between domestic manufacturers and importers of these items will continue.

Addressing this issue now, through Regulatory Systems Bill 3
Addressing this issue by amending the Schedules of the Act would require Cabinet approval. Section 4(4) of the Act sets out powers for an Order in Council to amend the Schedules to ensure alignment with the Tariff. However, we do not recommend using these powers because the changes are out of scope of their intended purpose.

Instead, we recommend that any amendments be included in the next Regulatory Systems Bill (RSB3). This Bill is currently in legislative bid phase and is expected to progress for Cabinet approval in March 2021.

We are confident in the evidence for this problem
Import data from Customs, financial records from HERA and submissions by the industry all support our problem definition. We therefore have high confidence in this evidence. Consultation submissions from the industry also give us high confidence in our assumption that this problem is negatively affecting domestic manufacturers.

2.2 Who is affected and how?

Importers
This change will have a small direct effect on importers, as they will be required to pay the levy of $20 per tonne on the relevant prefabricated items. Importers of these prefabricated items may be either the end consumers and/or the on sellers of the items.

On average, the top 50 importers of these items import 1000 tonnes per year, with a value of $2 million. On average, the change would incur an additional annual levy payment of $20,000 for these importers (less than 1 per cent of the value of the items).

While importers who also consume the items will directly incur the cost of the levy, on sellers may pass the small cost on to the consumer by increasing their pricing of these items (and keep the same profit margin). The average import value per unit of these items is $39,340 and the average levy payment would be $257, 0.6 per cent of the items' import value. Assuming that on sellers increase the retail price of these items proportionally, we expect this will have little or no effect on the sales of these items.

MBIE acknowledges that some importers may oppose levy payment on these items. These businesses may believe that the cost of the levy is greater than the benefit that it provides. MBIE recommends that such businesses become involved in HERA's operations and help guide their services into areas that benefit them more directly.

Domestic manufacturers
This change will affect domestic manufacturers of these items, who will no longer bear an inequitable portion of levy payment. For example, domestic manufacturer Eastbridge

Steel is currently paying $30,000 of levied on these items each year, which is not equitably matched by importers of the items.

Support from the industry
MBIE has received written support for these changes from:

- HERA
- An industry body
- A domestic steel manufacturer.

2.3 What are the objectives sought in relation to the identified problem?

Objective: Equitable levy payment throughout the industry
MBIE's primary objective is to ensure equal distribution of HERA's legislated services across industry members. This meets the Act's intention outlined in Section 4(2), which intends to ensure items are treated equally, independent of origin (domestically manufactured or imported). This will also fulfil the Act's high-level purpose to support the heavy engineering industry.

Section 3: Options identification

3.1 What options have been considered?

We have assessed the options against their ability to fulfil the purpose of the legislation at two levels:

- Equitable distribution of the cost of HERA's across industry members.
- Supporting the heavy engineering industry, through research and science.

Option 1: Status quo – no change

Equitable distribution of the cost of HERA's legislated services

- Continuation of inequitable levy payment on prefabricated items between domestic manufacturers and importers of prefabricated items
- Under-contribution by importers of prefabricated items to HERA's services

Supporting the heavy engineering industry, through research and science

- Ongoing unfairness to local manufacturers, due to inequitable funding of HERA's services
- Opportunity loss of revenue for HERA decreases the amount of support provided to the industry in the form of research and science

+ Some importers may feel that lower levy payment is better for their business

Option 2: Update the Act to allow the levy to be collected on prefabricated steel and iron items

To amend Schedule 2 of the Act to include four prefabricated steel items (Tariff item numbers 73.08.10.00 (00H), 73.08.90.90 (10C), 73.08.90.90 (15D), 73.08.90.90 (29D)).

Equitable distribution of the cost of HERA's legislated services

+ The same levy amount is paid on prefabricated items, independent of origin
+ All members of the industry will fund HERA's legislated services equitably

- Domestic manufacturers will continue to pay the same amount of levy on these items (neutral)
    - Domestic manufacturers may experience increased business due to the equitable levy payment removing this preferential cost advantage to overseas suppliers (indirect effect)

- Importers of prefabricated items will experience greater costs, due to paying the levy on these items

Supporting the heavy engineering industry, through research and science

+ Levy payment equity between domestic manufacturers and importers, supporting local industry
+ HERA's levy revenue is increased and there in an increase in the amount of research and science provided to industry, thus supporting a more productive and safe industry

Option 3: Increase the levy rate

Equitable distribution of the cost of HERA's legislated services

- Continuation of inequitable levy payment on prefabricated items between domestic manufacturers and importers of prefabricated items
- Under-contribution by importers of prefabricated items to HERA's services

Supporting the heavy engineering industry, through research and science

+ HERA's levy revenue is increased and there in an increase in the amount of research and science provided to industry, thus supporting a more productive and safe industry.

