Australian Government

Department of Agriculture and Water Resources

Regulation to establish levies on tea tree oil

Regulation impact statement

Office of Best Practice Regulation, ID no. 21687

March 2017

Cataloguing data
This publication (and any material sourced from it) should be attributed as: Department of Agriculture and Water Resources 2017, *Regulation to establish levies on tea tree oil: regulation impact statement*, Office of Best Practice and Regulation, Canberra, March. CC BY 4.0.

ISBN 9781-7-6003-126-8

This publication is available at agriculture.gov.au/publications.

Department of Agriculture and Water Resources
Postal address GPO Box 858 Canberra ACT 2601
Telephone 1800 900 090
Web agriculture.gov.au

Contents

Tables

.

Background

Introduction

In July 2015 the Australian Government announced in the Agricultural Competitiveness White Paper that it would provide $1.4 million in matched Commonwealth funding over four years for a new statutory research and development (R&D) levy on Australian tea tree oil. The Coalition confirmed its commitment to the White Paper during the 2016 election campaign.

R&D activities to support the tea tree industry are currently funded from voluntary contributions made by the majority of the industry's 119 producers, and eligible R&D activities are matched by the Australian Government through the Rural Industries Research and Development Corporation (RIRDC).

The voluntary nature of industry contributions has led to a market failure in funding R&D activities that the tea tree industry considers essential to the industry's development, productivity and profitability. The small size of the industry increases the risk of market failure even if a small number of producers stop or reduce their voluntary contributions. While the majority of producers contribute, there is little consistency and predictability in poor production years or when prices are low. Payment of voluntary levies rose from 85 per cent of production in the 2012-13 to a high of 92 per cent in 2015-16. However, this fell back to 83 per cent in 2016-17 due to increased production by non-members of the Australian Tea Tree Industry Association (ATTIA), who pay no contribution, and under-reporting by some ATTIA members.

The voluntary nature of contributions means that non contributors are free riders that benefit from industry R&D without contributing to its cost. These factors put the sustainability of long term R&D projects at risk. Furthermore, funding from RIRDC to match voluntary contributions will cease on 30 June 2017. Tea tree projects will need to compete for R&D funding from RIRDC's general funding pool available to all small and emerging primary industries from 1 July 2017.

ATTIA proposes a statutory R&D levy at a rate of $0.25 per kilogram of tea tree oil to address this market failure. In addition to the R&D levy, ATTIA also proposes a statutory Emergency Plant Pest Response (EPPR) levy (introduced at a nil rate) to contribute to responses to pest and disease incursions. The levies proposed by ATTIA are consistent with government commitments.

More than 90 per cent of ATTIA members support an R&D levy of $0.25 per kilogram of tea tree oil to be collected at the first point of sale, beginning on 1 July 2017. ATTIA will review the R&D levy every three years by inviting producers to provide feedback on the R&D levy and its rate.

RIRDC currently manages the tea tree R&D program on behalf of the industry through a five year plan developed jointly with industry. The program has contributed to a doubling of plantation yield, efficacy research, market access, and increased efficiency in harvesting, distillation and storage. RIRDC would administer the R&D program using an industry-based advisory panel to make recommendations on the investment of available funds. The relevant RIRDC research manager will be a member of the panel. RIRDC has successfully used this model in other industries.

Table 1 Summary of proposed tea tree levies

Label	Label
Sector	Tea tree industry
Product	Tea tree oil
R&D levy rate	$0.25 per kg
Levy collection point	First point of sale
Levy due date	30 June and 31 December each year
EPPR levy rate	$0.00 per kg

About the Australian tea tree oil industry

In 2016, 4,000 hectares of tea tree were under production by 119 identified producers. Of these producers, 75 (63 per cent) are ATTIA members representing approximately 90 per cent of Australia's tea tree oil production. There are also 43 reported buyers of tea tree oil.

Australia currently produces over 700,000 kg of pure tea tree oil annually. Over 90 per cent of this is exported to the USA (54 per cent) and Europe (26 per cent), providing export income of around $29 million annually.

The current farm gate price of tea tree oil is approximately $40.00 per kg. This provides a good return on investment for producers while maintaining a competitive edge for pure Australian tea tree oil.

Tea tree oil research and development

RIRDC and ATTIA are currently implementing the Tea Tree Oil Five Year Research, Development and Extension Plan 2013-2018.

