



Meat Industry Association of New Zealand (Inc)

Submission to New Zealand Customs Service
on

Customs' Goods Clearance Activities:
Review of Funding Arrangements

20 February 2006

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I: About the Meat Industry Association

1. The Meat Industry Association of New Zealand Incorporated (MIA) is a voluntary trade association representing New Zealand meat processors, marketers and exporters. It is an Incorporated Society (owned by members) that represents companies supplying the majority of New Zealand sheepmeat exports and all beef exports, producing 17 per cent of our nation's exports by value (30 percent of New Zealand's primary sector export revenue) and earned export revenue of \$5.3 billion in the year ending April 2005.
2. MIA member companies operate approximately 80 processing plants dispersed throughout the country. The plants slaughter and process approximately 25 million lambs, 3.8 million sheep and 4.5 million cattle and calves each year. Ninety percent of this production is processed into value-added products. Approximately 750,000 tonnes or 85% of the production is exported to overseas destinations. Our affiliate members add to the depth of expertise available from the membership, with representation throughout the meat supply chain, including road and rail transport, shipping lines, ports, packaging firms, specialist product exporters, research and technology.
3. The Association advocates on behalf of its members and provides advice on economic, trade policy, market access, employment relations, business compliance costs and technical and regulatory issues facing the industry, with a particular focus on:
 - Food safety trends and developments in importing countries
 - Economic and trade aspects of market access to key overseas markets
 - Major public policy proposals that could impact on industry operations
4. The MIA is also the interface between the meat industry and government (i.e., it is the consultative body referred to in various New Zealand statutes, such as the Meat Board Act 2004, Meat Act 1981 and the Animal Products Act 1999).
5. The Association's mission is to:
 - Provide a forum for consideration of industry-wide commercial, human resource, marketing, and sanitary and zoosanitary issues; and
 - Provide the means of formulating a collective view on issues of industry wide interest, and of conveying that position to government, departments of state, trade bodies, and other appropriate external agencies and organisations.
6. A list of MIA members is attached as Appendix 1.

II: Consultation

7. In preparing this submission all members and affiliate members were invited to provide input. Association members may also make individual written submissions supplementing this paper and reflecting concerns relating to their specific operations.
8. As the representative organisation for the meat industry, a significant export sector, this submission focuses on the proposals to recover costs primarily associated with export supply chain.

9. The Association welcomed the opportunity to be represented at the working group convened by New Zealand Customs Service to assist in the development of the discussion document and additionally acknowledges and appreciates the opportunity to comment on this discussion document.

III: Background

10. The government is reviewing sources of funding for the goods clearance activities of the New Zealand Customs Service. Any new funding arrangements are scheduled to be implemented on 1 July 2006. Customs' has released a discussion document '*Customs' Goods Clearance Activities: Review of Funding Arrangements*' (the Discussion Document) on funding options which it is seeking feedback from key stakeholders. Currently, the costs of these activities are shared between the Crown and users (importers, exporters and transport operators), on the basis of 31% Crown funded to 69% user funded. For the export sector, this split is 69% Crown funded to 31% user funded.
11. The Association notes that this review is not considering the specific level of fees currently paid for goods clearance activities, and that, if, as a result of the review, the broad mix of funding is changed, further consultation will be undertaken on the level of any fees. The MIA would welcome the opportunity to contribute to that process.
12. This submission is in two parts:
 - Consideration of the principles of goods clearance funding; and
 - Response to the questions in the Discussion Document.
13. The Association participated in the consortium of Customs' clients which commissioned a report from NZIER analysing and commenting on the Discussion Document. This report is attached at Appendix 2 and should be read in conjunction with this submission.

IV: Executive Summary

Funding Principles

14. The Association considers the broad principles outlined on Page 9 of the Discussion Document to be generally sound, subject to recognition of their limitations in practice (such as the ability to accurately quantify and apportion costs; and that transaction costs imposed on all parties by the proposed approach are economically efficient), and the need to consider the characteristics of each good or service.

Outcomes of the Goods Clearance Process

15. The MIA submits that the four outcomes identified in the Discussion Document, viz revenue collection, community protection, border security and trade support; that result from, or determine, goods clearance activities are primarily carried out for the benefit of all New Zealander's and as such the activities should be funded from general taxation.

Funding of Goods Clearance Activities through General Taxation

16. For each of the four outcomes identified in the Discussion Document (refer also paragraph 15) the outcome is predominantly a public benefit for the reasons set in paragraph 23. For this, and the following reasons, the Association submits that goods clearance activities should be funded through general taxation:
- Goods clearance activities were not instigated with the objective of making users the primary beneficiaries, but rather to collect revenue, protect the community, and to discharge international obligations and thus foster trade.
 - Where a private benefit does accrue, it is minor in the context of the primary outcome, and is a by-product of the goods clearance activity.
 - The government determines the risk management standards and priorities for goods clearance which in turn drive the costs of the service¹ The ability of users to influence these standards and priorities is particularly limited, leaving only the area of administrative efficiency where they can influence costs. This is minor in the overall context, and may not recover the total transaction costs incurred by both Customs' and the users.
 - Customs' has an obligation to keep compliance and collection costs to a minimum which can be best done through systems design and review processes. Users will drive efficiencies through minimising their internal costs of compliance within the constraints of the system. Regular system review in consultation with users will improve the overall efficiency levels.
 - Any additional charge against users will erode New Zealand's national competitiveness and place additional costs on an already fragile export industry, which is unable to reflect increased charges in its pricing structures.
 - The imposition of a charge at any point in the value chain, such as transport or port operators, will ultimately be recovered from exporters, who will, in turn, recover those costs from the supply chain.
 - Use of the goods clearance activity is obligatory, thus there is considerable difficulty in establishing accurate benefits, firstly for each of the activities, importing, exporting and transshipping, and secondly for each of the individual users of the service.
17. In its report, the NZIER notes in relation to the identification of Outcomes, Beneficiaries and Risk Exacerbators, that

'There is a tendency to identify as a beneficiary every party that uses a service, directly or indirectly. However, if use is compulsory, or effectively compulsory, then every user may not be a beneficiary in the economic sense.'

NZIER goes on to note that:

'A useful test of whether a party is, or is not, a beneficiary in an economic sense is to identify what are the outcomes of the provision of the good or service and then consider

¹Discussion Document, pp.17

whether the party would voluntarily pay for one or more of those outcomes if it knew that without payment the good or service would not be provided.'

18. One consequence of the Customs' good clearance activities is the ability for export products to leave New Zealand's exclusive economic zone. The Association submits that it would be inappropriate, however, to describe this as an 'outcome' of the policy that requires there to be goods clearance activities. This outcome would happen if there was no Customs' service.

