Regulatory Impact And Business Compliance Cost Statement: Application For A Commodity Levy Order On Milksolids

May 2004

Ministry of Agriculture and Forestry
Te Manatū Ahuwhenua, Ngāherehere

Requests for further copies should be directed to:

Publication Adviser
MAF Information Bureau
P O Box 2526
WELLINGTON

Telephone: 0800 00 83 33
Facsimile: 04-894 0300

Contents

Page

Background

The Commodity Levies Act 1990 (the Act) enables the imposition of levies on certain commodities, payable to organisations that are representative of levy payers. Levy payers can only be producers of the commodity. Levies are imposed by Order-in-Council, signed by the Governor-General on the recommendation of a Minister. An application has been received under the Act for a commodity levy order on milksolids produced in New Zealand by dairy farmers (owners and sharemilkers) and for supply to a dairy company.

Statement of the problem and the need for government action

- If the New Zealand dairy industry wants to remain competitive in the international markets, where it sells around 95 percent of its products, worth around $5.8 billion in export earnings a year, it is vital for the industry to continue with the research that was previously funded by the Dairy Board. The industry must continue to improve its productivity and provide quality assurances on its products. These can only be achieved by investments made by industry participants, in activities such as farm-focussed research, information transfer, and quality assurance programmes.
- Around $40 million needs to be raised each year from dairy farmers to fund industry good activities that will benefit all dairy farmers. It will be difficult to voluntarily fund these activities on an on-going basis because of a free-rider problem. The provision of the outcome of these activities to one person will not prevent another person from using it, and one individual's consumption will not diminish the supply to other individuals for consumption. It would be difficult for a funder of these activities to appropriate to themselves (as opposed to non-paying industry participants) the benefits of the activities.
- Previously these activities were funded by the New Zealand Dairy Board. With the restructuring of the dairy industry in 2001, the 3 main dairy companies agreed to fund the activities voluntarily on an interim basis for a year, and have stated they will not fund them voluntarily in the future. There are other small players in the industry who at present are not contributing. With the deregulation of dairy exporting, new entrants are expected in the processing sector. The free-rider problem with dairy farmers mentioned above would also apply if voluntary levies were imposed on the processing sector. Processing companies will fund their own product research and development that could be protected with intellectual property rights or otherwise, and the proposed levy in this paper will be used on farm-focused research and other activities to benefit dairy farmers.
- These industry good activities rely on longer term investments and therefore a longer term guarantee of funding. This guarantee cannot be provided by voluntary levies.

Statement of the public policy objective

The policy objective of the proposed levy order is to promote the most efficient and effective means of collecting funds to finance industry-good activities, whilst protecting the interests of those funding these activities.

Statement of options for achieving the desired objective

Status Quo

- As stated in paragraph 4 above, the New Zealand Dairy Board used to fund these activities. When the Board was deregulated in 2001, the three biggest dairy companies, Fonterra, Tatua and Westland, who account for about 98 percent of the industry, agreed to voluntarily fund these activities during 2002/03 to provide for transition to a levy under the Commodity Levies Act 1990. Funding was based on the percentage of milksolids supplied in the 2001/02 season.
- Under the current interim arrangement, while the three companies are paying the voluntary levy, it is the dairy farmers (98 percent of them) who are indirectly paying for it by receiving a lower payment for the milk they supply to the three companies.
- Only three of the 15 dairy companies currently operating in New Zealand are voluntarily providing funds. The suppliers of the other 12 companies free-ride under this arrangement. The three big dairy companies insist this is untenable given the free-rider population could increase in the newly deregulated industry and the inherent uncertainty surrounding voluntary levies. The non-regulatory option of a voluntary levy paid by dairy companies on behalf of dairy farmers as a long-term solution was rejected by Fonterra, Tatua and Westland.