The current R&D objectives for the Australian tea tree industry are:

1) Increased market access through regulatory response, product efficacy and safety research and its communication
2) Production systems that lower cost and increase productivity, including the tea tree breeding program
3) Proof of concept for innovative uses for tea tree oil
4) Communication and industry capacity building.

Within these objectives, tea tree oil producers nominated the following priorities:

1) Retaining support for the tree breeding program
2) Access to new chemicals and pesticides
3) Reducing the cost of production
4) Regulatory risk management, including bolstering the science to respond to threats as they emerge
5) Communicating science to major overseas manufacturers and gaining their subsequent support for Australian tea tree oil

6) A 'big picture' strategy to drive industry development and demand.

Impact group identification

ATTIA identifies 119 tea tree producers and 43 buyers or direct exporters. As the R&D levy will be collected at the first point of sale, both the producers and buyers will be impacted. Producers will receive $0.25 less per kg of tea tree oil sold. Buyers will need to withhold and remit levy funds back to the Department of Agriculture and Water Resources (the department). However, producers with total annual retail, market or roadside stall sales of less than 100 kg of tea tree oil will be exempt from paying the R&D levy.

If the EPPR levy is activated, it will also be collected at the first point of sale. Under the Emergency Plant Pest Response Deed (EPPRD) agreement, the industry liability for a national cost-shared emergency response may initially be met by the Australian Government. An EPPR levy provides a mechanism for industry to repay this liability to the government. The levy will be introduced at a nil rate, on the understanding that it will be increased to a positive rate in the event that a relevant emergency response takes place. ATTIA would decide on the rate of the EPPR levy and how to repay the liability over a maximum of ten years.

Assessing the problem

The current voluntary nature of R&D contributions by producers could lead to a market failure in funding R&D activities that are essential to the industry's development. The small size of the industry increases the risk of market failure if even a small number of producers stop or reduce their voluntary contributions, as this could significantly reduce the available funds. ATTIA believes the industry is too small to facilitate effective R&D activities without collective action and resource sharing.

While the majority of producers contribute, there is little consistency and predictability in poor production years or when prices are low. This puts the sustainability of longer term R&D projects at risk. Furthermore, funding from RIRDC to match voluntary contributions will cease on 30 June 2017. Tea tree projects will need to compete for R&D funding from RIRDC's general funding pool available to all small and emerging primary industries from 1 July 2017.

About 10-20 per cent of ATTIA producer members (who pay membership fees) do not pay the voluntary R&D levy, but are still able to access the research outcomes. Non-ATTIA members make no financial contribution but can benefit from more than 20 years of research. The nature of research and extension outputs makes it impossible to exclude individual producers from accessing the benefit.

An incursion of pests and diseases into tea tree plantations could result in substantial costs to the industry and risk its enviable biosecurity status. There is currently no mechanism to fund a response to an incursion on tea tree plants. A statutory levy would provide equity in funding when a biosecurity response is being repaid, and ensure all producers deriving a benefit make an equal financial contribution.

Objective of government action

Government action is needed to prevent market failure to fund R&D activities that are essential to the tea tree industry's development. Statutory levies will address the inherent market failure of the voluntary contribution system and increase certainty around the amount of funding available. Without action, the industry also risks a future decline in funding for R&D due to competition for matching government funding with other small and emerging industries.

Government action to create a statutory R&D levy, as sought by industry and matched by government funds, will reduce the uncertainty of funding for long term R&D projects. This should eliminate free riding by producers currently not contributing to R&D by providing an equitable funding mechanism. Increased R&D funding certainty will strengthen the viability of the tea tree industry and boost potential export income. This is consistent with government policy to support agricultural industry R&D, by collecting and distributing statutory levy funding, matching eligible expenditure, and supporting jobs and growth.

Government action is also needed to fund immediate responses to incursions of emergency pests and diseases of tea tree plantations. Without emergency responses, incursions could result in substantial costs to the industry and risk its biosecurity status. Government action to implement an EPPR Levy, as sought by the industry, would provide a contingency mechanism to share the industry's responsibility for the cost of an eradication response. The EPPR Levy would be introduced at a nil rate, but it would be activated to a positive rate during an agreed emergency response to repay industry's financial liability for eradication activities.

