

Stage 2 Cost Recovery Impact Statement

Amending the Biosecurity (Readiness and Response – Kiwifruit Levy) Order 2015

Ministry for Primary Industries

June 2018

Agency Disclosure Statement

This cost recovery impact statement has been prepared by the Ministry for Primary Industries. It provides analysis of a proposal by Kiwifruit Vine Health Inc (KVH) for a legislative amendment to raise the maximum rate of an existing levy under the Biosecurity Act 1993 (the Act) on kiwifruit growers.

The kiwifruit industry sector is seeking this proposed amendment to enable it to meet its commitments for biosecurity readiness and/or response activities under the Government Industry Agreement for Biosecurity Readiness and Response (GIA).

The analysis relies on information held by MPI and/or supplied by Kiwifruit Vine Health Inc, the industry body recognised as representing the kiwifruit industry for the purposes of GIA.

The mechanisms of the levy and its collection are well understood, but some particulars of the proposed amendment cannot be predicted with certainty. It is possible that a biosecurity incursion may occur that exceeds even the \$15 million in reserves that the levy is intended to secure over a three-year period. A number of measures are available to mitigate this risk, from lowering the industry share of contributions in a major response, to extending the period over which contributions may be made.

The amount received may also vary according to the market prices received for kiwifruit, but this risk is regarded as low in light of forecast strong growth and export returns for the sector.

The process has involved consultation with all 2043 registered growers, and their views have been taken into account. The levy proposal has received strong support.

In putting forward this levy proposal, KVH proposes to reduce the overall levy burden on growers by reducing an existing biosecurity levy aimed at managing the impacts of the Psa bacterium.

Implementing the levy amendment would increase levy costs on kiwifruit growers by some \$16.66 per ha. We expect that growers will be able to absorb the increase in cost given the average orchard gate return of \$68,868 per ha.

The proposed biosecurity levy will not impact on market competition, incentives to invest, or override fundamental common law principles.

Grant Bryden, Director, Biosecurity and Animal Welfare

19 June 2018

Executive summary

This application is for an amendment to the existing Biosecurity (Readiness and Response – Kiwifruit Levy) Order 2015, to increase the maximum levy rate from 0.28 cents per kg of kiwifruit exported (1 cent per tray of kiwifruit) to 1.4 cents per kg (5 cents per tray of kiwifruit).

KVH is able to vary the rate of the levy at any time at amounts below the maximum set in the levy order. KVH will continue to apply the first 0.28 cents per kg (1 cent per tray of kiwifruit) of levy funds to meet the current minimum GIA commitments and existing operational activities. The additional funding will be used to build up reserves that can be used in responding to biosecurity incursions.

The Minister for Primary Industries approved KVH's application to represent the kiwifruit sector for the purposes of GIA in 2014. That approval requires an industry organisation to demonstrate that it has consulted its sector on the funding arrangements that will be used to meet GIA commitments; and has arrangements in place, or a plan to fund, its commitments.

To meet those commitments, KVH requested the Biosecurity (Readiness and Response – Kiwifruit Levy) Order be established in 2015.

The levy is currently being collected at its maximum rate. KVH has now identified several factors which require additional funding, which will need a legislative amendment to increase the maximum rate:

- Increased kiwifruit industry investment in operational biosecurity activities as GIA arrangements have progressed;
- New understanding of biosecurity risks to the kiwifruit industry, such as the scale of impacts from an incursion of brown marmorated stink bug (BMSB) or Brazilian wilt disease; and
- Establishment of multi-sector Operational Agreements with other industries (for economically significant fruit flies, BMSB, and high-risk pests for kiwifruit and kiwiberries) have identified additional funding commitments.

The industry is seeking to collect \$15 million over a three-year period so that it can respond to potential biosecurity incursions. KVH intends to levy at the maximum rate for this three-year period only, in order to build up the reserves, and to lower the rate after this time.

The rate of a levy is determined by the industry, in deciding the extent of the commitments it enters into. The rate increase, even if it requires a regulatory amendment, is a routine adjustment reflecting the GIA commitments of an industry organisation, rather than an increase requiring a government policy decision.