V: Consideration of the Principles of Goods Clearance Funding

Funding Principles

19. The MIA considers the broad principles outlined on Page 9 of the Discussion Document to be generally sound; these being:
 - Taxpayers or third parties should contribute to the costs of services where the outcomes provide a benefit to them;
 - Third parties who influence the costs of service delivery should contribute to the costs of the service;
 - The Crown should meet the costs of a service where recovering costs from third party beneficiaries or risk exacerbators is impracticable or uneconomic;
 - There should be equity and economic efficiency benefits from identified groups contributing to the costs of services, in particular that charges make users realize the consequences of their choices and these become factored into commercial decision making.
20. The Association agrees with these principles as broad guidance for funding public sector goods and services, subject, however, to recognition of their limitations in practice and the need to consider the characteristics of each good or service.
21. This does however assume the benefits are identifiable, clear and quantifiable to the beneficiaries. In the case of Goods Clearance Activities, the real test - if the element of compulsion was removed - is would the "beneficiary" purchase the service, and if so, to what value. For example, is the lodgement of an Export Entry in itself critical to the operation of an exporting company's operation, and what are the benefits it confers on the exporter?
22. Importers and exporters have a legal obligation to make declarations regarding the movement of goods so that Customs' can carry out its statutory obligation to collect excise and other taxes, and therefore have no option but to use the service whether it confers a benefit on them or not.
23. International trade treaties or bilateral arrangements entered into by the Government require Customs' to give assurances to treaty partners that goods imported into their countries are what they are declared to be and have not been tampered or interfered with. Through meeting these obligations both the New Zealand government and our trading partners are therefore direct beneficiaries. Further, the ability of the sector to influence or contribute to government policy re international treaties or bilateral arrangements is limited,

and therefore it is not appropriate to expect the sector to pick up any increased costs arising from government's decisions.

Application of the Funding Principles

24. The scope of the current review of funding arrangements is limited to Customs' goods clearance activities. These activities contribute to four outcomes, as defined in the discussion document:

- *Revenue collection: All Crown revenue that is lawfully due is collected.*

This activity provides benefits in the form of revenue to the Crown and hence the wider community.

The Association concurs with the position taken in the Discussion Document that this outcome is a public benefit, collecting about 15% of total Crown revenue, and therefore should be funded from general taxation.

- *Community Protection: Risks associated with the movement of goods into and out of New Zealand are prevented from harming New Zealand's economy, community and environment.*

This activity primarily provides benefits to the wider community, and where possible private benefits occur, such as intellectual property protection, and use of statistics, these are already charged for under the current arrangements.

This public benefit, results from providing protection from harm through the exercising of import and export controls, ranging from total prohibitions to trade conducted under licensing or permit type arrangements, as well as controls on the way goods are traded. This wide public benefit supports funding from general taxation.

- *Border Security: The domestic and international communities have confidence in New Zealand's border security and the security of New Zealand's travel channels.*

In previous submissions the Association has stated it believes increased security measures, for example, in response to US security requirements are a public good, (as per the Treasury Guidelines definition), and should therefore be funded by the Crown from general taxation.

Such security measures also provide a benefit to New Zealand's trading partners, through New Zealand implementing the security measures in international treaties and arrangements, thereby also making them beneficiaries.

Benefits to New Zealand exporters are a by-product of the Government's international obligations, and therefore of its primary Public Benefit purpose.

Operators who wish to increase their supply chain security have the option of participating in the Secure Export Partnership programme, or, for example, through their US importer, in the US scheme Customs and Trade, Partnership Against Terrorism (C-TPAT). Such membership is voluntary and will provide benefits such as enhanced border clearance in the importing country, which can then be equated to the costs incurred of participating in the scheme.

New Zealand also has international obligations through the World Customs Organisation (WCO) *Framework of Standards to Secure and Facilitate Global Trade*,² which by its title, reinforces the beneficiaries as being the international community. The MIA also contends any private benefit is a by-product of the four core elements in the Framework.

- *Trade Support: Legitimate and compliant trade is fostered by efficient border regulation.*

The Discussion Document states “This outcome recognises the positive impacts that efficient customs processes can have on trade “...fostering legitimate and compliant trade by way of efficient regulation and minimum imposition is critical to NZ’s economy³.”

This clause in itself strongly suggests a Public Benefit, in that the trade support activity being “critical to NZ’s economy” is sufficient justification for its existence, and it therefore benefits New Zealand as a whole.

Any private benefits accruing under this outcome are again by-products of the primary outcomes of the goods clearance activities.

The MIA also contends that the collection of statistics falls under this outcome. Statistics underpin the formulation of Government policy, therefore making Statistics New Zealand a direct beneficiary, and the public of New Zealand an indirect beneficiary. The information produced by Statistics New Zealand from trade and excise data is paid for by third party users of the statistical information.

Third parties who influence the costs of service delivery should contribute to the costs of the service

25. The MIA contends Customs’ have an obligation to ensure compliance and collection costs are kept to a minimum. As with any procedure, costs are incurred by the originator of the activity, in the case of our members, exporters, and it is therefore not only the costs incurred by Customs’, but also the costs incurred by users which must be considered by systems designers in formulating the procedures. Users of the service will already be seeking to minimize their administrative costs, and imposing charges to cover mandated service provider costs will achieve only minor efficiency gains.
26. The costs incurred in the administration of goods clearance activities are small in comparison to the operational costs. Users are therefore very limited in their ability to influence the costs. Therefore levying a charge as a mechanism to increase administrative efficiencies is both cumbersome and inefficient.
27. As stated above, MIA members are significant exporters and contributors to New Zealand’s economy. A further imposition of costs on a fragile export industry, where those costs cannot be recovered from customers in the competitive international market place, will reduce competitiveness and erode margins.

² www.wcoomd.org/ie/En/en.html

³ New Zealand Customs Service, Statement of Intent 2005/06 pp19

28. Imposing goods clearance costs at any point in the value chain, such as freight forwarders or transport operators, will result in those costs being passed back to the originators of the transaction, in our case, exporters.

Options for Funding Goods Clearance Activities

29. The Discussion Document reduces six possible to two feasible funding options consistent with the funding principles set out above:

- full Crown funding from general taxation; or
- a mix of Crown and third party funding from the users of goods clearance.

30. The MIA concurs with Customs' rejection of:

- exacerbator funding as a feasible and effective option.
- 100% third party funding and 100% user funding on the grounds that the primary purpose and almost all of the benefits are public benefits.
- a mix of funding from the Crown and third parties who receive benefits from Customs' border protection, trade security and trade support activities, as this is in effect a targeted user charge option and in practice it would be uneconomic to source funding from non-user beneficiaries.