Regulatory Options (the Commodity Levies Act 1990) – the preferred option

- As stated in paragraphs 2 and 5 above, it is vital the industry continues to fund the proposed industry good activities, and that certainty of funding is considered essential in order to optimise the achievement of long term goals achieved in areas like research.
- The only statutory provision available to the industry is the Commodity Levies Act. The Act is enabling legislation, giving the industry the opportunity to impose a levy if the majority of participants in a levy payer referendum support the proposal. The levy order will contain procedures for setting the levy rate each year and deciding on levy spending.
- Dairy InSight Incorporated is an incorporated society formed by the industry to replace the Dairy Board to undertake industry good functions. This is the only body that represents all dairy farmers in New Zealand. A majority of its directors will be elected by farmers. The dairy companies will be used as levy collection agents for reasons of efficiency and effectiveness, but farmers will be consulted by the board of Dairy InSight on levy spending. The Act provides for accountability of the board to levy payers, and has clear reporting requirements to the Minister and to levy payers.
- The levy proposal is for Dairy InSight to collect and administer the levy and contract service providers to deliver the outcomes. There will be a clear funder-provider split, which is the most efficient and effective means of delivering industry-good services.

Statement of the net benefit of the proposal

Benefits

- Many of the projects to be funded by the proposed levy are a continuation of long term projects previously funded by the New Zealand Dairy Board. Most of these activities are unlikely to be funded if the proposed commodity levy proposal does not proceed.

Potential levy payers have voted in support of the proposal because they consider that these activities should be continued, and based on the information provided to them in the referendum material they consider that there are net benefits for them from funding these activities.

- Dairy InSight has quantified the future net benefits from continued investment in these projects. For instance, it estimates benefits of $17 million a year from the body condition score fertility project in the area of animal improvement, $24 million a year from the national breeding objective, and over $220 million a year from education to move five percent of farmers from the bottom quartile of performance to the top quartile.
- The following example illustrates projected benefits from securing the levy. Dairy InSight intends to contribute $300,000 annually to a consortium of affected production sectors to eradicate Johne’s disease. Johne’s disease is a chronic, infectious disease that affects cattle, sheep, goats and farmed deer. The disease causes weight loss and death of adult animals and is a world-wide problem in all advanced agricultural countries with significant cattle and sheep industries. In New Zealand, it is widespread in dairy cattle and sheep and is rapidly spreading in farmed deer. The cost to the dairy industry of clinical cases, at the current rates of infection, is $33.9 million per annum.
- Vaccination development is currently underway and could be available in 7-10 years time. At $300,000 invested per year the cost to reach the product would be $2.1m - $3m. Vaccination would cost farmers approximately $5 per cow per lifetime. For a 250-cow herd, that equates to $1,250 in the first year and $287.50 thereafter at a 23 percent replacement rate. Within 5 years the old stock will have been replaced with new vaccinated young stock and the clinical cases should be zero.

Table 1: Cost of vaccination to eradicate Johne’s disease

	Estimated Time	Cost
Investment into vaccine development	7 years @ $300,000/year	$2.1m
Investment to vaccinate 40% of national herd	Year 1	$7.0m
	Year 2-5 total	$6.4m
Total		$15.5 m

- Control of the disease by vaccination would result in a net benefit of $18.4 million ($33.9 million less $15.5 million) in the first year of zero clinical cases, with the net benefit increasing in subsequent years.
- The largest proposed expenditure item is funding the bovine Tb National Pest Management Strategy. This would cost around $12 million a year, to protect an industry that exports around 95 percent of its products worth around $5.8 billion in export earnings.

Costs

- The proposed levy order is estimated to raise around $37.7 million in the first year, including $6 million budgeted for extra spending on Tb control. This will replace what the Dairy Board was spending (around $35million a year, if the extra $6 million is included), and what the three biggest companies have agreed to spend in the current year ($37 million, if the extra $6 million is included). Dairy farmers were indirectly paying for this. Therefore, the proposed levy order will not impose any additional costs on potential levy payers, and on levy collectors, other than a small percentage of farmers and small dairy companies who are currently free-riding.