KVH will reduce the overall levy burden on kiwifruit growers by simultaneously reducing the level of another existing levy. The effect will be to increase levy payments overall by 1 cent per tray of kiwifruit, or \$16.66 per ha of production. We expect that growers will be able to absorb the increase in cost given the average orchard gate return of \$68,868 per ha.

The levy increase has very wide support from the industry and the growers who will be responsible for paying it. Growers and exporters are familiar with the mechanisms of the levy and their roles in its collection.

MPI considers that the levy amendment meets the relevant cost recovery principles and objectives, and recommends that it proceeds.

GIA policy framework

The policy decision for the design of GIA was agreed to by Cabinet in 2009 [CAB Min (09) 31/11]. The Biosecurity Act 1993 was amended in 2012 to include a statutory authority for GIA, which includes provisions allowing for GIA biosecurity levies.

The GIA partnership provides for government and industry to consider, commit to, and plan biosecurity readiness and response activities in advance. Joint decision-making and cost-sharing helps to ensure that primary sectors have a formal role, alongside government, in managing their biosecurity risks.

The GIA consists of:

- An overarching Deed, which is signed by all parties and sets the framework for the GIA; and
- Operational agreements on behalf of government, and one or more industry organisations, which set out an agreed approach to specific readiness or response activities, including the agreed cost-shares.

Section 100ZB readiness and response levy policy

Section 100ZB provides a mechanism for industry organisations that have signed up to GIA to meet their cost-share of agreed biosecurity readiness and response activities. The cost-shares for readiness and response activities are determined by industry and government.

Each cost-share represents the proportion of public to industry benefit that is likely to accrue in avoiding the impacts of the unwanted pest or disease. There may be multiple industry GIA signatories affected by the unwanted pest or disease. Examples are those industries that have signed up to multi-sector agreements on BMSB and economically significant fruit flies. In this case, industry cost-share is determined by the proportional benefits to each industry in avoiding the impact of the unwanted pest or disease.

Industry organisations have several ways of funding commitments made under GIA, including internal funding mechanisms, or existing commodity levies. However, due to limits with existing mechanisms, transparency objectives, and the possibility of a significant biosecurity response, industries have so far generally preferred section 100ZB levies under the Act.

Amendment to existing levy

This application is for an amendment to the existing Biosecurity (Readiness and Response – Kiwifruit Levy) Order 2015, to increase the maximum levy rate from 0.28 cents per kg of kiwifruit exported (1 cent per tray of kiwifruit) to 1.4 cents per kg (5 cents per tray of kiwifruit).

The provisions for GIA in the Act make levies available to an industry organisation in order to meet its commitments. The rate of a levy is therefore effectively determined by the industry, in deciding the extent of the commitments it enters into.

The rate increase, even if it requires a regulatory amendment, is a routine adjustment reflecting the GIA commitments of an industry organisation, rather than an increase requiring a government policy decision.

Cost Recovery Principles and Objectives

The underlying principles that guide this levy proposal are set out in legislation and MPI policy guidance deriving from the Office of the Auditor-General's *Charging Fees for Public Sector Goods and Services*, and Treasury's *Guidelines for Setting Charges in the Public Sector*.

Section 100ZB of the Biosecurity Act – *Readiness or response levy orders* – sets out that a levy may be imposed for the purposes of wholly or partly funding an industry organisation's commitments under the GIA.

Before imposing the kiwifruit readiness and response levy in 2015, the Minister had to be satisfied of its:

- effectiveness and efficiency – that funds are collected to provide maximum benefits at minimum cost; and
- equity in targeting the right people – that funds are collected from industry members who will benefit from the readiness and response services, and costs are proportionate.

MPI principles to be taken into account in designing cost recovery mechanisms include:

- justifiability;
- transparency; and
- ease of administration.

The principle of justifiability is met, as the funding sought is directly related to the costs modelled in responding to the potential biosecurity incursions identified. The levy funding is transparent, as the levy order requires that the rates are set via discussion at the AGM, that KVH keeps records of the amount of levy funding it receives, and how the money has been spent or invested. The routine amendment to the levy will be easy to administer and costs kept as low as possible, as existing collection mechanisms will not be affected. Growers and exporters are familiar with these mechanisms, and their respective roles in setting and collecting the levy.