31. The Association submits that the funding option "a mix of Crown and third party funding from the users of goods clearance" should also be rejected on the following grounds:

- (a) For each of the four outcomes identified by Customs', the primary outcome is shown to be overwhelmingly a Public Benefit.
- (b) Where a Private Benefit accrues, it is minor in the context of the primary outcome, and is a by-product of the goods clearance activity.
- (c) Customs' has an obligation to keep compliance and collection costs to a minimum which can be best done through systems design and review processes. Users will drive efficiencies through minimising their internal costs of compliance within the constraints of the system. Regular system review in consultation with users will improve the overall efficiency levels.
- (d) Any additional charges imposed on New Zealand exporters which are not imposed on our international competitors will have an adverse impact on New Zealand's international competitiveness.
- (e) The imposition of a charge at any point in the value chain will ultimately appear in the accounts of exporters.
- (f) Use of the goods clearance activity is compulsory, thus there is considerable difficulty in establishing accurate benefits, firstly for each of the activities, importing, exporting and transshipping, and secondly for each of the individual users of the service.
- (g) The government determines the risk management standards and priorities for goods clearance which in turn drive the costs of the service⁴ The ability of users to

⁴Discussion Document, pp17

influence these standards and priorities is particularly limited, leaving only the area of administrative efficiency where they can influence costs. This is minor in the overall context, and may not recover the total transaction costs incurred by both Customs' and the users.

- (h) Unless the benefit to users is both significant and tangible, much of that private benefit will be eroded by the administrative costs of monitoring, collection or enforcing compliance and therefore may not be economically efficient.

For the reasons enunciated above the MIA contends that the option of full Crown funding from general taxation is the most appropriate option for goods clearance funding activities.

VI: Response to the Questions in the Discussion Document

- *Question 1: Do you agree or disagree with the funding principles for this review and what are your reasons?*

The MIA agrees with these principles as broad guidance for funding public sector goods and services, subject, however, to recognition of their practical limitations (accurately determining the public: private split of the benefits) and the need to consider the characteristics of each good or service.

The primary beneficiary should be clearly identified; in this case the Government. There is a strong Public Benefit, and also a Public Good, in that use of goods clearance by one person, does not detract from its use by another.

The MIA qualifies the above position, in that benefits must be real, accurately quantifiable and significant, and should emanate from an additional specific service before third party funding is invoked.

- *Question 2: Do you believe any principles should be emphasised over the others, and if so why?*

Each of the four principles is important.

- *Question 3: Are there any other relevant principles you believe are relevant to the funding of goods clearance, if so what are they and why are they relevant?*

As goods clearance is compulsory, there is no practical test as to whether the benefits realised by users are real or significant in relation to the compliance costs incurred; nor is there any opportunity to use an alternative service provider. Accordingly there is no real measure of the benefits, or the service efficiency. A further principle is, the benefits should be significant and tangible to third parties before an administrative cost is incurred to establish a billing regime together with its associated costs.

- *Question 4: What is your view on whether there are both public and private benefits from goods clearance?*

The MIA is firmly of the view the benefits from goods clearance activities are overwhelmingly in the public domain. This is also reflected in the Discussion Document where the outcomes of goods clearance activities are revenue collection, community protection, border security, and trade support, described as "critical to NZ's economy."

Where private benefit occurs, it is minor in the overall context, it is difficult to accurately quantify, and in the case of supply chain security, alternative voluntary schemes exist.

Goods clearance activities were not instigated with the objective of making users the primary beneficiaries, but rather to collect revenue, protect the community, and to discharge international obligations and thus foster trade.

- *Question 5: Do you have a view on the weighting or percentage split between public and private benefits arising from goods clearance?*

The MIA is firmly of the view Goods Clearance Funding should be from general taxation as the public benefits far outweigh any private benefits, and the beneficiaries (both public and private) are dispersed. The private benefits of goods clearance will vary according to the individuals situation, making any weighting or percentage split either an average figure or administratively excessively costly to implement and maintain.

- *Question 6: Do you consider goods clearance to be predominantly public good or private good in nature, or a mix of the two, and how does this inform your views on how it should be funded?*

As stated in the answer to Question 5 MIA is firmly of the view goods clearance is predominantly public good, and should be funded from general taxation. Goods clearance meets the principles of a public good in that it is impossible to exclude people from its benefits and use by one person doesn't necessarily detract from use by another. (Treasury guidelines).

- *Question 7: Do you have a view on who the primary beneficiaries of goods clearance are?*

The primary beneficiaries are all New Zealanders, who benefit by goods clearance activities facilitating trade on which New Zealand is economically dependent for both employment and its standard of living.

- *Question 8: Do you agree that the users of goods clearance partially drive the costs through their expectations of efficient quality service delivery? If so should they be prepared to contribute to the costs?*

The Association is of the view that the primary cost drivers of goods clearance are the standards and priorities set for goods clearance according to the level of protection and security sought by or on behalf of society. These are set by the government. The ability of users to influence these standards and priorities is particularly limited, leaving only the area of administrative efficiency where they can influence costs. This is minor in the overall context, and may not recover the total transaction costs incurred by both Customs' and the users combined.

- *Question 9: Are there particular characteristics of goods clearance that you believe should be weighted more heavily in consideration of the choice of funding option and if so, why?*

The MIA believes the characteristics of goods clearance that should be given more weighting are

- (a) The service provider is a government monopoly and where use of the service is compulsory, where the standards and priorities are set by the government, where all New Zealanders are the primary beneficiaries, users of the service are extremely limited in their ability to influence costs.
 - (b) There is no ability for users to apply commercial pressure by using a contestable alternative service to drive efficiency or service levels, which may result in poor incentives to control costs, as outlined in the Discussion Document (p.10). Therefore introducing a billing regime to effect efficiency gains is unlikely to achieve the desired outcome.
- *Question 10: Do you agree that the most feasible options are either full Crown funding or a mix of Crown and third party funding?*

The Association agrees the most feasible options are either full Crown funding or a mix of Crown and third party funding, however due to reasons provided above, full Crown funding is by far the most compelling option.

- *Question 11: Do you have a preference for either of these options, and if so, why?*
The MIA has a clear preference for full Crown funding.
- *Question 12: If there is to continue to be a mix of Crown and third party funding, do you think the current mix is equitable?*

The MIA is strongly of the view that Goods Clearance Activities should be fully Crown funded from general taxation, and therefore has the view that the current mix of 31% Crown and 69% third party is totally inappropriate. This is especially so when the level of funding required for Goods Clearance Activities has moved from \$18.2m in 2000/01 to \$42.2m in 2005/06.

- *Question 13: Currently third parties meet 69 percent of the cost of Customs' goods clearance activities and the Crown meets 31 percent. This will change to 20% and 80% respectively in 2006/07 under current government financial planning. If you do not think the current mix is equitable, what in your view would be the preferred level of contribution by each, to improve equity and economic efficiency?*

This question contradicts the statement made on p3 of the Discussion Document, where it states

"Currently the costs of goods clearance are shared between the Crown and third parties (importers, exporters, transport operators, etc.). The Crown will pay 31 percent (13.0m) of the Customs' goods clearance costs for 2005/06. Third parties, through a mixture of user fees and other charges will pay 69 percent (\$29.2m). Under the current government financial planning this will change to 20 percent and 80 percent respectively in 2006/07, because the government has previously decided that some Crown funding of the costs of export goods clearance is to be replaced by third party funding from 1 July 2006"

We assume the position in italics is the correct one.