Options that may achieve the objective

Option 1 is the current situation. Option 2 is consistent with the Government's announcement in the Agricultural Competitiveness White Paper to provide $1.4 million over four years to match a new statutory R&D levy to be collected from the tea tree industry. The Coalition confirmed its commitment to the White Paper during the 2016 election campaign.

The current process for establishing R&D investment plans will continue in both options. ATTIA and RIRDC will continue to work collaboratively to ensure all levy payers will continue to have the opportunity to participate in the R&D program. The current Tea Tree Oil Five Year Research, Development and Extension Plan 2013-2018 will be reviewed by industry in 2017 18. This will inform a new Five Year Tea Tree R&D Plan, 2018 – 2023. Industry continues to strongly support the key funding priorities (most recently at ATTIA's annual general meeting on 20 October 2016), which will underpin the new five year plan. Based on industry consultation to date, an additional focus on extension will be included in the new five year plan to ensure producers can capitalise effectively on their R&D investment.

Option 1: no regulation (current situation)

The current voluntary system for producers to contribute to R&D would continue unchanged. Guaranteed matched government funding will cease on 30 June 2017 and tea tree R&D projects would compete for R&D funding available to all small and emerging primary industries from 1 July 2017. There would be no mechanism to fund emergency plant pest and disease incursions.

Option 2: minimal regulation (statutory industry levies)

A statutory R&D levy of $0.25 per kilogram of tea tree oil would be collected from all buyers of tea tree oil at the first point of sale from 1 July 2017. The government would match eligible R&D funding through RIRDC. A nil-rated EPPR levy would be introduced on 1 July 2017 to fund industry's liability for eradicating emergency plant pest and disease incursions. The EPPR would initially be set at zero and activated to a positive rate when required.

All producers would be responsible to pay the levies, except those with total annual retail, market or roadside stall sales of less than 100 kg of tea tree oil who will be exempt.

Option 2 is the preferred option and is strongly supported by industry.

Impact analysis: benefit, cost and assessment

Option 1: No regulation (current situation)

Assessment:

There are minimal expected net benefits of this option as it is the current situation. There are no changed costs for producers, nor are any benefits realised through mitigating market failure.

Option 2: minimal regulation (statutory industry levies) - preferred

While this option increases costs to industry compared to the current situation, these costs are outweighed by the likely benefits that mitigate market failure. This option therefore has a net benefit. This option is strongly supported by industry.

Implementing statutory levies (on R&D at $0.25 per kg tea tree oil and on the EPPR initially at $0.00) would mitigate the risk of market failure associated with voluntary contributions. This option increases certainty for the long term funding of R&D, and a mechanism to fund responses to emergency pest and disease incursions, should they occur.

This R&D rate would raise an estimated $175,000 annually from industry and an extra $175,000 annually from matched government contributions. These monies would fund priority R&D projects aimed at increasing industry profitability and competitiveness. This option would impact a greater number of businesses than the current situation, as all buyers (and indirectly, producers) would be required to submit a levy return to DAWR and make a payment. Despite this, the regulatory burden of the levy is expected to be low.

ATTIA estimates around 43 buyers of tea tree oil will need to collect the R&D levy at the first point of sale by withholding $0.25 per kg bought to be remitted to the department. The 43 buyers would need to register in the department online levy system, as a one-off task taking about 15 minutes each or 10.75 hours in aggregate.

Twice each financial year, each buyer would fill in a levy returns form to be remitted to the department along with the levy payment. The estimated ongoing accounting, administrative and remittance costs would be one half hour per buyer per annum, or 21.5 hours. This is generally in line with imposts on industry for other levies.

In addition, auditing of a maximum of four levy payers per annum (about 10 per cent of the 43 levy payers) to ensure compliance will be undertaken by RIRDC (at its cost), taking a maximum of about 2 hours of each levy payer’s time, or an aggregate of 8 hours.

The one-off R&D levy registration is estimated at 10.75 hours, and the aggregate ongoing time impost on the industry of collecting the levy is estimated as 29.5 hours per annum. The average wage for business accounting, including superannuation costs, is estimated at $65 per hour in Australia (Seeking Services, 2017), resulting in an estimated impost for the total regulatory impact on business to be around $2,103 per annum.