Status quo

KVH signed up to the GIA in 2014, and the Biosecurity (Readiness and Response – Kiwifruit Levy) Order 2015 was established to fund the industry's commitments. The levy applies only to kiwifruit being exported to countries other than Australia, and identifies three different classes of kiwifruit that may be levied:

- green kiwifruit;
- gold, and red kiwifruit; and
- any other variety

There is potential for each class of kiwifruit to be levied at different rates. Currently the levy rate is set at the same for all three classes, at 0.28 cents per kg of kiwifruit exported (equivalent to the measure better understood by growers of 1 cent per tray of kiwifruit).

Kiwifruit growers are responsible for paying the levy. Kiwifruit exporters are responsible for collecting the levy, by deducting the amount from the return paid to the grower, and paying it directly to KVH. The harvest season begins in March and is usually completed by mid-June.

KVH is able to vary the rate of the levy at any time at amounts below the maximum set in the levy order. Normally, variations must follow discussion at the kiwifruit industry's AGM, but in the case of a response may be varied without holding an AGM.

Since 2015, the levy has been set at the maximum rate. Since then, KVH has identified several factors which mean the maximum rate of levy needs to be increased through an amendment to the levy order. These are:

- Increased kiwifruit industry investment in operational biosecurity activities as GIA arrangements have progressed;
- New understanding of biosecurity risks to the kiwifruit industry, such as the scale of impacts from an incursion from BMSB or Brazilian wilt disease; and
- Establishment of multi-sector Operational Agreements with other industries (for economically significant fruit flies, BMSB, and high-risk pests for kiwifruit and kiwiberries) have identified additional funding commitments.

Changes sought

KVH is seeking to increase the maximum levy rate to 1.4 cents per kg (5 cents per tray of kiwifruit). KVH will continue to apply the first 0.28 cents per kg (1 cent per tray of kiwifruit) of levy funds to meet the current minimum GIA commitments and existing operational activities. The proportions of the total GIA levy are as presented below:

Table 1: Proposed total GIA levy payable

GIA element	Levy cost (cents per tray of kiwifruit)
GIA commitments and operational activities	1
Response reserve fund	4
total	5

The industry is seeking to collect \$15 million over a three-year period so that it can respond to potential biosecurity incursions. KVH intends to levy at the maximum rate for this three-year period only, in order to build up the reserves, and to lower the rate after this time.

KVH's assessment is that a prudent level of reserves will be 50% of the industry's liability under GIA Operational Agreements, and based on the scenario of incursions of a fruit fly, BMSB and Brazilian wilt all occurring within a short timeframe.

In calculating its potential total liability for eradication campaigns, KVH has pointed out to its growers that:

- BMSB is causing over 30% fruit loss in the gold variety of kiwifruit in some Italian orchards;
- In southern Brazil up to 50% of kiwifruit vines have died in areas where Brazilian wilt is present; and
- In New Zealand, eradicating the small and isolated breeding population of fruit fly in Grey Lynn in 2015 cost \$18 million.

Reserves also need to increase over time, as the relative cost-share for the kiwifruit industry will increase under the Operational Agreements as the value of the industry increases. The 50% reserve figure currently equates to \$1.6 million, but based on a mid-range projection of

8% annual growth in the kiwifruit industry, the liability will increase to over \$2.5 million in under 10 years.

It is important during biosecurity responses that decisions can be made and implemented quickly. With reserves on hand the industry can respond immediately, and not need to divert its attention in raising funds.

Why the levy increase is appropriate, and who pays

All kiwifruit growers who produce for export are responsible for paying the levy – there are no exceptions.

As a matter of convenience the levy is collected by exporters, who may recover the levy as a deduction from the amount they pay to the grower after the kiwifruit has been loaded for export.

MPI considers that the mechanisms for the proposed levy change will be transparent and allow for activities to be referred directly back to the purposes for which the levy is collected, and ensure that the costs to the persons of paying the levy are not disproportionate to the benefits that they are likely to receive.

MPI also considers that the levy increase meets a sensible principle of flexibility, with sufficient design scope to take account of:

- a reasonable degree of change in the profitability of the sector;
- a reasonable degree of variability in the commitments it enters into;
- reasonably foreseeable biosecurity risk and;
- the amount of funding required.

