REGULATIONS FOR LAYING CHICKENS (RESEARCH AND DEVELOPMENT) LEVY

Background

The Australian Egg Corporation Limited (AECL) has proposed an increase in the research and development (R&D) component of the laying chickens levy (the levy) from 7.2 to 10 cents per laying chicken from 1 July 2009 and from 10 to 13.5 cents per laying chicken from 1 July 2010. The levy was introduced in 1999 under the Primary Industries (Excise) Levies Act 1999 (the Act). The levy was a continuation of the levy imposed under the Laying Chicken Levy Act 1988 which had been set at 7.2 cents per laying chicken in July 1997. The increase to 10 cents will restore the levy’s 1997 purchasing power and the further increase to 13.5 cents will enable AECL to meet its R&D objectives outlined in the industry agreed 2008-12 strategic plan.

Following an industry-wide ballot a recommendation was made by AECL to increase the levy. This recommendation was supported by a submission that conforms to the Department of Agriculture, Fisheries and Forestry’s Levies Principles and Guidelines (the guidelines). The submission is available from AECL (see http://www.aecl.org/ for details).

Under the guidelines, operators of commercial hatcheries (producing more than 1000 chicks per year), as the levy payers, must be polled on proposals to change the levy. The majority of hatcheries (77.8%) that voted, voted in favour of increasing the levy to 13.5 cents on the proposed timetable.

Hatcheries pass the cost of the levy to egg producers, who are the primary beneficiaries of the R&D funded by this levy. Therefore, egg producers are clearly affected by this proposal and voted as well. AECL’s constitution1 prescribes voting on a production-weighted basis. The majority of egg production voting (79%), voted in favour. However, a simple majority ie, 87 out of 149 (58.4%) of the egg producers that voted on a one egg-producer one-vote basis voted against the levy increase.

The egg industry is dominated by a few high-volume producers, with the top five egg producers producing more than 50% of Australia’s eggs and the top 20 producing more than 80% of the eggs. The distribution of production in the hatchery sector is also skewed, with four out of nine active companies supplying 96% of layers.

In light of the business planning and legislative processes required, AECL proposed a two step increase. An increase in levy rate from 7.2 to 10 cents per laying chicken from 1 July 2009 will require amendment to the Primary Industries (Excise) Levies Regulations 1999 (the Regulations). The Act caps the levy at a maximum of 10 cents per laying chicken, therefore the Act will require amendment to enable a further increase in the levy rate from 10 to 13.5 cents per laying chicken from 1 July 2010.

In line with other primary industry R&D corporations, AECL has taken a systematic and structured approach to the evaluation of the impact of R&D investments. To assist consideration of an increase in the levy by the egg industry, AECL presented a business case that includes an independent cost-benefit analysis (available at http://www.aecl.org/). This analysis provides strong support for increasing the levy. However, a key difficulty for all such evaluations is that calculation of ‘returns’ can be highly subjective, sensitive to the assumptions made about the social and other benefits and the evaluation methodology employed.

AECL is an industry-owned company under the Corporations Act 2001 and has been declared under the Egg Industry Services Provisions Act 2002 as the industry services body for the laying

1 Available at http://www.aecl.org/index.asp?pageid=553
chicken industry. Levy funds are provided under the Statutory Funding Agreement with the Commonwealth Government.

Assessing the Problem

Since July 1997 the levy has lost a significant amount of its purchasing power. AECL asserts that the cost of service provision from research institutions, scientists and contractors/consultants has also increased at a similar or higher rate than the consumer price index. Anecdotal evidence supports this assertion.

The proposed levy increase is a significant proportional change on the current levy (39% for the increase to 10 cents and a further 35% for the increase to 13.5 cents). Assuming 100% of the levy is passed on to producers, the increases will cost an egg producer with an average sized flock (AECL figures indicate the average flock size is around 80 000 laying chickens) around an additional $1650 per annum for the first and further $2200 per annum for the second. For a producer with a median sized flock (around 11 500 laying chickens) each increase will cost around $248 and $310 per annum. The median number of laying chickens controlled by AECL members is 11 500 and non-AECL member egg producers predominantly control a relatively small number of birds. Therefore, the median number of laying chickens controlled by levy payers is less than 11 500. On average, egg producers replace 77% of their flock each year.