Given the MIA position in respect of Question 12 above, that Goods Clearance Activities should be fully Crown funded, the MIA's preferred level of contribution by each would be 0 percent third party and 100 percent Crown. Although this does not necessarily address the

equity position as minor private benefits accrue, it can address the economic efficiency as goods clearance can be transacted particularly for exports, on a per vessel basis. The Association concurs with the assessment of beneficiaries by activity type as set out in the NZIER report⁵

Table 1: Beneficiaries of Outcomes of Customs Goods Clearance

	Public Benefit	Private Benefits					
		Goods Clearance Service Users					
		Exporter	Importer	Trans-shippers	Mail Carriers	Excise Duty Payers	Other
Revenue and Statistics	Yes	No	No	No	No	No	Stats users - but user charges
Community Protection	Yes	No	No	No	No	No	IPR owners – but user charges
Border Security	Yes	Some to exporters to US	No	No	No	No	
Trade Support	Yes	Some but hard to identify beneficiaries and quantify benefits they receive			No	No	

Source: NZIER

- *Question 14: What impact would you expect from any change to the current funding mix, particularly in the context of the funding principles for this review?*

The Association would expect the impact of any change to the funding mix to reflect the benefits accruing to the Crown (public benefit and public good) and to third parties. This would shift the funding source heavily to general taxation.

⁵ NZIER Customs Goods Clearance Review of Funding Arrangements; Report to Consortium of Customs Clients, February 2006

- *Question 15: Under the current funding arrangements, different levels of contribution from the Crown and third parties apply to imports, exports, international mail and excise. Do you have any views on the relative levels of contribution for each of these major transaction types and how are these views related to the funding principles?*

The MIA has the view that under the current funding arrangements, a cost recovery mechanism should be based on the principles of efficiency, effectiveness and fairness, and should necessarily vary according to the goods clearance activity undertaken. The MIA does not have sufficient information on which to make an assessment on the relativities which should be applied to reflect each of the goods clearance activities, but reiterates its view that the primary characteristic which should be given maximum weighting is identification of the primary beneficiary.

- *Question 16: In respect to each type of transaction (imports, exports, international mail or excise), if there were a change to the funding mix what impact would you expect that to have?*

The MIA would expect the impact of any change to the funding mix to reflect the benefits accruing to the Crown (public benefit and public good) and to third parties. This would shift the funding source heavily to general taxation.

- *Question 17: If a form of mixed Crown and third party funding is to continue into the future, are there any changes to the current administration of cost recovery that would in your view improve equity or economic efficiency?*

The Association recommends that prior to any decisions being made on changes to administrative procedures of cost recovery that a survey is conducted of the users to determine the optimum overall plan to maximise the efficiency of the administrative procedures.

VII: Concluding Remarks

32. For any queries relating to this submission, please contact Rowan Ogg, Manager, Trade and Economic on 04 473 6465 or e-mail: rowan.ogg@mia.co.nz

Appendix 1: List of Association Members and Affiliate Members

LIST OF MIA MEMBERS AND AFFILIATE MEMBERS (YEAR COMMENCING 1 JULY 2005)	
Members	Head Office Location
Advance Marketing Ltd	Auckland
AFFCO New Zealand Ltd	Hamilton
Alliance Group Ltd	Invercargill
ANZCO Foods Ltd	Wellington
ANZCO Green Island Ltd (ANZCO group)	Dunedin
ANZPAC Foods Ltd	Auckland
Auckland Meat Processors Ltd	Auckland
Ballande New Zealand Ltd	Auckland
Bernard Matthews New Zealand Ltd	Waipukurau
Blue Sky Meats (NZ) Ltd	Invercargill
<i>Brookland (NZ) Ltd (in receivership)</i>	<i>Auckland</i>
Canterbury Meat Packers Ltd (ANZCO group)	Ashburton
Columbia Exports Ltd	Auckland
Crown Marketing Ltd (ANZCO group)	Wellington
Crusader Meats New Zealand Ltd	Benneydale
Dairy Meats NZ Ltd (AFFCO group)	Auckland
Davmet New Zealand Ltd	Napier
Fern Ridge Ltd	Napier
Frasertown Meat Company Ltd	Auckland
Garra International Ltd	Christchurch
Glovers Foods Ltd	Auckland
Greenlea Premier Meats Ltd	Hamilton
Harrier Exports Ltd	Auckland
Horizon Meats New Zealand Ltd (wholly owned subsidiary of Blue Sky Meats (NZ) Ltd)	Auckland
Lamb Packers Feilding Ltd (wholly owned subsidiary of Bernard Matthews NZ Ltd)	Waipukurau
Land Meat (NZ) Ltd (AFFCO group)	Hastings
Lanexco Ltd	Tauranga
Lowe Corporation Ltd	Hastings
Mathias International (Mathias Meats NZ Ltd)	Auckland
Pilot (NZ) Ltd	Christchurch
Primary Producers Co-operative Society Ltd (PPCS)	Dunedin
Progressive Gisborne Ltd (wholly owned subsidiary of Bernard Matthews NZ Ltd)	Waipukurau
Progressive Meats Ltd	Hastings
Rakaia River Meats Ltd	Rakaia
Riverlands Ltd (ANZCO group)	Eltham
South Pacific Meats Ltd	Invercargill
Tara Exports Ltd	Auckland
Taylor Preston Ltd	Wellington
Te Kuiti Meat Processors Ltd	Te Kuiti
Towers Thompson (New Zealand) Ltd	Christchurch
Universal Beef Packers Ltd (UBP)	Te Kuiti
Wallace Corporation Ltd	Waitoa, Waikato

Affiliate Members	Head Office Location
AgResearch-MIRINZ Centre	Hamilton
Aon New Zealand Limited	Wellington
Australia-New Zealand Direct Line (ANZDL)/Contship Containerlines (Divisions of CP Ships UK Ltd)	Auckland
Carter Holt Harvey, Packaging	Auckland
CentrePort Wellington	Wellington
Energy for Industry (ex Meridian Solutions)	Wellington
Hamburg-Sud New Zealand Ltd	Auckland
Hapag Lloyd (New Zealand) Ltd	Auckland
Maersk New Zealand Ltd	Auckland
New Zealand Natural Casing Association Inc	Napier
Oceanic Navigation Ltd	Auckland
P&O NedLloyd Ltd	Wellington
Port of Napier	Napier
Port Otago Ltd	Port Chalmers
Port Taranaki Ltd (previously Westgate Transport Ltd)	New Plymouth
ProAnd Ltd (Meatek Ltd)	Fielding
Rissington Breedline Ltd	Napier
Thompson Clarke Shipping Pty Ltd (ANZ Marketing Representative for the Port of Los Angeles)	Australia
Toll NZ Consolidated Ltd	Auckland
Vero Marine Insurance	Auckland

Appendix 2: NZIER Report

Customs Goods Clearance

Review of Funding Arrangements

**Report to Consortium of Customs
Clients**

13 February 2006



Preface

NZIER is a specialist consulting firm that uses applied economic research and analysis to provide a wide range of strategic advice to clients in the public and private sectors, throughout New Zealand and Australia, and further afield.

NZIER is also known for its long-established *Quarterly Survey of Business Opinion* and *Quarterly Predictions*.