3.2 Which of these options is the proposed approach?

We recommend Option 2: Update the Act to allow the Levy to be collected on prefabricated steel and iron items

To amend Schedule 2 of the Act to include the four prefabricated steel items (Tariff item numbers 73.08.10.00 (00H), 73.08.90.90 (10C), 73.08.90.90 (15D), 73.08.90.90 (29D)). Customs can then collect the levy on the import of these items and there will be equity between domestic manufacturers and importers.

Domestically manufactured items will be levied either on the component steel items, or on the prefabricated steel items. Section 4(3) of the Act prevents HERA from collecting the levy on these items twice.

This will best fulfil the purpose of the legislation, as the cost of HERA's legislated services will be equitably distributed across industry members. HERA's services will be equitably funded by both domestic manufacturers and importers of the prefabricated items.

As an incidental effect, HERA will experience increased levy revenue. The association will therefore be able to provide significantly greater levels of support to the industry through the conduct and promotion of industry-good research and science.

Section 4: Impact Analysis (Proposed approach)

4.1 Summary table of costs and benefits

Affected parties	**Comment**: nature of cost or benefit (eg, ongoing, one-off), evidence and assumption (eg, compliance rates), risks	**Impact** *In NZD*
Additional costs of proposed approach, compared to taking no action		
Importers of the proposed prefabricated metal items	Levy payment at rate of $20 per tonne on the proposed prefabricated items (levy rate as per Schedule 2 of the Act). Assuming that total levy payment on these items increases at 23 per cent annually. Refer to Key Limitations or Constraints for assumptions and data limitations.	Annual levy payment per importers of these items (next five years) = $1578 **Total** annual levy payment by importers of the prefabricated items (next five years) **= $1.59 m**
Consumers of prefabricated metal items (where the consumer is not also the importer)	~ 0.6 per cent increase in retail prices of imported prefabricated items. Assumption that importers that on sell the items will increase prices to pass the levy on to consumers. Refer to Key Limitations or Constraints for assumptions and data limitations.	$256 per item
Total Monetised Cost	Total cost to industry, equivalent to total levy payment by importers of the items. Final distribution of cost across manufacturers and consumers unknown.	Total annual cost to industry (next five years) **= $1.59 m**
Non-monetised costs		N/A
Expected benefits of proposed approach, compared to taking no action		
Manufacturers of proposed prefabricated metal items	Equitable levy payment.	Small
HERA	An initial 48 per cent levy revenue increase. Then increasing at 23 per cent annually. Refer to Key Limitations or Constraints for assumptions and data limitations.	Total annual levy revenue on the prefabricated items (next five years) **= $1.59 m**
Total Monetised Benefit		Total annual levy revenue on the

		prefabricated items (next five years) **= $1.59 m**
Non-monetised benefits		Small

4.2 What other impacts is this approach likely to have?

There may be indirect affects to the following groups:

- Importers
- HERA
- Domestic manufacturers
- Wider industry
- Wider public

Importers

The levy on imported items may indirectly increase the likelihood of current importers purchasing domestically manufactured prefabricated steel and iron items instead. However, this is unlikely due to the very small cost margin shift.

MBIE acknowledges that, due to the national lockdown and other effects of COVID-19 throughout 2020, businesses may currently be experiencing low revenue. However, as RSB3 is enactment is anticipated in 2023, and the impact is expected to be negligible, we do not expect any effects of these changes to unfairly compound any financial challenges caused by COVID-19.

HERA

This change will indirectly affect HERA, by increasing their levy revenue. HERA's levy revenue determines the amount of legislated support and services HERA can provide. HERA's revenue dictates their number of employees and the number and scope of their research projects.

We estimate that the addition of these items would increase HERA's levy revenue by around 48 per cent in coming years. This will significantly increase their capacity to promote and conduct research and science that benefits the industry.

Domestic Manufacturers

Levying the import of these items will remove part of the preferential cost advantage of importers experience over domestic manufacturers. However, this is unlikely to significantly affect sales and revenue for domestic manufacturers of prefabricated steel and iron items.