The levy is a small component of the overall cost of business for hatcheries and egg producers. For example, in relation to $2.95 that it currently costs to purchase a day old laying chicken, the cost is small (less than 1% for each increase). In relation to the productive capacity over a hen’s life time i.e. around 27.5 dozen eggs, with current retail price of around $100, the cost of levy is around 0.09 cent per dozen eggs from 1 July 2009 and an additional 0.13 cents from 1 July 2010.

Egg producer R&D investment through AECL has totalled in excess of $3.5 million between 2003 and 2007. An independent analysis of AECL’s R&D investment showed that there is a demonstrable return on R&D levy investment. The estimated return on egg R&D of $12.60 for every levy dollar invested is not inconsistent with estimates from other industries. This analysis reveals that 72% of project investments have delivered benefits for egg producers and 65% have also delivered outcomes for the Australian community. AECL estimates that only 5% of all project investments made to date would have been funded in the absence of the current laying chickens (R&D) levy.

The approximate distribution of AECL’s proposed funding across the Australian Government’s national rural research priorities for the next 10 years is as follows ($m): Animal welfare (15%), Feed and nutrition (15%), Environment (15%), Health and disease (25%), Food safety (15%), Extension (10%) and Other (5%).

The results of egg industry R&D are a ‘public good’. The use of a public good by one person generally does not affect the ability of others to use it. This encourages ‘free riding’ by individuals and is likely to result in a market failure. Therefore, a statutory levy is necessary to collectively address the egg industry R&D issues and challenges that are outside the influence or capability of any one egg producer to address.

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2 Note: The term average is potentially misleading. The egg industry is dominated by a few companies who control very large flocks. AECL figures indicate that there are only 27 (8.5%) producers with flocks between 50 000 and 100 000 layers and that 38 (12%) have flocks over 100 000.
Objectives of Government action

The objective of the Government’s use of its levy powers is to address a market failure in funding the R&D for the general benefit of the egg industry. The objective of increasing the levy rate is to respond to a request from the egg industry to increase its funding of R&D activities. As identified in the industry-agreed AECL’s strategic plan 2008-2012, the egg industry will need to target R&D investments over the next five years in flock health and disease management; environmental sustainability; building egg demand; food safety; animal welfare; profitability; feed availability and nutrition; supply chain and egg distribution; and training, information and technology transfer.

Options that may achieve the objective

Option 1 – Status quo

Under this option the current level of funding going to the egg industry for R&D activities will remain at its current level of 7.2 cents per laying chicken.

Option 2 - Implement a voluntary levy system

Hatcheries and egg producers could be asked to pay voluntary contributions to raise money to fund R&D activities related to egg industry above the funds collected under the statutory levy.

Option 3 – Increase the levy to 13.5 cents per laying chicken

The Government could accept the AECL’s proposal to increase the levy to 10 cents per laying chicken from 1 July 2009 and to 13.5 cents per laying chicken from 1 July 2010.

Option 4 – Use Primary Industries (Excise) Levies Regulations 1999 to establish a new levy

The Government could increase the current levy rate to 10 cents per laying chicken and at the same time create an additional levy of 3.5 cents under clause 2.2 of Schedule 27 of the Regulations, without raising the levy cap in the Act.

Impact analysis – costs, benefits and risks

Impact group identification

Increasing the funds available for R&D is expected to principally impact on hatcheries and egg producers. Hatcheries are legally liable to pay levy and an increase will initially affect their cash flow. However, in line with other operating costs they pass on the cost of levy to egg producers. AECL does research for its members, who are egg producers. They are likely to be the direct beneficiaries of the outcomes achieved by the R&D activities.

The impact on consumers in the long term will include the ability to more regularly purchase better quality egg products. In the short term, the cost of the proposed increase in levy is very low in relation to the retail price of dozen eggs. On an average each laying chicken will produce around 27.5 dozen eggs during its productive life, worth around $100 at current retail price. Therefore the cost of proposed levy increase per dozen eggs will be around 0.09 cent from 1 July 2009 and an additional 0.13 cents from 1 July 2010. However, due to the competition in the wholesale market for eggs, egg producers tend to be price takers and would most likely need to absorb the cost instead of passing it down the supply chain.
**Option 1 – Status Quo**

Continuing the status quo, with no increase in levy would mean the egg industry would have insufficient funds to pursue the R&D activities as outlined in their strategic plan 2008-12. Not undertaking all planned R&D will decrease the industry’s ability to respond to challenges posed by changes affecting production (e.g. climate change and new diseases) and marketing (e.g. health claims made by other protein producing industries). In the long run, this will reduce the competitiveness, productivity and sustainability of the egg industry.

