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Paper prepared by:	Hon Meka Whaitiri, Minister of Customs
Date considered by Cabinet:	27 September 2021
Name of paper:	Policy proposals for resuming full cost recovery of border processing services
Cabinet reference:	CAB-21-MIN-0388 and DEV-21-MIN-0185
Purpose of the paper:	This paper seeks agreement to increase border processing levies from 1 December 2021 so that the New Zealand Customs Service (Customs) and the Ministry for Primary Industries (MPI) can return to fully recovering the costs of border processing services over the next three years. It also seeks technical amendments to the levy orders to improve the management of the levies.
Redactions:	Parts of the Minute of Decision have been redacted under section 9(2)(f)(iv) of the Official Information Act 1982. Any redactions appear in the text as black boxes, with an explanation of why the redaction was made.

As part of implementing the decisions, the Customs and Excise (Border Processing Levy) Order 2015 and the Biosecurity (Border Processing Levy) Order 2015 have been amended. These orders can be accessed on the New Zealand Legislation website:

[Customs and Excise \(Border Processing Levy\) Order 2015](#)

[Biosecurity \(Border Processing Levy\) Order 2015](#)



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# Cabinet Economic Development Committee

## Minute of Decision

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### Proposals for Resuming Full Cost Recovery for Border Processing Services

Portfolios                      Biosecurity / Customs

On 22 September 2021, the Cabinet Economic Development Committee:

- 1        **noted** that on 1 March 2021, the Cabinet Economic Development Committee invited the Minister of Customs and the Minister for Biosecurity to consult publicly on the option to resume full cost recovery for border processing services from 1 December 2021 over three years [DEV-21-MIN-0011];
- 2        **noted** that:
  - 2.1      the New Zealand Customs Service (Customs) and Ministry for Primary Industries (MPI) received 13 submissions, including from the air, cruise and tourism industries;
  - 2.2      submitters largely oppose any changes to levy rates at this time due to the perceived impacts on industry;
  - 2.3      feedback from submissions has been considered in the preparation of the proposals below;
- 3        **agreed** to return to full cost recovery of border processing services over a three-year levy period from 1 December 2021, using the rates set out in Appendix 1 to the submission under DEV-21-SUB-0185;
- 4        **agreed** to technical proposals that would support the operation of the levy regime:
  - 4.1      setting new Customs and Excise (Border Processing Levy) Order 2015 Biosecurity (Border Processing Levy) Order 2015 levy rates referred to in paragraph 3 for a three-year period starting on 1 December 2021;
  - 4.2      setting the maximum levy rates (caps) in the Customs and Excise (Border Processing Levy) Order 2015 and Biosecurity (Border Processing Levy) Order 2015 at the amounts set out in Appendix 1;
  - 4.3      specifying that the Director-General of MPI may set the duration of future levy periods, including the start and end date, up to a maximum of 36 months;

4.4 specifying that the Chief Executive of Customs and the Director-General of MPI may start a new levy period when resetting levies under the Biosecurity (Border Processing Levy) Order 2015 and Customs and Excise (Border Processing Levy) Order 2015;

5 **invited** the Minister of Customs and Minister for Biosecurity to issue drafting instructions to the Parliamentary Counsel Office to implement the proposals in paragraph 4 above;

6 **authorised** the Minister of Customs and the Minister for Biosecurity to make minor policy and technical decisions as drafting progresses, consistent with the proposals set out above;

7 **agreed** that Customs pays airlines the difference between Customs' and MPI's current and new levy rates for travel within six months of the government announcing the new rates taken by levied travellers carried on tickets purchased and fully paid before the announcement;

8 **noted** that the proposal in paragraph 7 above is estimated to cost no more than \$3 million;

9 **approved** the following change to appropriations to give effect to the policy decision in paragraph 7 above, with a corresponding impact on the operating balance and/or net core Crown debt:

10 **agreed**

Vote Customs Minister of Customs	\$m – increase/(decrease)				
	2021/22	2022/23	2023/24	2024/25	2025/26 & Outyears
Departmental Output Expenses: Travellers Clearance and Enforcement (funded by revenue Crown)	3.000	-	-	-	-

that the expenses incurred under paragraph 9 above be charged against the between-Budget contingency established as part of Budget 2021;

11 **agreed** that the change to appropriations for 2021/22 above be included in the 2021/22 Supplementary Estimates and that, in the interim, the increase be met from Imprest Supply;