NZIER was established in 1958.

Authorship

This report has been prepared at NZIER by Brent Layton and Johannah Branson.

Consortium of Customs Clients

The following organisations are members of the consortium of Customs' clients which commissioned this report:

- The Board of Airline Representatives in New Zealand;
- Business New Zealand;
- Export New Zealand;
- Meat Industry Association;
- New Zealand Post Ltd;
- The Retailers' Association;
- Seafood Industry Council; and
- The New Zealand Shippers Council.

The opinions contained in this report are those of NZIER and should not be assumed to reflect the views of any of the parties to the consortium that commissioned the report.

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1. Introduction

The government is reviewing sources of funding for the goods clearance activities of the New Zealand Customs Service (“Customs”) for implementation of new funding arrangements from 1 July 2006. Currently, the costs of these activities are shared between the Crown and users (importers, exporters and transport operators, etc), split 31 per cent (\$13.0m) to 69 per cent (\$29.2m). Under current government financial planning this will change to 20 percent Crown funding and 80 percent user funding in 2006/07 because the government has previously decided that some Crown funding of the costs of export goods clearance is to be replaced by third party funding from 1 July 2006.

In December 2005, Customs released a Discussion Document on funding options.¹ It is seeking feedback from key stakeholders by 20th February 2006. The principal issue to be addressed is whether current and planned funding arrangements should be varied in order to improve the equity or economic efficiency of the provision of goods clearance services. Once Customs has received and considered the submissions, it will report back to the Minister of Customs who will in turn make recommendations to the government on the funding arrangements to apply to goods clearance from 1 July 2006. If, as a result of the review, the broad mix of funding is changed, there will be a further review relating to the relevant fees. This review will be conducted in consultation with affected parties.²

A broadly based consortium of Customs’ clients has asked NZIER to prepare an independent report for them analysing and commenting on the Discussion Document. This paper is that report. Its contents reflect the independent views of NZIER, and not necessarily the views of members of the consortium that commissioned the report.

In this report we first consider the funding principles set out in the Discussion Document. We then consider the nature of the goods clearance activities conducted by Customs and Customs’ application in the Discussion Document of the funding principles to the specifics of these activities. Finally, we review the options for funding identified by Customs and its assessment of them against the funding principles. There are seventeen specific questions in the Discussion Document on which feedback is sought by Customs. We summarise our discussion in the various sections by indicating what we consider to be appropriate responses to these questions.

¹ New Zealand Customs Service (2005), *Customs’ Goods Clearance Activities: Review of Funding Arrangements: A New Zealand Customs Service Discussion Document for Key Stakeholders*. Hereinafter referred to as the “Discussion Document”.

² Discussion Document, p.3.

2. Funding Principles

2.1 Government Endorsed Principles

The government has previously agreed the following principles in developing options for funding Customs goods clearance activities:³

- Taxpayers or third parties should contribute to the costs of services where the outcomes provide a benefit to them;
- Third parties who influence the costs of service delivery should contribute towards the costs of the service;
- The Crown should meet the costs of a service where recovering costs from third party beneficiaries or risk exacerbators is impracticable or uneconomic; and
- There should be equity and economic efficiency benefits from identified groups contributing to the costs of services, in particular that charges make users realise the consequences of their choices and these become factored into commercial decision-making.

We generally agree with these principles as broad guidelines for funding public sector goods and services, subject, however, to:

- Recognition of their limitations in practice;
- The appropriate identification of outcomes and the parties that are beneficiaries or risk exacerbators in relation to those outcomes;
- Clarification of the principle of charging parties who influence the costs of service delivery; and
- Recognition of the need to consider the characteristics of each good and service separately to determine the appropriate application of the principles.

2.2 Limitations in Practice

One of the more significant practical limitations on the application of the government's four principles is the transaction costs to which various funding arrangements can give rise. An arrangement that creates very high costs of monitoring, collection or enforcing compliance may not be economically efficient, or appropriate, even if evaluation against these principles suggests it is the "right" approach.

In other words, the application of these principles needs to be tempered by consideration of the transaction costs they impose on all parties to ensure that the proposed approach to charging is in practice economically efficient.

³ Discussion Document, p. 3.

2.3 Identification of Outcomes, Beneficiaries and Risk Exacerbators

There is a tendency to identify as a beneficiary every party that uses a service, directly or indirectly. However, if use is compulsory, or effectively compulsory, then every user may not be a beneficiary in the economic sense. The most bizarre example of this confusion we have seen was an argument that prisoners are beneficiaries of prisons because they use them. Obviously, it is society more generally that is intended to be the beneficiary of prisons by keeping criminals secure and punishing them through loss of their liberty.

A useful test of whether a party is, or is not, a beneficiary in an economic sense is to identify what are the outcomes of the provision of the good or service and then consider whether the party would voluntarily pay for one or more of those outcomes if it knew that without payment the good or service would not be provided. There are two aspects to this test. Firstly, appropriately identifying the outcomes of the policy that leads to the provision of the good or service and, secondly, consider whether the only reason a party might not pay for the provision of these outcomes is that it believes it can “free ride” because the good or service would be provided any rate.

Not all consequences of the provision of a good or service should be treated as outcomes when applying this test. One consequence of Customs goods clearance activities relating to imports is that importers are able to receive the goods they have legally imported. It would be inappropriate, however, to describe this as an “outcome” of the policy that requires there to be goods clearance activities. This outcome would happen if there was no Customs service, so it is obviously not an outcome of the policy to have one.

In this case, the outcomes of the policy are to intercept contraband and smuggled goods, intercept illegal imports, collect accurate statistical data, gather duty, and identify goods that may breach laws relating to intellectual property, and so on. The appropriate question to determine whether importers, for example, are the beneficiaries of the service is whether they would voluntarily pay to ensure these outcomes and not whether they will pay to ensure they get their goods.

The “risk exacerbator” label is also open to misinterpretation. Sometimes it is used to describe a party whose activities give rise to a particular service. So, for example, it is on the basis of this approach argued that all importers are risk exacerbators because without importers there would be no need for Customs goods clearance of imports. But under this approach there is no effective limit to who is a risk exacerbator. Without aircraft and ships or airports and ports there would be no imports, hence the operators and owners of these are risk exacerbators. Without exporters in other countries

and purchasers wanting overseas goods in New Zealand there would be no imports, and so these groups are also risk exacerbators according to this simplistic approach.

A more appropriate way to identify risk exacerbators is to identify the groups whose actions and decisions create the need for the service or increase the level of activity necessary to achieve the outcomes desired. As the Treasury's Guidelines put it, risk exacerbators are those whose actions create negative externalities or who put a positive externality at risk.⁴ Thus, importers of illegal drugs and pornography are risk exacerbators because if no one imported these things there would be no need for a service to block their entry. By the same definition, legal importers and exporters are not risk exacerbators. The definition of an exacerbator in the Discussion Document is also along these lines and avoids the pitfall of applying too wide a definition. The definition used is "someone whose actions make it necessary for the government to become involved."⁵

2.4 Parties Who Influence Costs

One of the principles the government has agreed to is:

Third parties who influence the costs of service delivery should contribute towards the costs of the service.