AECL believes that the investment in R&D is essential for the long term future of the egg industry. Like other agricultural industries, the egg industry relies heavily on R&D to improve productivity and maintain returns to producers without significant increase in consumers’ egg prices.

**Option 2 - Implement a voluntary levy system**

The option of raising the necessary funds through a voluntary levy system would provide levy payers more flexibility to make contributions in accordance with their financial state at the time.

Independent industry analysis commissioned by AECL indicates positive returns for its R&D investments, estimating that, with Commonwealth matching, for every levy dollar it invests, the egg industry and the community receive $12.60 in return. However, to obtain such matching, the Government’s policy of matching research expenditure up to 0.5% of a rural research industry’s gross value of production would need to be extended and the *Egg Industry Service Provisions Act 2002* amended to enable such matching.

A voluntary levy may encourage ‘free riding’ by individuals who realise that they can benefit from the egg industry’s R&D program as long as somebody else is paying for it. This is likely to lead to a market failure as it would be difficult or impossible to exclude free riding individuals from the benefits of the R&D. This would result in equity problems between levy payers.

Under this option, it would be difficult to forecast voluntary levy contributions in any given year. Inconsistent and unpredictable funding would make it difficult to commit to R&D projects that run for longer than 12 months. The potential for unpredictable and varying revenue is a significant detraction of a voluntary levy system. In the event that AECL is not able to undertake its entire planned R&D, the implications outlined under option 1 would accrue to a greater or lesser degree depending on levy income and access to matching contributions.

**Option 3 – Increase the levy to 13.5 cents per laying chicken**

The levy increase proposed (13.5 cents per laying chicken) would be a significant change (39% from 1 July 2009 and further 35% from 1 July 2010), however the cost to levy payers of the proposed increase is low in relation to:

a. the current purchase price of a day old laying chicken (approximately $2.95) and
b. the productive capacity of hens in their life time (worth approximately $100).

Increasing the levy above 10 cents per laying chicken will require amendment to the Act to increase the current 10 cent cap. The levy rate would then be set by Regulation. To avoid administrative cost of further changes to the Act the Australian Government Department of Agriculture, Fisheries and Forestry (the department) believes it would be prudent to factor the potential for further levy rate rises that may become necessary in the future due to inflation or changes in industry or Government policy. AECL has not formally proposed a levy cap figure because it has no direct bearing on the
collection of the levy. Any future increase to the levy rate above 13.5 cents would require further industry consultation similar to that conducted for the current change.

The department notes that under clause 6 of Schedule 27 (Regulations may impose primary industries levies) to the Act, the cap applying to an egg levy is $5 “per unit of animal product”. Therefore, the department considers a cap of 30 cents per laying chicken would be reasonable.

The levy would not have a disproportionate impact on a particular group or size of hatchery, as the proportion of levy payable on the sale of laying chickens would be the same for all hatcheries, irrespective of size of operation (producing more than 1000 chicks per year).

As the levy is paid by hatcheries they will bear the direct cost of the levy. However, it is likely that hatcheries will choose to pass the cost of levy on to the egg producers by way of a minor increase in the price of laying chickens. Assuming 100% of the levy is passed on, an egg producer with a median-sized flock \(^3\) (i.e. 11 500) would on average need to pay $248 more following the first step and another $310 more after the second step, on an annual basis.

There will be an annual cost to the Government under its policy of matching rural research expenditure. It is likely that the government will need to provide approximately $275 000 in the 2009-10 financial year if the levy is increased to 10 cents per laying chicken from 1 August 2009. It will also need to provide in excess of $0.7m per annum in additional matching contributions each financial year from 2010-11 compared with the current levy rate of 7.2 cents, if the levy is set at 13.5 cents per laying chicken. There will be no administrative costs for the Government in collecting and remitting the levy as the Levies Revenue Service of the department operates under full cost recovery.

AECL estimates that with the proposed two step increase in levy, the gross R&D funds for egg industry will increase from $1 549 800 in 2008-09 to $2 206 312 in 2009-10 and then to $3 052 985 in 2010-2011. This increase includes R&D levy funds and assumes full matching Government contributions.

Over the ten years to June 2006, the number of new R&D projects supported by the egg industry has declined by 30% while the average cost per project has increased by more than 100%. Additionally, funds available for R&D stayed the same.