12 **directed** officials to report back to the Minister of Customs and the Minister of Finance by June 2022 on the amount claimed by the airlines against the increase in appropriation;

13 **noted** that the Border Executive Board has endorsed using the traveller scenarios for planning and funding purposes, and that these scenarios will be updated every six months, with the next update due before the end of 2021;

14 **noted** that scenarios for border movements will be impacted by decisions to be taken on border settings under the *Reconnecting New Zealanders* approach, s 9(2)(f)(iv) OIA

15 s 9(2)(f)(iv) OIA

16 **noted** that as part of their role under the levy orders of adjusting levy rates if necessary, Customs and MPI actively monitor the impact of new information on the likely balance of the memorandum accounts, including the impact of any new traveller projections or scenarios;

- 17 **directed** Customs and MPI to review the levy calculations outlined in this paper, based **█** s 9(2)(f)(iv) OIA **█** on the Border Executive Board traveller scenarios;
- 18 **noted** that delaying the introduction of new levy rates until s 9(2)(f)(iv) OIA **█** scenarios are available to be incorporated into the border processing levy rates would delay the resumption of full cost recovery from these levies, and result in foregone revenue in the interim.

Gerrard Carter  
Committee Secretary

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**Present:**

Hon Grant Robertson (Chair)  
Hon Dr Megan Woods (Deputy Chair)  
Hon Chris Hipkins  
Hon Carmel Sepuloni  
Hon David Parker  
Hon Nanaia Mahuta  
Hon Poto Williams  
Hon Damien O'Connor  
Hon Stuart Nash  
Hon Kris Faafoi  
Hon Willie Jackson  
Hon Michael Wood  
Hon Dr David Clark  
Hon Dr Ayesha Verrall  
Hon Meka Whaitiri  
Hon Phil Twyford  
Rino Tirikatene, MP  
Dr Deborah Russell, MP

**Officials present from:**

Office of the Prime Minister  
Office of the Chair  
Officials Committee for DEV

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Office of the Minister of Customs

Office of the Minister for Biosecurity

Cabinet Development and Economic Committee

## **Policy proposals for resuming full cost recovery for border processing services**

### **Proposal**

1. This paper seeks agreement to increase border processing levies from 1 December 2021 so that the New Zealand Customs Service (Customs) and the Ministry for Primary Industries (MPI) can return to fully recovering the costs of border processing services over the next three years.
2. The paper also seeks approval to:
  - increase the maximum rates (the caps) up to which the chief executives of Customs and MPI can set the levy rates, if necessary, in the future;
  - allow the Director-General of MPI to set start and end dates when setting levy periods;
  - allow the chief executives of Customs and MPI to start a new levy period when resetting levy rates; and
  - establish transitional arrangements for airlines that have pre-sold tickets before the new levy rates are announced.

### **Relation to government priorities**

3. This paper is consistent with Government's objectives of protecting New Zealand from biosecurity and other border-related risks, facilitating legitimate travel, supporting economic recovery, and prudent financial management.

### **Executive Summary**

4. In March 2021, Cabinet noted that current levy rates were likely insufficient to recover future costs of traveller processing even when traveller numbers recovered [DEV-21-MIN-0012], and directed us to:
  - consult publicly on the option of returning to full cost recovery over three years from December 2021; and
  - report back to the Cabinet Economic Development Committee with final policy proposals for changing border processing levy caps and rates.
5. Customs and MPI publicly consulted between 4 June and 9 July 2021 on a range of options to return to full cost recovery for border processing services, including from 1 December 2021 over a three-year period.