In costing this option, assumptions were based on historical horticulture levy return information held by the department. The department is responsible for the effective collection, disbursement and administration of levies and charges and operates under cost recovery arrangements. On this basis, the tea tree industry would be liable to pay the initial one-off administrative cost expected to be in the order of $36,750; and on-going administrative costs of approximately $14,172 per annum. These costs would be recovered from the total revenue collected from the R&D levy.

The total regulatory cost for this option for business in general was calculated using the Commonwealth's Regulatory Burden Measure and is estimated to be approximately $2,103 in annual average costs over a period of 10 years. This cost was based on an assumption that it would take one administrative person per business about 15 minutes to print or download and complete a levy return on tea tree oil.

A regulatory offset has not been identified. However, the department is seeking to pursue net reductions in compliance costs and will work with affected stakeholders and across government to identify regulatory burden reductions where appropriate.

Assessment:

This option would allow for a greater investment in tea tree oil R&D than the current situation. It would provide positive benefit for the whole industry and an equitable financial impost on all buyers (and indirectly, producers) to mitigate the risk of market failure posed by the current voluntary contributions system. The impact of a small regulatory burden from administrative costs is well balanced by the benefit of equitably funded R&D.

The nil-rated EPPR levy would benefit industry by allowing it to fund its share of costs of emergency responses. No additional set up fee is required to establish the EPPR levy.

Table 2 Regulatory burden table

Change in costs	Business	Community organisations	Individuals	Total change in costs
Total, by sector	$2,103	-	-	$2,103

Note: Total (change in costs-cost offset) is $2,103.

Competition policy

Option 2 would be applied equitably to all Australian tea tree oil buyers. R&D levy funds would be directed solely to industry agreed projects that benefit the industry as a whole. Therefore, establishing the statutory R&D levy would be competition-neutral by not advantaging or disadvantaging any one individual producer or buyer over another.

Consultation

ATTIA consulted extensively with tea tree oil producers, with initial discussions starting in 2007, before putting its proposal to government. The consultations revealed strong industry support for the proposal. The consultation commenced in May 2015 and a formal process was conducted from 1 March – 30 June 2016, with no formal opposition lodged. Three submissions suggested an alternative levy collection point and mechanism to increase efficiency and practicality. However, these options were unanimously rejected in an October 2015 meeting of ATTIA members and observers, based on equity, transparency and accountability.

A range of communication tools and strategies were used to ensure all tea tree oil producers were informed about the options and had an opportunity to provide feedback. These tools included releasing a discussion paper to producers, postings on the ATTIA webpage, industry newsletters, postal ballot conducted by the Australian Election Company, releases sent to various media outlets, advertisements in the rural press, consultation meetings and a workshop, email and direct mail. In addition, the proposal was taken to a producer ballot in August 2016, with the following results:

Question 1: do you support establishing a levy of 25c/kg of tea tree oil produced to invest in research, development and extension to improve the productivity and profitability of the tea tree oil industry?

In response to question 1 96% of producers voted yes (52 votes) and 4% voted no (2 votes). From a production viewpoint 93.9% voted yes (representing 372,899.5 tonnes of tea tree oil) and 6.1% (representing 24,249.5 tonnes of tea tree oil).

Question 2: Do you support the establishment of the 0.0c/kg EPPR levy which may be set to a positive rate to cover tea tree oil industry costs in an agreed response to an emergency plant pest incursion affecting the tea tree oil industry?

In response to question 2 94% of producers voted yes (51 votes) and 6% of producers voted no (3 votes). From a production viewpoint 93.7% voted yes (representing 373,199.5 tonnes of tea tree oil) and 6.3% voted no (representing 24,949.5 tonnes of tea tree oil.)

Of the two “no” votes for the R&D levy, one supported the levy in principle but had no confidence in ATTIA leadership, raising issues unrelated to the R&D program. An organic producer lodged the second “no” vote claiming the R&D program was not relevant to their operation. However, ATTIA argued this producer has had market access and agronomic advances developed by the R&D program and will continue to have access to research outcomes. On balance, ATTIA believes both these producers will continue to gain significant short and long term benefits from the R&D program.

For the three EPPR levy “no” votes, the organic grower also believed it was not relevant while another voter distrusted the efficiency of ATTIA to quickly respond to a biosecurity threat. No reason was recorded for the third vote.