Consultation and industry support for the levy

The proposed levy increase is industry driven. Section 100ZB of the Act requires KVH to consult the proposed levy payers on the levy revenue and to take their views into account.

KVH provided written material on the levy to all 2043 registered growers through information packs:

- before the AGM in August 2017; and
- with more detail in October 2017.

Written material on the levy proposal and background documentation was also posted on KVH's website in November 2017. Further articles on the proposal were published in:

- KVH's three fortnightly Bulletins through November 2017; and
- Zespri growers' newsletter in December 2017.

The proposal was discussed face-to-face roadshows with:

- Seeka (company) growers in November 2017; and
- Zespri growers (approx. 550 attendees at 13 locations) in November 2017; and
- The Kiwifruit Industry Advisory Council in December 2017.

Despite a large number of abstentions at the earliest meetings, attendees at the later Zespri road shows were all strongly in support of the levy increase proposal. The Kiwifruit Industry Advisory Council, which comprises growers, post-harvest businesses, and Zespri representatives, was convened in December 2017 and voted unanimously in favour of the proposal.

Why the proposed levy increase is being requested

This proposal is for an increase to a levy which has been in place since 2015. Growers and export agents are familiar with the mechanisms of the levy, and their roles in its setting and collection.

KVH has explored other approaches to funding biosecurity incursion response costs including:

- “grower pools” via the Zespri supply agreement;
- insurance; and
- a Government loan facilitated under the GIA arrangements.

While funding from the grower pools could potentially be used to meet biosecurity incursion response costs, it is difficult to set up an arrangement in advance when the amount needed cannot be known with certainty. The KVH Board also felt that this arrangement would not meet legislative requirements under Part 5A of the Act, which call for certainty around funding mechanisms. This option was also no cheaper for growers than the levy proposal.

The options of insurance or a Government loan would be more expensive for growers than the levy proposal, and so were not preferred.

The level of the proposed levy and its cost components

The maximum rate of the Biosecurity (Readiness and Response – Kiwifruit Levy) Order 2015 will be increased from 0.28 cents per kg of kiwifruit exported (1 cent per tray of kiwifruit) to 1.4 cents per kg (5 cents per tray of kiwifruit).

The intention is to raise \$15 million over a three-year period by collecting at the maximum rate, which will be lowered in subsequent years. This amount has been decided on after the kiwifruit industry modelled its potential total liability in dealing with the most significant biosecurity risks known at this point, should eradication campaigns be necessary.

Some elements of the proposed levy cannot be predicted with certainty. It is possible that a biosecurity incursion may occur that exceeds even the \$15 million sought. For example, in responding to the Psa bacterium in 2010, industry contributed \$25 million to access a further \$25 million provided by government. The amount received may also vary according to the market prices received for kiwifruit. However, the industry is currently receiving high revenues, and growth is expected to continue.

In 2016 kiwifruit exports received \$1,660 million from 123 million trays exported. The industry is forecast to grow, and based on the existing level of returns would provide the following revenue:

Table 2: Forecast kiwifruit production and revenues

Year	Production forecast (trays)	Forecast export revenue (\$ millions)
2019/20	150 million	\$2,025
2020/21	160 million	\$2,160
2021/22	170 million	\$2,295

The levy is designed to allow for flexibility. KVH is able to amend the levy rate below the maximum specified in the levy order, to adapt to changing production conditions and biosecurity risks.

Impact analysis

Production and orchard gate returns for growers for the 2016 year were as follows:

Table 3: 2016 kiwifruit production and orchard gate returns to growers

Variety	Average production (trays per ha)	Orchard gate return (\$ per ha)
green	12,281	53,555
Organic green	7,933	54,427
gold	11,442	98,838
Green14	7,921	45,853
Average all	9,894	68,868

In 2016 the total area planted in kiwifruit orchards was 12,185 ha. On the figures above, the average planting was almost 6 ha, producing almost 60,000 trays, and providing the “average producer” with an orchard gate return of \$413,208.