6. We recommend a return to full cost recovery from 1 December 2021 over a three-year levy period at the proposed rates set out in Appendix 1. This will result in a total increase in levy rates of \$20.54 for air travel to \$38.03 and an increase of \$13.62 for cruise travel to \$31.93.<sup>1</sup> We consider this increase to be small compared to the overall costs of travel, and likely to result in only a very small reduction in traveller numbers.
7. The main risk related to this proposal is the potential for changing circumstances resulting in under or over-recovery in the short term. For example, traveller numbers are negatively affected by the recent quarantine-free travel (QFT) pause and New Zealand's move to COVID-19 Alert Level 4, but could be positively affected by an individual risk-based approach to border settings in 2022. This risk is addressed by the way the levy orders operate, with Customs and MPI proposing adjustments to levy rates, if necessary, to prevent ongoing over or under recovery.
8. The proposed levy rates are based on current best estimates. Officials will closely monitor the levies and we would return to Cabinet if levy rates needed to increase significantly, but expect future adjustments might be relatively small. For example, under officials' current "pessimistic" scenario for the number of travellers, the levy rates for non-cruise travel would only need to increase by a further \$6.25.
9. The levies are a charge on travellers, and are collected by airlines and cruise lines on behalf of Customs and MPI. Customs and MPI usually endeavour to give six months' notice of levy rate increases. However, the current proposal would result in announcing the Government's decisions on levy rates less than three months in advance, which means that airlines may face a loss on any tickets sold before the Government announces the levy changes.
10. To mitigate this, we propose that the Crown pay airlines the difference between the current and new levy rates for travel that is taken within six months of the Government announcing the new rates, and which was purchased before the announcement. Officials estimate this would cost less than \$1 million and advise that a similar proposal is not required for the cruise industry, as international cruise travel is not currently permitted in New Zealand.
11. To implement the new levy rates, we seek agreement to issue drafting instructions to the Parliamentary Counsel Office to amend the Customs and Excise (Border Processing Levy) Order 2015 and Biosecurity (Border Processing Levy) Order 2015 to:
  - set new border processing levy rates for a three-year period starting on 1 December 2021;
  - set the maximum levy rates (the caps) five percent above the levy rates;
  - allow the Director-General of MPI to set the duration of future levy periods, including the start and end date, up to a maximum of 36 months; and
  - allow the chief executives of Customs and MPI to start a new levy period when they reset levies, to enable Customs and MPI to address any unexpected surpluses or deficits in a timely way.

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<sup>1</sup> All levy rates are exclusive of GST.

## Background

12. Customs and MPI provide border processing services to mitigate biosecurity threats and other risks posed by travellers such as prohibited goods and health risks, while also facilitating secure and efficient travel. Since 1 January 2016, Customs and MPI have recovered the costs of these services through border processing levies (levies), based on the legislated principle that travellers should fund the costs of managing the risks associated with their travel.
13. The number of international travellers fell by 98 percent following the Government's decision to impose border restrictions in early 2020 to mitigate the spread of COVID-19. This significantly impacted the transport and tourism sectors as well as border-related agencies. At the same time, Cabinet provided support to the aviation sector through an aviation relief package which included suspending funding reviews of all aviation and border agencies for 12 months [CVD-20-MIN-0010]. As a result of this suspension of funding reviews, Customs and MPI carried over existing levy rates.
14. Following the fall in the number of travellers, Customs and MPI took actions to reduce costs while continuing to process the few travellers still crossing the border, but could not fully offset the loss in revenue. They initially redeployed staff and reduced other costs, but brought staff back to the airports when quarantine-free travel (QFT) with Australia opened and because of the resource-intensive activities needed to mitigate the COVID-19 risks posed by travellers.
15. The 12-month suspension of funding reviews affected reviews that Customs and MPI were carrying out. Instead of completing those reviews, the levy rates were carried over into the next levy period at their existing rates. In March 2021, Cabinet approved Crown funding to eliminate the estimated \$186 million deficits in border processing services up until 30 June 2021, recognising the extraordinary circumstances of COVID-19 and that future levy payers should not be required to fund the large deficits that had accumulated. [DEV-21-MIN-0011].
16. Cabinet also invited public consultation on resuming full cost recovery of border processing services over three years from December 2021 [DEV-21-MIN-0012]. Customs and MPI carried out public consultation from 4 June 2021 to 2 July 2021 on a range of options to return to fully cost recovery. An extension to 9 July 2021 was provided to some submitters due to the announcement of the pause to QFT. Customs and MPI conducted both general consultation and targeted engagement with airline, cruise and tourism stakeholders.
17. During the consultation period, the Border Executive Board approved updated passenger scenarios for budgeting and planning purposes. Therefore, Customs and MPI consulted further with submitters on the consequential updates to the estimated traveller numbers and levy rates.

## Submissions received

18. A total of 13 submissions were received. This included submissions from the airline, cruise and tourism sectors. A summary of the submissions is attached as Appendix 2 to this paper.