The rationale is that by forcing these parties to contribute to costs they will be incentivised to ensure their level of demand is efficient and not excessive; which it could be if they did not face any charge.

We have three comments in relation to this principle. Firstly, since the aim of charging those that cause costs is to ensure that they take into account the costs their activities impose, the limit of any charges under this principle should be the marginal costs created by the party. The principle should not be interpreted as an entitlement to impose any charge upon a party which influences cost.

Secondly, this principle is obviously not applicable when the party being charged has no ability to influence the level or nature of the demand they impose. In this situation no incentive effects will occur, and applying the approach would not be consistent with the purpose of the principle.

Thirdly, the principle should not be restricted to "third parties" – those not directly involved in the activity; it should also apply to users and the government. The exclusion of users from the wording by using the term "third parties" appears to us to be a drafting error. The inclusion of the

⁴ The Treasury (2002), *Guidelines for Setting Charges in the Public Sector*, p.7.

⁵ Discussion Document, p.9.

government is important as the government is often in a position to significantly influence the costs of its services by setting the standards. One other area where this can be the case is in the arrangements with other countries over access for New Zealand exports. Requiring the government to incorporate in general taxation some or all of any extra costs imposed on exporters by, for example, the United States should incentivise the government to negotiate hard for the benefit of New Zealanders.

2.5 Characteristics of Good or Service

Care needs to be taken when applying the four principles to ensure that the application fits the specific circumstances. In general, when there are effectively several different services or outcomes bundled together then care has to be taken to look at the application of the principles to each aspect separately, and on its merits. In the context of Customs goods clearance activities there are effectively a range of different services – clearance of imports, clearance of exports, clearance of international mail, and clearance of goods subject to excise duties in addition to the provision of statistics and enforcement of intellectual property rights (IPR).

2.6 Customs' Questions on Funding Principles

Q1: Do you agree or disagree with the funding principles for this review and what are your reasons?

We generally agree with these principles as broad guidelines for funding public sector goods and services, subject, however, to:

- Recognition of their limitations in practice;
- The appropriate identification of outcomes and the parties that are beneficiaries or risk exacerbators in relation to those outcomes;
- Clarification of the principle of charging parties who influence the costs of service delivery; and
- Recognition of the need to consider the characteristics of each good or service separately to determine the appropriate application of the principles.

Q2: Do you believe any principle should be emphasised over the others, and if so why?

No. The principles should be assessed against the particular characteristics of the good or service and the context in which it is being provided.

Q3: Are there any other principles you believe are relevant to the funding of goods clearance, if so what are they and why are they relevant?

We would reformulate the second principle along the following lines:

Parties who make a decision which influences the costs of service delivery should contribute towards the incremental costs of the service which arise as a result of their decisions

We would also incorporate into the list of principles the need to consider the efficiency consequences of the transaction costs – monitoring, collection and enforcement - that result from various charging options.

3. Customs Activities

The scope of the current review of funding arrangements is limited to Customs goods clearance activities. There is, however, a range of separate trade and commercial activities covered:

- Exports;
- Imports and trans-shipments;
- Goods subject to excise duty; and
- International mail items.

Even within these separate activities there are some differences in the actual service provided which depend on the character of the trade and the party involved. For instance, the service provided for clearance of exports to the United States is different, in some aspects, from that provided for export elsewhere. The service provided to exporters in a Secure Export Partnership with Customs also differs from the service to other exporters.

According to Customs, the goods clearance activities contribute to four outcomes:⁶

- The collection of Crown **revenue** from import and excise duties and as a by-product of these activities trade statistics and data relating to goods subject to excise duty are gathered;
- The provision of **community protection** from risks associated with the movement of goods that could harm New Zealand's community, economy and environment;
- The provision of **border security** to reassure the international and domestic community that trade to and from New Zealand does not constitute a security risk; and
- The provision of **trade support** to facilitate the efficient passage across borders of legitimate and compliant trade.

⁶ Discussion Document, p.12.

4. Application of Funding Principles to Goods Clearance

4.1 Risk Exacerbators

In the Discussion Document it is argued that:

Sourcing funding from ... exacerbators is not a realistic funding option. The chief means of seeking to modify or deter certain behaviour by these exacerbators is the threat and imposition of criminal sanctions. This applies not only in respect to security risks such as terrorism, but also in other risk areas such as trafficking of illicit drugs.⁷

We concur with Customs on this point.

4.2 Beneficiaries

4.2.1 Revenue and Statistics

We concur with Customs that the beneficiary of the revenue gathering outcome is the Crown. We also agree that the trade and excise good data collected by Customs is largely shaped by the revenue requirements.⁸ The information produced by Statistics New Zealand from these data is actually paid for by the third-party users of the statistical information.

4.2.2 Community Protection

We also concur with Customs that the beneficiary of most of the community protection outcomes is the general public.⁹ The enforcement of controls related to intellectual property rights (IPR) are a potential exception as a major beneficiary of this outcome is the party that owns the IPR. There is a consumer protection aspect to this outcome that has the wider public as its beneficiary. Moreover, those wishing Customs to protect their rights under the Copyright Act 1994 or the Trade Marks Act 2002 are required to provide Customs with an indemnity, meet Customs' actual costs and lodge in advance security to cover these costs. The current arrangements require beneficiaries to meet all Customs' actual costs, despite there being a potential consumer protection aspect to the outcome.

⁷ Discussion Document, p.14.

⁸ Discussion Document, p.12.

⁹ Discussion Document, p.12.

4.2.3 Border Security

Customs argues in the Discussion Document that there are both public and private benefits from the border security outcome. They claim the public benefits arise from the international expectations of cooperation on trade security. The private benefits they identify as accruing “to exporters and those transshipping goods through New Zealand who are engaged in trade with countries where trade agreements incorporate specific customs elements linking trade security to facilitation.”¹⁰ The only example that Customs gives of a private benefit is the facilitation of trade under the 2004 Supply Chain Security Arrangement between New Zealand and the United States.¹¹

There is almost certainly a private benefit arising from this NZ-US arrangement in the form of lower risks of trade disruption and so quicker delivery times and less inventory, storage and demurrage costs. But this benefit only accrues to exporters or trans-shippers shipping to the United States, and not at all to importers or exporters elsewhere. Moreover, the benefit to each shipper is limited to the value of the facilitation to the shipper.

4.2.4 Trade Support

In this category Customs places such matters as customs-to-customs arrangements to overcome issues relating to valuation, origin and classification of goods, and providing input into trade treaties relating to the rules of origin and levels of duty, and so on. Customs argues that these can give rise to benefits to traders but concludes it is difficult to characterise the trade support outcome in public or private benefit terms.¹²

As Customs also notes, there is a duty on regulators to ensure the reasonableness of regulatory requirements, and that they do not unduly hinder otherwise lawful activities.¹³ Some of Customs’ trade support activities fall into this category and it is not appropriate to classify the traders as beneficiaries; without Customs there would be no hindrance. Other aspects of trade support are akin to diplomatic activities. These may benefit particular segments of the community more directly than others, but they also have a community wide policy purpose in terms of outcomes. For many of the trade support activities – for example, agreeing trade classifications, negotiating arrangements - it will be hard linking the expenditure to the benefits derived by particular groups of traders at

¹⁰ Discussion Document, p.12.