The egg industry (in its Strategic Plan 2008-12) has identified nine research areas as key priorities that will need to target R&D investments over the next five years. These projects will benefit egg industry through:

- Improving prevention, diagnosis and treatment of exotic and endemic diseases to enhance management of flock health and poultry diseases
- Creating a sustainable future through improved environmental stewardship
- Building egg demand by promoting a positive association with health
- Minimising food borne illnesses by improving food safety and traceability
- Developing best management practices to improve animal welfare
- Building enhanced profitability into egg businesses
- Managing feed availability and nutrition to improve feed utilization and decrease costs
- Optimising the supply chain and egg distribution to ensure consumer requirements are met, and

\(^3\) The median number of laying chickens controlled by AECL members is 11 500 and non-AECL member egg producers predominantly control a relatively small number of birds. Therefore, the median number of laying chickens controlled by levy payers is less than 11 500. On average, egg producers replace 77% of their flock each year.
• Providing adequate training to employees in the latest egg production technology to ensure the benefits outlined above are maximised.

An increase in levy to 13.5 cents per laying chicken will account for:

• An appropriate level of funding for each of the nine industry agreed key R&D projects;
• A portfolio of 28 new projects each year rather than the 20 proposed under the partial funding model (i.e. at 10 cents levy per laying chicken) or the 12 possible projects in the absence of any increase to the levy;
• Optimal funding of market support, supply chain and on-farm R&D investments;

There is a demonstrable return on R&D investment across agricultural industries. The estimated return for egg R&D of $12.60 for every levy dollar AECL invests on behalf of the egg industry is not inconsistent with estimates from other industries. Accordingly, it is highly likely that the benefits of the increased investment in R&D will result in a positive return for egg producers and the community. The R&D programs to be funded by the levy will be compatible with the Government’s rural research priorities.

**Option 4 – Use Primary Industries (Excise) Levies Regulations 1999 to establish a new levy**

Increasing the total R&D levy collection from 7.2 cents to 13.5 cents per laying chicken could also be done by creating an additional levy of 6.3 cents per laying chicken under Schedule 27 of the Regulations. The egg industry was not consulted about this option and establishment of new levy will require further industry-wide consultation similar to that conducted for the current change.

This option will avoid the initial Government administrative cost required to amend the Act. The need to administer two separate levy payments would impose a minor additional ongoing burden in administration and compliance costs on levy payers. However, the collection mechanism could be structured to mirror the existing arrangements and therefore the substantive costs and benefits of this option are the same as for option 3.

**Competition Policy**

The levy will be applied equitably across the entire egg industry. Laying chickens are a fundamental production input in egg production, and while the volume of eggs sold per chicken will vary depending on the production system used (cage, barn or free range), the lower volume systems (barn and free range) tend to offer a higher return per egg. As a result, the proposed levy increase will have no significant impact on competition within the industry.

**Consultation**

AECL consulted the egg industry at various times over an 18-month period from June 2007, culminating in a national series of workshops and one-on-one meetings in October 2008. The feedback obtained was predominantly positive. Prior to the development of a business case, AECL discussed the need and options for changes to the levy with Victorian Farmers’ Federation egg group in August 2007 and July 2008 and with New South Wales (NSW) Farmers’ Association egg group in July 2008. Both organisations which represent producers in the two key egg producing states indicated their in-principle support for AECL to review the levy. During the AECL consultative workshops held in different states, various levels of support were expressed to increase the levy. Egg producers from Victoria and Western Australia indicated major support and no opposition was indicated by NSW.
In Tasmania some small scale producers did not support the levy increase mainly as there is no AECL director in Tasmania and over concern about the near monopoly of large scale egg producers in Tasmania. Other states expressed concerns in relation to the value and appropriateness of certain R&D investments, the increase in levy cost and the return on investment. AECL responded that R&D was essential for the industry to maintain its competitiveness, that the industry should be self-reliant in the face of State Government cuts to research funding. It also noted that the levy rate had not changed for 12 years and that independent analysis showed a good return.

This was followed by a six week voting period from 12 December 2008 to 30 January 2009 regarding an increase in the levy rate from 7.2 cents to 10 cents per laying chicken from 1 July 2009 and from 10 cents to 13.5 cents per laying chicken from 1 July 2010.

A majority of hatcheries (77.8%) that voted, voted in favour of the increase. A simple majority of egg producers (58.4%) voted against the change. However, on a production-weighted basis, producers representing 79% of production supported the change. The department supports a production-weighted vote as it reflects individual producer’s economic interest in the levy. In addition, AECL’s constitution prescribes a production-weighted voting system. Details of AECL’s consultation process are attached (Attachment 1).