19. The majority (10 of 13 submitters) strongly preferred leaving rates unchanged for the time being, and for the Crown to fund any deficits. The main themes of the submissions were:
- the Crown should provide funding because border processing services deliver a 'public benefit' by protecting New Zealand from risks posed by travellers, including health risks related to COVID-19;
  - the airline, cruise, and tourism industries are struggling, and levy increases could hamper their recovery. For example, increased levies may reduce airline route profitability and may harm New Zealand's air connectivity if airlines decide to reduce flight frequency and move aircraft to other international routes;
  - levy changes could have a much greater effect on decisions to travel than Customs and MPI estimated;
  - levy increases might make New Zealand a less competitive destination compared to other cruise markets; and
  - Customs' and MPI's costs have not reduced in proportion to the fall in the number of travellers.

### ***Response to submissions***

20. We have carefully considered the points made by submitters. We consider that, on balance:
- it is more equitable for travellers to pay the costs of managing the risks they pose to New Zealand than asking taxpayers to fund those costs;
  - Customs and MPI used an established methodology developed by economic consultants to estimate the impacts of levy increases on travel demand. Customs and MPI used this methodology in 2015 when the government introduced border processing levies, and the Ministry of Business, Innovation and Employment has used it to estimate the impact of the International Visitor, Conservation and Tourism Levy. This methodology assumes travellers consider the total cost of their travel when deciding whether to travel, while the airline industry's methodology assumes that travellers only consider their airfare and do not consider other travel-related costs;
  - Customs' and MPI's levies are not the appropriate avenue to provide support to the travel or tourism industries. The Government is currently providing support through the Tourism and Transport Votes;
  - current border processing costs reflect the resource-intensive activities needed to protect New Zealand from the COVID-19 risks posed by current travellers;
  - the \$186 million provided by taxpayers to eliminate deficits in border processing memorandum accounts reflects a considerable level of support provided by the public to travellers;

- in addition to this \$186 million contribution, it is likely that taxpayers will fund considerable additional costs to implement a proposed traveller health declaration system;
- the Government's current financial position and the extraordinary spending pressure from other areas means that there would need to be a strong case to provide what would be, in essence, a subsidy to international travellers. We do not consider that there is such a case here;
- Customs and MPI are continuing to improve border processing services. For example, border agencies are exploring a health declaration system for travellers to share COVID-19 vaccination and test information before travelling to New Zealand; and
- submitters did not appear to be in favour of any of the changes that would need to be made to cut costs by reducing services — such as reducing the number of airports available to receive QFT flights, or reducing working hours at airports. Such options would create additional costs and inconvenience for travellers and disrupt airlines' operations.

### **Proposal to reset levy rates**

21. We recommend returning to full cost recovery from 1 December 2021 over a three-year levy period. The proposed rates to achieve this are set out in Appendix 1. The combined rates for border processing levies would be \$38.03 per traveller for non-cruise travel and \$31.93 per traveller for cruise travel.
22. Implementing the new levy rates from 1 December 2021 would ensure that travellers start paying rates that will recover the costs of processing them. It would be inequitable to continue undercharging current travellers and expect either future travellers or taxpayers to fund the deficits from processing their travel.
23. Recovering costs over a period of three years is a standard duration for levy periods. The alternative of a six-year levy period, would result in lower rates as there would be more travellers to recover costs from. However, travellers in six years' time would likely be using very different services from the resource-intensive services that current travellers are using. As such, it is more equitable for travellers to pay for the relevant services provided in the time period that they travelled.
24. The proposed levy rates would recover any deficits that have accumulated since 1 July 2021. Customs and MPI continue to deliver and maintain border processing services at a sufficient level to accommodate current travellers, but to also ensure services are in place as travel reopens. It is therefore equitable for those travelling after 1 December to cover the cost of providing these services between 1 July 2021 and 30 November 2021, as opposed to the cost being funded by taxpayers.

## Impact of the proposed levy rates

25. The proposed increase in levy rates (totalling \$20.54 per traveller for non-cruise travel and \$13.62 per traveller for cruise travel) are very small compared to the overall average cost of travel, estimated at \$4,200 for non-cruise travel and \$4,500 for cruise travel in 2019.<sup>2</sup>
26. Officials estimate that the proposed levy increases will not have a material impact on decisions to travel, with less than one percent of travellers likely to decide not to travel due to the proposal.
27. Table 1 summarises the impacts of our proposal and two alternative options, namely a six-year levy period or the Crown funding deficits from 1 July 2021 to 30 November 2021.