The proposed GIA levy will be increased five-fold from 1 cent to 5 cents per tray. At the same time however, KVH intends to reduce the levy burden on growers by lowering the existing Psa management levy from 6 cents per tray to 3 cents per tray. The net effect will be to increase the total amount levied by 1 cent per tray. The effect on the “average producer” of 6ha is noted below:

Table 4: Comparison of current and proposed levy burden on growers

Levy type	Current (2018) impact on “average producer” (\$)	Proposed impact on “average producer” (\$)
Hort New Zealand (15 cents per \$100 of sales)	568.50	568.50
NZ Kiwifruit Growers Inc (9 cents per tray all varieties)	900.00	900.00
KVH PSa levy	6 cents per tray exported 600.00	3 cents per tray exported 300.00
KVH GIA levy	1 cent per tray exported 100.00	5 cents per tray exported 500.00
Total	2,168.50	2,268.50

The total levies payable per “average grower” under the proposed changes will be raised by an additional \$100. We expect that growers will be able to absorb the increase in cost given the return per ha. Expressed on an area basis, the proposed levy increase would result in additional costs of some \$16.66 per ha of production, compared to the average orchard gate return (gross) of \$68,868 per ha.

On this basis the increase is expected to be manageable. Growers appear to agree, given they have strongly supported the proposed levy increase.

Risks and mitigation

As noted above, GIA biosecurity levies can be used to fund both readiness and response activities. Readiness activities are planned and costed in advance and are therefore well understood before they start. Cost recovery for biosecurity responses is more challenging. Unlike readiness activities, responses are unpredictable – both in their occurrence and their costs.

As MPI pays response costs upfront, there is a risk that, in the incursion of a serious pest or disease, industry may not be in a position to pay its cost-share specified under an operational agreement. In mitigation, the design of GIA provides a number of mechanisms to reduce the potential burden on industry, including:

- Industry fiscal caps for responses;
- Industry cost-share capped at 50% of the total;
- Industry able to pay their share off over several years;
- Crown to always pay the first 20% of costs; and
- Reduced cost shares in large responses will reflect industry ability to pay – for example, the Fruit Fly Operational Agreement provides for an industry share of 10%.

The KVH Board has been prudent in entering only into commitments that can be funded. It is a recognised risk, however, that a biosecurity incursion may happen that exceeds even the increased funding level being sought. For example, in the response to the Psa bacterium, industry contributed \$25 million to access a matching \$25 million provided by Government.

In mitigation, should this occur again, KVH will seek wider industry direction through New Zealand Kiwifruit Growers Inc. as to what actions should be taken, and how costs might be funded over time.

Implementation

MPI will continue to work with KVH in developing the content of the amendment to the levy order. MPI will organise the mechanisms of the legal amendment, and KVH will proceed with making the new levy rate after discussion at its AGM.

The proposed amendment is for an increase to a levy which has been in place since 2015. Growers and export agents are familiar with the mechanisms of the levy, and their roles in its setting and collection.

Monitoring, evaluation and review

KVH will monitor the revenue received over the three-year period during which the levy will be collected at its maximum rate, to ensure that the reserves are building up according to projections.

Industry members will evaluate the success of the increased levy rate. KVH will present its proposed budget and related levy charge to its AGM every year. At the AGM growers will vote and decide whether to accept it or not. If at any point growers become unhappy with the direction that KVH is taking, they have the power to create change.

The levy order requires the keeping of accounts, statements, and records by the collection agent, the levy payer, and KVH. KVH is required to account for the amount of money received, and how the money has been spent or invested.

The levy order allows for the appointment of arbitrators and a right of appeal to the District Court for the purposes of resolving disputes.

Conclusions and recommendations

MPI, KVH, and kiwifruit growers support the amendment, which will raise the maximum rate of the Biosecurity (Readiness and Response – Kiwifruit Levy) Order 2015. The levy will provide secure and ongoing funding for the kiwifruit industry's commitment to the GIA partnership.

The levy is fully transparent to growers, and will also be controlled by growers via the mandate given to KVH to operate on their behalf for the purposes of GIA. Every year the growers will be able to vote on KVH's proposed budget for the year, and proposed levy funding.

MPI considers the proposed levy aligns with cost recovery principles, and recommends the amendment proceeds.