The department is aware from discussions with egg producers that some of the opposition has come from producers who do not intend to remain in the egg industry. AECL surveys indicate that a significant number of producers are operating with outdated production assets. Some of these producers will have limited scope for adopting innovations because local planning regulations in some areas, such as the peri-urban areas of capital cities, prevent reinvestment in egg production facilities. Therefore, it would not be in the interests of producers in this situation to support the increase regardless of its benefit to the egg industry as a whole.

AECL estimated that 48% of producers (as at September 2008) did not comply with the changes in cage size regulations introduced in most jurisdictions on or before January 2008, in line with the national Model Code of Practice for the Welfare of Animals - Domestic Poultry 2001. However, these producers only accounted for 17% of production, indicating that the higher-volume producers have upgraded their facilities. Further, 10% of producers (33 farms accounting for less than 5% of production) had not indicated an intention to comply. It is likely that these producers cannot re-invest in their current location due to planning restrictions and, as they have not moved to a new site in order to comply with animal welfare legislation, they are unlikely to be committed to egg production in the long term, and therefore would not support increased R&D funding.

After formal submission of the AECL proposal to the Government, the Minister for Agriculture, Fisheries and Forestry invited dissenting comments on the proposal during a six week period which ended on 24 April 2009. This was advertised by AECL at the department’s request. This is consistent with the department’s guidelines. The Government did not receive any dissenting submissions during this six week period.

**Conclusion and recommended option**

The recommended option is option 3 - increasing the levy to 10 cents per laying chicken as soon as possible and further increasing the levy to 13.5 cents from 1 July 2010 to fund the egg industry R&D activities through the industry services body. The later increase will require an increase to the cap in the Act from 10 cents to at least 13.5 cents per laying chicken. The department considers a cap of 30 cents per laying chicken is reasonable to accommodate potential for future increases in the levy rate.
Failure to secure the proposed increase in the levy will result in under-funding of the industry agreed AECL Strategic Plan 2008-2012 and lack of capacity to fulfil its strategies and deliver its outcomes. Industry R&D fundamentally underpins ongoing productivity across a range of agricultural industries. Without adequate R&D funding the egg industry will not be able to respond to the challenges posed by climate change, other protein sources and other market developments.

The proposal for increase in levy for R&D for the egg industry:
- conforms to the department’s levy principles and guidelines
- will be applied equitably across the levy paying population
- has clear potential to benefit the industry and community
- is not expected to impose significant extra costs on consumers.

**Implementation and review**

The increase in the levy to 10 cents per laying chicken is to be implemented from 1 July 2009 and the further increase to 13.5 cents is to be implemented from 1 July 2010. This will require changes to the Regulations and the Act. Payment of levies is enforced by the Levies Revenue Service of the Department of Agriculture, Fisheries and Forestry.

AECL’s annual general meeting provides the industry with an annual forum in which levy matters can be raised and reviewed as agreed by the members.

Intensive Livestock and Game Industries Section
Livestock Industries
Agricultural Productivity Division
Australian Government Department of Agriculture, Fisheries and Forestry

May 2009
Australian Egg Corporation Ltd’s Consultation with Stakeholders

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During the AECL consultative workshops held in different states, various levels of support were expressed to increase the levy. Egg producers from Victoria and Western Australia indicated major support and no opposition was indicated by NSW. In Tasmania, some small-scale producers did not support the levy increase mainly as there is no AECL director in Tasmania and over concern about the near monopoly of large-scale egg producers in Tasmania. Producers in other states expressed concerns in relation to the value and appropriateness of certain R&D investments, the increase in levy cost and the return on investment. AECL responded that R&D was essential for the industry to maintain its competitiveness, that the industry should be self-reliant in the face of State Government cuts to research funding. It also noted that the levy rate had not changed for 12 years and that independent analysis showed a good return.

The Australian Electoral Commission polled the egg industry on a proposal to increase the levy from 7.2 to 13.5 cents per laying chicken from 12 December 2008 to 30 January 2009, as required by the guidelines. A two-step increase was proposed; 7.2 cents to 10 cents per laying chicken from 1 July 2009 and from 10 cents to 13.5 cents from 1 July 2010. AECL also advertised the poll in October/November 2008 edition of the bi-monthly Poultry Digest. Poultry Digest is a poultry management magazine published by CD Supplies Pty Ltd and it has an Australian circulation of 2000 copies.