**Table 1 – Options and their impacts**

	Option 1 (preferred)	Option 2	Option 3
<b>Levy period</b>	Three years	Six years	Three years
<b>Deficits</b> accrued between July and November 2021 (\$50.6 million) funded by:	Travellers	Travellers	Crown
<b>Impact on travellers</b>			
Increase in levy rates <sup>[1]</sup>			
Non-cruise	+\$20.54	+\$11.23	+\$16.71
Cruise	+\$13.62	+\$6.11	+\$13.56
Change in number of travellers			
Non-cruise	-0.6%	-0.3%	-0.5%
Cruise	-0.2%	-0.1%	-0.2%
<b>Crown funding</b> <sup>[2]</sup>	Nil	Nil	\$50.6 million

<sup>[1]</sup> Combined Customs and MPI arrival and departure levies compared to current rates.

<sup>[2]</sup> Excludes temporary capital injections (see paragraph 47) and funding for a proposed transitional arrangement (see paragraph 44).

28. The levies are some of the many costs that have a cumulative effect on the cost of travel. Other costs include the cost of complying with the Government's COVID-19 health requirements (for example, pre-departure testing), and other fees and levies related to travel such as for aviation and maritime safety, immigration processing, and the International Visitor Conservation and Tourism Levy (IVL). The Government is, or may soon be, considering increases to these other fees and levies. In submissions, the airline and tourism industries suggested that the cumulative impact of increases to government fees and levies could affect recovery of their industries.
29. Border cost recovery is a regulatory tool to recover the costs of services from those that use them. It is not appropriate to set levies at a level above or below full cost recovery to discourage or encourage air or cruise travel.

<sup>2</sup> Estimated cost includes the fare to travel and visitor's average spending while in New Zealand.

## Managing risks and uncertainties

30. The main risk related to this proposal is the risk of potential under or over-recovery due to the uncertainty about the future number of travellers and the cost of processing them:
- **the number of travellers** are negatively affected by the recent QFT pause and New Zealand's move to COVID-19 Alert Level 4, but may be positively affected by a phased introduction of an individual risk-based approach to border settings in 2022. The scenario underpinning the proposed levy rates was approved by the Border Executive Board in June 2021 and remains the best available estimate of traveller numbers.<sup>3</sup> It assumed some disruption to QFT but gradually increasing numbers of travellers over the next three years; and
  - **border processing costs** are affected by the Government's COVID-19 border requirements and how they are implemented. For example, current travellers need resource-intensive processes to mitigate the COVID-19 risks that they pose. In the future, innovations such as a traveller health declaration system may reduce the cost of processing each traveller.
31. This risk is addressed by the way the levy orders operate. Over the medium term, Customs and MPI will set levy rates for each levy period that fully recover costs. In the shorter term, reflecting the uncertainties due to COVID-19, Customs and MPI might need to reset rates part way through the levy period to avoid any under or over-recovery. Customs and MPI will actively monitor the memorandum accounts and undertake annual performance reporting. As per standard practice, Customs and MPI will propose adjustments to levy rates, if necessary, to ensure they remain appropriate. Moreover, Customs and MPI intend to mitigate this risk by continuing to improve the quality and efficiency of border processing services.
32. The size of the adjustments will depend on future traveller estimates but might be modest. For example, under officials' pessimistic scenario that involved fewer travellers in 2021/22, the levy rates for non-cruise travel only needed to increase by a further \$6.25. We would seek Cabinet approval for any material levy increases needed in the future. This is appropriate because we consider that Ministers should make future decisions on significant increases beyond those proposed in this paper.
33. The future course of the COVID-19 pandemic remains uncertain. In the event that conditions unexpectedly change beyond those currently envisaged, the Border Executive Board would develop new scenarios of the number of travellers. In that case, we may seek further direction from Cabinet together with Ministers responsible for other transport and border agencies.

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<sup>3</sup> Customs and MPI have estimated the number of levied travellers based on the moderate scenario approved by the Border Executive Board on 10 June 2021 for budget and planning purposes only. This scenario assumed that the border would partially or fully reopen by January 2023 to travellers in addition to Managed Isolation and Quarantine and QFT travellers, with the number of travellers increasing gradually to pre-COVID-19 levels by the end of 2024. Further detail is set out in Appendix 7 of the CRIS.