¹¹ Customs also refers to the World Customs Organisation (WCO) adopting in June 2005 the *Framework of Standards to Secure and Facilitate Global Trade* but has not effectively identified how this gives rise to private benefits. See Discussion Document, p.13.

¹² Discussion Document, p.13.

¹³ Discussion Document, p.13.

particular times. To illustrate the difficulty, what exporters and importers would, for example, benefit from New Zealand and Australia agreeing on a new definition of country of origin? Obviously, it would not just be traders today, but would include traders in the future. Moreover, not all traders in all commodities would benefit.

Overall, we see that Customs's trade support activities may provide some private benefits to exporters, importers and trans-shippers; that these groups might be willing to fund some of these activities if there was no other way they could obtain the outcomes. However, we would also suggest that some of the activities have wider public benefits. Moreover, we have not identified from the Discussion Document any trade support activities that benefit those producing goods subject to excise duty or handling international mail.

4.2.5 Conclusion on Beneficiaries

We concur with Customs that the outcomes it identified provide a mix of public and private benefits. The first outcome – revenue and statistics – principally provides benefits in the form of revenue to the Crown and hence the wider community. The second – community protection – principally provides benefits to the wider community. To the extent there are private benefits from these two outcomes the third parties receiving them – statistics users and IPR owners - are required to pay under current arrangements. There are no proposals to change that.

The third outcome – border security – also gives rise to mainly public benefits, although many exporters and trans-shippers to the United States will derive some private benefit from the facilitation of trade under the 2004 Supply Chain Security Arrangement between New Zealand and the United States.

The fourth outcome – trade support – is, as Customs argues, hard to characterise in terms of public and private benefits. What private benefits there are appear to be limited to exporters, importers and trans-shippers and not extend to those paying excise duty or conveying mail. Moreover, it would be hard to link any private benefits to particular groups of traders in terms of the goods involved, destinations and time period of their activities. In short, identifying beneficiaries and the benefits they receive would be difficult and involve high transaction costs.

4.3 Costs

The costs of Customs goods clearance activities are also influenced by the behaviour of users of the system through the accuracy of the documentation they submit, the volumes of goods for which they seek clearance, the

destinations they choose, the methods of reporting they adopt and the compliance systems they operate.

The costs are also in part shaped by the quality of service in terms of turn around times, access to information and so on - that users expect. Customs is a monopoly provider and some might argue this allows it to determine unilaterally the level of service it provides. However, through direct feedback from users to Customs and indirect feedback through the political process from users to politicians to Ministers to Customs its users also influence its service levels.

The Government also influences the costs of goods clearance systems by the international arrangements it negotiates, its requirements in terms of revenue gathering, border security and auditing and the level of community protection and trade support it seeks.

4.4 Customs' Questions on the Application of Funding Principles

Q4: What is your view on whether there are both public and private benefits from goods clearance?

The first outcome – revenue and statistics – principally provides benefits in the form of revenue to the Crown and hence the wider community. The second – community protection – principally provides benefits to the wider community. To the extent there are private benefits from these two outcomes the third parties receiving them – statistics users and IPR owners - are required to pay under current and proposed arrangements.

The third outcome – border security – also gives rise to mainly public benefits, although many exporters and trans-shippers to the United States will derive some private benefit from the facilitation of trade under the 2004 Supply Chain Security Arrangement between New Zealand and the United States.

The fourth outcome – trade support – is hard to characterise in terms of public and private benefits. What private benefits there are appear to be limited to exporters, importers and trans-shippers and not extend to those paying excise duty or conveying mail. Moreover, it would be hard to link benefits received to particular groups of traders in terms of the goods involved, destinations and time period of their activities. In short, identifying beneficiaries and the benefits they receive would be difficult and involve high transaction costs.

Q5: Do you have a view on the weighting or percentage split between public and private benefits arising from goods clearance?

Table 1 summarises our discussion of the beneficiaries of the four outcomes identified by Customs in the Discussion Document. From this it can be seen that for all four outcomes there are public benefits, but that for only two outcomes are there private benefits for some users of the goods clearance service. It is obvious from Table 1 that the benefits accrue in the main to the public.

Table 1 Beneficiaries of Outcomes of Customs Goods Clearance

	Public Benefit	Private Benefits					
		Goods Clearance Service Users					
		Exporter	Importer	Trans-shippers	Mail Carriers	Excise Duty Payers	Other
Revenue and Statistics	Yes	No	No	No	No	No	Stats users - but user charges
Community Protection	Yes	No	No	No	No	No	IPR owners – but user charges
Border Security	Yes	Some to exporters to US	No	No	No	No	
Trade Support	Yes	Some but hard to identify beneficiaries and quantify benefits they receive			No	No	

Source: NZIER

Q6: Do you consider goods clearance to be predominantly public good or private good in nature, or a mix of the two, and how does this inform your views on how it should be funded?

A public good is one that is non-rivalrous in consumption and for which exclusion from the benefits would be difficult to achieve. Considering the four outcomes identified by Customs as the outcomes of goods clearance we conclude it is predominantly a public good. It is very hard to exclude people from the benefits of revenue collection, community protection, border security (except possibly in relation to trade facilitation for exporters to the United States) and trade support. Moreover, to a large measure, “consumption” of all these outcomes is non-rivalrous.

Concluding that, because everyone can be excluded from having their goods cleared, the service is an excludable one misses the point that it is excludability from the output or outcomes that is the test and not excludability from access to the process.

Q7: Do you have a view on who the primary beneficiaries of goods clearance are?

The Crown and general public in the main.

Q8: Do you agree that the users of goods clearance partially drive the costs through their expectations of efficient quality service delivery? If so should they be prepared to contribute to its costs?

We do agree that users’ expectations of the quality of service they should receive partially drive the costs of goods clearance.

We agree that a user should pay the additional costs when the user wants additional services over and above those that the general public through the political process demand be provided or the government has agreed to provide under international treaties.

We also note that the Government can also influence the costs of goods clearance systems by the international arrangements it negotiates, its requirements in terms of revenue gathering, border security and auditing and the level of community protection and trade support it seeks.

Q9: Are there particular characteristics of goods clearance that you believe should be weighed more heavily in consideration of the choice of funding option and if so why?

No additional points

5. Funding Options

5.1 The Feasible Options

Customs identified and evaluated six possible funding options:¹⁴

- 100 percent Crown funding from general taxation;
- Mixed Crown and third-party beneficiary funding;
- Mixed Crown and user funding;
- 100 percent risk exacerbator funding;
- 100 percent third party beneficiary funding; and
- 100 percent user funding

As a result of this analysis Customs reduced the six possible to two feasible funding options which it considered to be consistent with the funding principles:¹⁵

- 100 percent Crown funding from general taxation; or
- Mixed Crown and user funding.