- The disadvantage to dairy farmers would be the opportunity cost of using the levy money elsewhere. The direct costs to the industry would be the cost of paying the levy by the levy payers and any administrative costs borne by levy payers and collection agents. This is no different to the current costs they are facing, except for the very small companies who currently are not paying levies under the voluntary arrangement.
- Dairy InSight estimates that the cost of the proposed levy to the average dairy farmer based on production of 78,914 kg of milksolids is $2,683 per annum (excluding GST). At a projected payout of $3.60 per kg of milksolids for the current season, the proposed levy rate of 3.4 cents per kg equates to less than 1 percent of gross revenue from milk. Compared to the benefits of the spending identified above, this spending is very small, and on average the returns a farmer would get from spending this money elsewhere would be far less than from these benefits.

Consultation

- Consultation with potential levy payers by Dairy InSight involved a round of farmer representative and major industry player meetings in November/December 2001, a Statement of Intent distributed to all dairy farmers in April 2002 and a round of nation-wide farmer meetings in April/May 2002.
- The farmer representatives and major industry players consulted included Dexcel, Fonterra, Tatua, Westland, Livestock Improvement Corporation Limited, discussion group representatives, breed associations, Federated Farmers and the Young Farmers' Association.
- Dairy InSight also targeted rural professionals such as veterinarians, bankers, farm consultants, accountants, universities and breed societies as a link to dairy farmers. Rural professionals are an integral part of most farming businesses. Consultation with rural professionals included posted information including the consultation document, nine nationwide stakeholder meetings held in January/February 2002, and a personal invitation to meet with Dairy InSight.
- In the levy payer referendum, supporters of the proposal made up 63 percent of all participants, and they produced 67 percent of the total production of milksolids by all participants. The participation rate was 59 percent, which is above the average for commodity levy referenda of about 40 percent.
- The three biggest companies (Fonterra, Tatua and Westland) who are providing all the industry-good funds to Dairy InSight for the 2002/03 year on a voluntary basis have stated that they do not intend to fund Dairy InSight on a voluntary basis in the future. The three companies are currently represented on the board of Dairy InSight, and they support the compulsory levy proposal.
- The following government departments were consulted in the preparing of a paper: The Treasury, The Ministry of Economic Development, Te Puni Kokiri, and the Department of Prime Minister and Cabinet.

Business Compliance Cost Statement

Sources of Compliance Costs

- Compliance costs include the cost of collecting the levy by dairy companies, and the cost of setting up systems for collecting the levy for those companies not paying the current voluntary levy.

Parties Likely to Be Affected

- Fifteen dairy companies will be required to collect the levy. Twelve of the 15 dairy companies are not paying the current voluntary levy, and they together account for around 2 percent of the industry.

Estimated Compliance Costs

- Two of the three companies currently paying the voluntary levy already have the collection systems in place and there will be no additional cost arising from setting up the collection systems for them. The other 13 companies are currently examining or will be examining and installing levy collection systems. Dairy InSight has offered to reimburse the costs, and at this stage no estimate is available as to how much installing such systems will cost.
- As levy collection will be linked with payment to farmers for supply of milk, the levy collection costs will be negligible for the companies. No estimate of this cost is available.

Longer Term Implications of the Compliance Costs

- There will be one-off costs for setting up the levy collection system for those companies not currently paying the voluntary levy. Over time, the collection costs will be negligible as levy payment will be linked with payment to farmers for supply of milk.

Level of Confidence of Compliance Estimates

- Dairy InSight is continuing to work with collection agents on installing the collection systems, and at this stage no estimates of costs are available.

Key Compliance Cost Issues Identified in Consultation

- The collection costs and setting up systems for levy collection, as discussed above, are the key compliance costs. These were identified early in the process of developing the levy proposal. No additional issues were identified during consultation.

Overlapping Compliance Requirements

- None were identified.

Steps Taken to Minimise Compliance Costs

- Using dairy companies as collection agents was identified as the most effective and efficient means of collecting the levy. Linking levy payments to Dairy InSight with payments to dairy farmers for milk supplied is a further attempt to keep the compliance costs low. To cover the costs and imposition of collecting the levy, collection agents are entitled to claim up to 0.5 percent of the amount of levy collected plus the GST payable on the fee, which they will deduct from the levy payment to Dairy InSight.

Contact for Enquiries

MAF Information Services
Pastoral House
25 The Terrace
PO Box 2526
Wellington, NEW ZEALAND

Fax: +64 4 894 0721
Contact this person