## Technical amendments to levy orders

### *Caps for levy rates*

34. The levy orders specify maximum amounts that levy rates cannot exceed (caps). We propose setting these caps at five percent above proposed levy rates. This would facilitate Customs and MPI making small future changes in levy rates if necessary. Cabinet approval and amendments to the levy orders would be required to implement increases above the caps. Submitters supported this proposal.

### *Duration of MPI's levy periods*

35. The Minister for Biosecurity proposes amending the Biosecurity (Border Processing Levy) Order 2015 to empower the Director-General to set the duration of future levy periods, including the start and end dates, up to a maximum period of 36 months. The start and end dates would be notified in the New Zealand Gazette.
36. The Biosecurity (Border Processing Levy) Order 2015 is made under section 140AA of the Biosecurity Act 1993, which allows the Director-General of MPI to calculate, set and notify levy rates as long as they don't exceed the cap. Section 140AA is broadly worded, and both this proposal, and the proposal in paragraph 40 below, are administrative, providing clarity about how the levy rate will be calculated and set.
37. This amendment would future proof the setting of levy periods by allowing for flexibility when setting start and end dates. Currently, levy periods must start on 1 July and end on 30 June. The proposal mirrors a provision already in the Customs and Excise (Border Processing Levy) Order 2015 and submitters did not object to it.

### *Recommended authority to start a new levy period when resetting rates*

38. Submitters expressed concern that Customs and MPI should address any over or under-recovery promptly.
39. The levy orders allow Customs and MPI to reset rates if the existing rates will over or under-recover costs.<sup>4</sup> However, the formula used to reset rates is designed for new levy periods, and does not take into account any surplus or deficit that has already occurred during the levy period as a result of the levies being too high or low.
40. To address this problem, MPI and Customs propose that the levy orders give the Chief Executive of Customs and the Director-General of MPI the ability to end a levy period and begin a new one if rates need to be reset. This ability would continue be subject to the current conditions for resetting rates, including:
- when determining whether it is appropriate to reset rates, for the Chief Executive or Director-General to consider:
    - i. the size of the over or under-recovery likely to result if the rates are not reset; and
    - ii. the time remaining in the levy period; and

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<sup>4</sup> Customs and Excise (Border Processing Levy) Order 2015, cl 10 and Biosecurity (Border Processing Levy) Order 2015, cl 8.

- the need to consult stakeholders in line with legislative requirements and notify any changes in the New Zealand Gazette.

41. This ability would ensure that Customs and MPI are better able to promptly address emerging surpluses or deficits, ultimately contributing to more stable levy rates over time.

### **Transitional arrangements for airlines who sold tickets before decisions are announced**

42. Airlines and cruise lines collect the levies for Customs and MPI by incorporating them into the ticket prices that they charge travellers, as this is the most efficient way of collecting the levy.

43. Customs and MPI usually endeavour to provide six months' notice of levy rate increases. However, the current proposal would result in announcing the Government's decisions on levy rates less than two months in advance. Airlines may have already sold tickets without incorporating the potential increase in levy rates. The proposed increases are large compared to previous increases, and there is a risk that airlines will bear the cost of these increases rather than travellers.

44. To mitigate this risk, we propose that the Crown pays airlines the difference between the current and new levy rates for travel that levied travellers take within six months of the Government announcing the new rates, and was purchased before the announcement. This proposal is similar to the transitional arrangements when the levies were established in 2016.

45. We have been advised that this proposal is likely to cost the Crown less than \$1 million (and highly unlikely to cost more than \$3 million) because Managed Isolation and Quarantine (MIQ) places are limited, and for other travellers the global pattern is to book much closer to the travel date due to COVID-19. A similar proposal would not be needed for cruise travel because international cruise travellers are not currently permitted to arrive in New Zealand. The pause in QFT and New Zealand's move to COVID-19 Alert Level 4 could further reduce the number of travellers making forward bookings.

### **Financial Implications**

46. The proposed increases in levy rates would generate enough revenue to fund Customs' and MPI's border processing services, provided the number of travellers increases as estimated in the moderate scenario. The proposal would avoid Customs and MPI needing to seek Crown funding for an estimated \$254.4 million deficits by June 2025.

47. The proposal would result in levy revenue gradually increasing until it fully recovers costs by the end of the levy period. Due to this uneven revenue profile, Customs and MPI may need temporary capital injections during the first part of the levy period, with this capital being repaid by the end of the levy period. Under the pessimistic scenario, additional temporary capital injections of \$100 million would be needed until adjusted levy rates recover costs over a three-year period.