Recommendation

Option 2 is the best option considered. Other than the current situation, no other options were considered as Option 2 was a 2016 election commitment, preceded by an announcement in the Agricultural Competitiveness White Paper. Over 90 per cent of industry supports this option.

Implementation and evaluation

Implementation:

Implementation of the levies would require amendments to the Primary Industries (Excise) Levies Regulations 1999, the Primary Industries (Customs) Charges Regulations 2000 and the Primary Industries Levies and Charges Collection Regulations 1991.

Following Executive Council approval, the amended regulations would be implemented as soon as practicable. The department notifies the respective levy payers of implementation, giving one month's notice prior to commencing the R&D and nil-rated EPPR levies, which are scheduled to commence on 1 July 2017.The tea tree oil industry would pay administrative set-up and on-going costs, expected to be approximately $2,103 per annum.

RIRDC would administer the R&D program using an industry-based advisory committee to make recommendations on the investment of available funds. This model has proven successful with for other industries that RIRDC manages R&D for.

Once established, the R&D levy will be reviewed every three years by ATTIA. The government does not intend to review the operation of the levy, but the department will provide input to, and consider outcomes of reviews.

To establish an EPPR levy, ATTIA will join Plant Health Australia, sign up to the Emergency Plant Pest Response Deed and develop an industry biosecurity plan to support and inform producer biosecurity responses. Plant Health Australia is willing to administer the EPPR levy on that basis.

Evaluation:

RIRDC has agreed to support a Tea Tree Industry Advisory Panel made up of producers and independent member/s, to oversee the expenditure of the R&D levy funds according to the investment plan as endorsed by levy payers. The panel will also advise RIRDC on the appointment of organisations/individuals to deliver on key projects in the plan and review project deliverables. The deliverables will be consistent with the government's Science and Research Priorities and the Rural R&D Priorities.

After the R&D levy is implemented, RIRDC will call for nominations to the new industry advisory panel. ATTIA will be invited to submit nominations, to achieve an appropriate balance of skills, experience and geographic location. The panel will consist of 3-5 members drawn from tea tree producers recommended by ATTIA and one independent member with technical and/or research experience.

RIRDC reports annually to Parliament, and would provide other industry publications for levy payers detailing how the levy has been used and the forward expenditure plans for future years.

The following review mechanisms would be applied to the R&D levy:

- Review the levy within 3 years of its introduction. This should allow enough time for R&D results to become evident and measured.

- ATTIA carries out a consultation process providing all levy payers with a detailed report on the tea tree oil R&D levy performance over the first three years, and inviting feedback on any levy performance issues.
- Objections (to continue the levy) to be considered by the ATTIA Board and communicated in the RIRDC annual report to levy payers.
- Continuing the R&D levy (for a further three years) to be voted on at an annual levy payers' meeting.

Funds from the R&D levy will be allocated towards research identified by levy payers and included in an investment plan to be developed with the input of all levy payers. The current Five Year Tea Tree R&D Plan will be evaluated and reviewed by industry, commencing in 2017 and prior to commencing the levy, with a new Five Year Tea Tree R&D Plan 2018-2023 to be developed with the following objectives and weightings:

1) Market access through regulatory response, product efficacy and safety research and its communication (35 per cent)
2) Production systems that lower cost and increase productivity, including the tea tree breeding program (30 per cent)
3) Proof of concept for innovative uses for tea tree oil (15 per cent)
4) Extension, communication and industry capacity building (20 per cent).

ATTIA members will be invited to review the continuing value of an R&D levy to industry, in keeping with ATTIA's annual reporting against the R&D investment plan and the industry advisory panel's recommendations on industry research needs.

The department will ensure the R&D levy meets public accountability and transparency requirements. The review will give levy payers and the department:

- an assessment of the levies' structure and performance against the Australian Government's Levy Principles and Guidelines,
- a summary of the outcomes and outputs of the previous three-year R&D investment plan, recommendations from the Industry Advisory Panel on industry's continuing research needs (on a rolling 3 year basis), a proposed budget for industry's continuing research needs (on a rolling 3 year basis), and
- different options for the levy rate for the following three years (linked to industry research needs).

ATTIA will work with the department to set up a database of all tea tree R&D levy payers to ensure all payers can be contacted to comment on the value of the levy and its rate.

ATTIA will consolidate feedback and report to RIRDC's industry advisory panel, levy payers and the department.