We agree with Customs' rejection of exacerbator funding as a feasible and effective option.

We agree, on grounds of the primary purpose and that the overwhelming majority of the benefits of Customs' good clearance activities being public in nature, with rejection of the options of 100 per cent third party beneficiary funding and 100 per cent user funding.

We note that third party beneficiaries that use statistical information generated by the goods clearance activities or receive IPR protection from Customs are subject to user charges. We consider these arrangements to be appropriate, although it is possible that charging IPR parties the full costs of enforcement is inefficient as it does not reflect the public benefit in consumer protection aspect of this activity. We accept that in other respects funding from third party beneficiaries, as opposed to users, is likely to be difficult.

We agree there is justification for charging exporters to the United States some of the additional costs that are incurred by Customs as a result of the 2004 Supply Chain Security Arrangement between New Zealand and the United States. The limit of these additional charges should be the value of the benefits that exporters receive from the agreement in terms of lower inventory costs, greater supply reliability, and so on. Since other users of the

¹⁴ Discussion Document, p.17.

¹⁵ Discussion Document, p.17.

goods clearance service are not beneficiaries of this agreement we see no justification for an additional charge to be levied on all exporters, or, indeed, on all parties involved in trade.

There may also be justification for Customs charging other groups of users the incremental costs of any additional services they require from Customs. However, the efficient way to provide additional services will generally be by voluntary agreement between Customs and those buying the additional services. Moreover, it is essential that such arrangements do not become a vehicle for Customs to effectively charge for services it should be providing already.

We accept there may be some justification for charging exporters, importers and trans-shippers (but not as far as we can determine excise duty payers and mail carriers) for some of the trade support costs incurred by Customs. However, in practical terms, identification of the values of the benefits and identification of the parties that will receive the benefits are likely to be extremely difficult. For transaction costs reasons we doubt that attempts to impose such charges will be efficient.

We accept there would be some efficiency advantages in incentivising users of the goods clearance service to adopt practices and procedures that allow Customs to adopt least cost provision of the outcomes. This is likely to be best done by imposing charges on users when their actions and decisions unnecessarily generate costs for Customs. For example, while an export entry may be free, a charge might be imposed for filing an erroneous one. This charge could be efficiently set to reflect Custom's incremental costs from handling an erroneous export entry. A rational business will then weigh up the costs of eliminating errors in its returns against this charge and the outcome will be efficient resource allocation.

Given that the public benefits seem large relative to the private benefits, we would expect the Crown to meet most of the costs of goods clearance. It is the government that sets the standards and priorities for goods clearance according to the level of protection/security sought by, or on behalf of, society. The Crown should bear the associated costs, so that it has both the information and incentive to compare benefits and costs to determine whether it considers the additional benefits of a higher level of protection/security to outweigh the additional costs. Where users contribute to funding the activities that generate these public benefits, they should also have a say in setting standards and priorities.

User charges should, however, relate as closely as practicable to the costs of providing activities or service levels that generate the private benefits to these users, not only on equity grounds but also for economic efficiency in enabling users to weigh up the benefits and costs of their use of Customs services. In all cases, there should be a sound economic rationale for the

charging mechanisms and levels of charges applied, developed in consultation with users. We note that it is not clear that there is currently.

5.2 Customs' Questions on the Funding Options

Q10: Do you agree that the most feasible options are either full crown funding or a mix of Crown and third party funding?

- We agree that full Crown funding is a feasible option.
- We note that third party beneficiary funding of IPR protection services and statistical information are features of the current arrangements and would not suggest material changes in regard to these outcomes.
- We agree that a mix of Crown and user funding is a feasible option.

Q11: Do you have a preference for either of these options, and if so, why?

Our preference for the various components of the service are:

- *Exports and trans-shipments:* Predominantly Crown funding with some charges on exporters to the United States to cover some of the additional costs that are incurred by Customs as a result of the 2004 Supply Chain Security Arrangement between New Zealand and the United States. The limit of these additional charges should be the value of the benefits that exporters receive from the agreement. In addition, there could be some provision for exporters that do not employ processes that facilitate least cost solutions to pay fees reflecting any incremental costs they impose on Customs;
- *Imports:* Predominantly Crown funding with some provision for importers that do not employ processes that facilitate least cost solutions to pay fees reflecting any incremental costs they impose on Customs;
- *International Mail:* Crown funding with possibly some incentives on mail carriers to employ processes that facilitate least cost solutions through their contractual arrangements with Customs;
- *Excise:* Crown funding with possibly some incentives on excise duty payers to employ processes that facilitate least cost solutions through their contractual arrangements with Customs;
- *IPR enforcement.* Beneficiary funding by IPR owners;
- *Statistical information:* Beneficiary funding through user charges imposed by Statistics New Zealand; and
- Users of Customs goods clearance services and third parties should be free to buy and Customs free to sell additional services by negotiation.

Q12: If there is to continue to be a mix of Crown and third party funding, do you think the current mix is equitable?

Definitely not. A large part of the benefit of the service is for the general public and the Crown yet, currently, 69% of the charges are paid for by users.

Q13: Currently third parties meet 69 percent of the cost of Customs' goods clearance activities and the Crown meets 31 percent. This will change to 20 percent and 80 percent respectively in 2006/07 under current government financial planning. If you do not think the current mix is equitable, what in your view would be the preferred level of contribution by each, to improve equity and economic efficiency?

If users of the goods clearance service adopt practices and processes that facilitate least cost solutions then our rough estimate of the split for each service would be:

- Exports and trans-shipments: Crown - 95%, Users - 5%;
- Imports: Crown -100%;
- International mail: Crown - 100%;
- Excise duties: Crown - 100%;
- IPR enforcement: Beneficiaries – 100%; and
- Statistics New Zealand data on trade and excise products: Beneficiaries – 100%.

However, if the users of goods clearance do not adopt processes that are least cost then any incremental costs to Customs will be borne by the users that impose the additional costs.

Q14: What impact would you expect from any change to the current funding mix, particularly in the context of the funding principles of this review?

- Customs may more rigorously review its cost structures;
- Users of Customs goods clearance service will probably carefully consider if it would be efficient for them to adopt practices and processes to reduce Customs' costs or bear any additional charges from not doing so.

Q15: Under the current funding arrangements, different levels of contribution from the Crown and third parties apply to imports, exports, international mail and excise. Do you have any views on the relative levels of contribution for each of these major transaction types and how are these views related to the funding principles?

We have identified that it is important to consider each of these areas separately and apply the principles to each on their merits.

Q16: In respect of each type of transaction (imports, exports, international mail or excise) if there were a change to the funding mix what impact would you expect that to have?

See response to Question 14 above.

Q17: If a form of mixed Crown and third party funding is to continue into the future, are there any changes to the current administration of cost recovery that would in your view improve equity or economic efficiency?

See responses to Questions 11, 13 & 14.