48. The amount of capital injection needed will largely depend on the number of travellers. For MPI, it will also depend on the outcome of a change proposal to match effort with the biosecurity risk that different pathways present.

49. Customs will address any additional capital requirements through the Budget process. MPI will address any additional capital requirements through the Natural Resources Cluster.
50. Crown operating expenditure would be required to implement the proposed transitional arrangement for tickets purchased before the Government announces the levy changes. Officials anticipate this proposal would cost less than \$1 million, especially given the pause in QFT and New Zealand moving to COVID-19 Alert Level 4, and estimate the cost is highly unlikely to exceed \$3 million.
51. We therefore propose Vote Customs: *Travellers Clearance and Enforcement* appropriation is increased by \$3 million, and that officials report back to the Minister of Customs and the Minister of Finance on the actual amount required. Any surplus funding not required to meet the airlines' claims will be returned through the Supplementary Estimates process.

### **Legislative Implications**

52. Amendments to the Customs and Excise (Border Processing Levy) Order 2015 and Biosecurity (Border Processing Levy) Order 2015 will be required to implement these proposals.

### **Impact Analysis**

#### Regulatory Impact Statement

53. A Cost Recovery Impact Statement (CRIS) has been prepared and is attached to this paper as Appendix 3. The Joint Customs and Ministry for Primary Industries RIA Panel considers that the information and analysis in the Cost Recovery Impact Statement meets the quality assurance criteria.
54. In addition, Treasury's Regulatory Impact Analysis team has determined that the proposal to allow the Director-General of MPI to set the duration of the levy period is exempt from the requirement to provide a Regulatory Impact Statement on the grounds that it has no or only minor impacts on businesses, individuals, and not-for-profit entities.

### **Climate Implications of Policy Assessment**

55. A Climate Implications of Policy Assessment is not required as this paper does not include proposals that impact climate change. While there may be an impact on air and cruise travel, this is expected to be minimal.

### **Population Implications**

56. There are no population implications from the proposals in this paper.

### **Human Rights**

57. There are no human rights implications from the proposals in this paper.

## Consultation

58. This paper has been consulted on with The Treasury, the Ministry of Foreign Affairs and Trade, the Ministry of Business, Innovation and Employment (tourism and immigration areas), Te Puni Kōkiri and the Ministry of Transport. The Department of the Prime Minister and Cabinet has been informed.

## Communications

59. Should Cabinet agree to the recommendations in this paper, an announcement will be made informing stakeholders of the decision. Information will be placed on Customs' and MPI's websites and communicated to stakeholders via newsletters and email. This will be done as soon as practicable to enable stakeholders to implement the necessary changes to their systems and pricing.

## Proactive Release

60. We intend to proactively release this paper and associated papers within 30 days of the Cabinet decision, subject to any redactions as appropriate under the Official Information Act 1982.

## Recommendations

The Minister of Customs and the Minister for Biosecurity recommend that the Committee:

- 1 **note** that on 1 March 2021, Cabinet invited the Minister of Customs and the Minister for Biosecurity to consult publicly on the option to resume full cost recovery for border processing services from 1 December 2021 over three years [DEV-21-MIN-0011];
- 2 **note** that the New Zealand Customs Service (Customs) and Ministry for Primary Industries (MPI) received 13 submissions, including from the air, cruise and tourism industries. Submitters largely oppose any changes to levy rates at this time due to the perceived impacts on industry. Feedback from submissions has been considered in the preparation of this paper;
- 3 **agree** to return to full cost recovery of border processing services over a three-year levy period from 1 December 2021, using the rates set out in Appendix 1;
- 4 **agree** to technical proposals that would support the operation of the levy regime:
  - 4.1 setting new Customs and Excise (Border Processing Levy) Order 2015 Biosecurity (Border Processing Levy) Order 2015 levy rates referred to in recommendation 3 for a three-year period starting on 1 December 2021;
  - 4.2 setting the maximum levy rates (caps) in the Customs and Excise (Border Processing Levy) Order 2015 and Biosecurity (Border Processing Levy) Order 2015 at the amounts set out in Appendix 1;
  - 4.3 specifying that the Director-General of MPI may set the duration of future levy periods, including the start and end date, up to a maximum of 36 months; and
  - 4.4 specifying that the Chief Executive of Customs and the Director-General of MPI may start a new levy period when resetting levies under the Biosecurity (Border Processing Levy) Order 2015 and Customs and Excise (Border Processing Levy) Order 2015;