Wider industry

This change may indirectly affect the wider heavy engineering industry, by increasing the amount of available research and science for their benefit. This will allow a safer and more productive heavy engineering industry in New Zealand.

Wider public

A safer and more productive heavy engineering industry may have beneficial downstream effects on the wellbeing of all New Zealanders. Safe heavy engineering practice ensures the integrity of all structures with metal components, from bridges to large buildings. This ensures that the New Zealand public is safe when conducting day-to-day activities.

A more innovative and productive industry will diversify and strengthen the economy and may increase national living standards.

Section 5: Stakeholder views

5.1 What do stakeholders think about the problem and the proposed solution?
MBIE built the proposal in consultation with HERA and with the support of the New Zealand Manufacturers and Exporters Association (NZMEA). MBIE has also conducted a public consultation on the changes. MBIE directly contacted 34 out of 50 top importers of the relevant prefabricated items. This follows initial policy approval by the Minister of Research, Science and Innovation and precedes Cabinet approval. We received submissions from: • A domestic manufacturer of these items • An industry body. These submissions did not modify our proposed approach to levy the prefabricated items. MBIE does not intend to undertake specific consultation with iwi/hapū. *HERA* Levies have contributed 59 per cent of HERA's revenue over the past five years. Levy revenue is used for promoting and conducting research and other scientific work into or relating to the heavy engineering industry as specified in Section 12 of the Act. HERA generates further revenue from membership fees and services such as workshops to fund any further activities. HERA supports this change as they wish to provide maximal support to the industry and ensure levy payment equity amongst their members. *Industry bodies* NZMEA, now operating as The Manufacturers Network, is an industry group with a focus on supporting globally competitive manufacturers. They support the change as it will ensure equity between importers and domestic manufacturers. Steel Construction NZ (SCNZ) shares this support. SCNZ submitted on behalf of its members (over 300), in consultation with its Executive Council. *Domestic manufacturers* Eastbridge Steel is a large domestic manufacturer, with around 110 staff and an annual turnover of $25 million. In their submission, Eastbridge Steel expressed that the technical support of the use of metals in New Zealand is being unfairly borne by domestic manufacturers. Eastbridge also perceive the current ability to import prefabricated steel and iron items as an unfair advantage to offshore manufacturers and importers in competition with domestic manufacturers. They believe that equitable levying of these prefabricated items will remove a $30,000 disadvantage to their company, partially evening the playing field with overseas manufacturers. MBIE notes that Eastbridge Steel's CEO is a member of HERA's board. *Importers*

We have not received any feedback from importers.

Customs
MBIE has consulted the New Zealand Customs Agency, which agrees to implement the levying of these prefabricated items.

Section 6: Implementation and operation

6.1 How will the new arrangements be given effect?
Schedule 2 of the Act will be updated via Regulatory Systems Bill 3 These changes have been accepted for inclusion in the next Regulatory Systems Bill (RSB3). This Bill is currently in legislative bid phase and is expected to progress for Cabinet approval in March 2021. *Customs will implement the levying of the items added to Schedule 2 of the Act* From this point in time, the process for implementation follows: • MBIE informs Customs' Revenue Policy Team of the Cabinet's policy approval and expected timing of enactment of the change. • MBIE advises Customs when the legislation is enacted. • The Customs' Revenue Policy team informs the Customs' Information Systems team of the upcoming changes. • HERA is expected to communicate these changes and their implications to the industry. • Custom's Information Systems team updates their electronic system, with review and support from MBIE and the Revenue Policy team. Where the coverage of the levy is extended, the Parties will allow at least three months between enactment and the commencement date. Customs has been consulted on the changes and has agreed that they are able to implement the changes to the levy on imported items. This is business as usual for Customs' Revenue Policy and Information Systems teams. A draft Memorandum of Understanding between HERA, MBIE and Customs outlines the transitional agreement for updates to the Schedules of the Act, as well as levy rate changes. This agreement is expected to come into effect in early 2021, ahead of the enactment of the proposed changes.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?
HERA financial records will show whether their revenue has increased. These reports are made public annually, as legislated by the Act. With further data provision from Customs, MBIE will be able to review the distribution of levy payment across domestic manufacturers and importers. MBIE does not have plans to review HERA's operations and the services that they provide.

7.2 When and how will the new arrangements be reviewed?
MBIE may review the Act when issues are raised. Issues are usually raised by HERA, but could also include NZMEA or other stakeholders.