- 5 **invite** the Minister of Customs and Minister for Biosecurity to issue drafting instructions to the Parliamentary Counsel Office to implement the proposals in recommendation 4 (above);
- 6 **agree** that the Minister of Customs and Minister for Biosecurity may make minor policy and technical decisions as drafting progresses, consistent with the proposals outlined in this paper;
- 7 **agree** that Customs pays airlines the difference between Customs' and MPI's current and new levy rates for travel within six months of the Government announcing the new rates taken by levied travellers carried on tickets purchased and fully paid before the announcement;
- 8 **note** that the proposal in recommendation 7 above is estimated to cost no more than \$3 million;
- 9 **approve** the following change to appropriations to give effect to the policy decision in recommendation 7 above, with a corresponding impact on the operating balance and/or net core Crown debt:

Vote Customs Minister of Customs	\$m – increase/(decrease)				
	2021/22	2022/23	2023/24	2024/25	2025/26 & Outyears
Departmental Output Expenses: Travellers Clearance and Enforcement (funded by revenue Crown)	3.000	-	-	-	-

- 10 **agree** that the expenses incurred under recommendation 9 above be charged against the between-Budget contingency established as part of Budget 2021;
- 11 **agree** that the proposed change to appropriations for 2021/22 above be included in the 2021/22 Supplementary Estimates and that, in the interim, the increase be met from Imprest Supply; and
- 12 **direct** officials to report back to the Minister of Customs and Minister of Finance by June 2022 on the amount claimed by the airlines against the increase in appropriation.

Authorised for lodgement

Hon Meka Whaitiri

Minister of Customs

Hon Damien O'Connor

Minister for Biosecurity

## Appendix 1 – Proposed border processing levy rates

	Current rates per traveller	Proposed rates per traveller	Change in rates per traveller	Proposed maximum rates per traveller
	(\$ excl GST)	(\$ excl GST)	(\$ excl GST)	(\$ excl GST)
<b>Non-cruise</b>				
Arrival - Customs	6.43	16.59	10.16	17.42
Arrival - MPI	8.50	16.92	8.42	17.77
Departure - Customs	2.56	4.52	1.96	4.75
<b>Total - non- cruise</b>	<b>17.49</b>	<b>38.03</b>	<b>20.54</b>	<b>39.94</b>
<b>Cruise</b>				
Arrival - Customs	10.40	15.66	5.26	16.44
Arrival - MPI	3.81	10.58	6.77	11.11
Departure - Customs	4.10	5.69	1.59	5.97
<b>Total - cruise</b>	<b>18.31</b>	<b>31.93</b>	<b>13.62</b>	<b>33.52</b>

PROACTIVELY RELEASED

## Appendix 2 – Summary of submissions

List of Organisations
Air New Zealand
Board of Airline Representatives New Zealand
Bus and Coach Association New Zealand
Carnival Australia
Cruise Lines International Association
Forest Owners Association
International Aviation Travel Authority
New Zealand Airports
New Zealand Cruise Association
Private
Qantas Airways Limited
Tourism Industry Association
Travel Agents Association New Zealand

### Table of Responses

Option	Description	Rate	Agree <sup>5</sup>	Alternative Proposed
Option 1	No change to levy rates, with deficits continuing to accumulate	Air/ Cruise	10	0
Option 2	Change levy rates from 1 December 2021 to recover costs over three years	Air	2	0
		Cruise	2	0
Option 3a	Change levy rates from 1 September 2023 to recover costs over three years, with <i>levied travellers</i> funding the deficits that accumulate between 1 July 2021 and 31 August 2023	Air	0	0
		Cruise	0	0
Option 3b	Change levy rates from 1 September 2023 to recover costs over three years, with <i>taxpayers</i> funding the deficits that accumulate between 1 July 2021 and 31 August 2023	Air	4	2
		Cruise	2	3
Option 4	Change levy rates from 1 December 2021 to recover costs over one year	Air	0	0
		Cruise	0	0
Option 5	Change levy rates from 1 December 2021 to recover costs over six years	Air	1	0
		Cruise	2	2

<sup>5</sup> Some submitters expressed support or agreement to more than one option, or referred to both rates. As such, the total number of entries in this column is higher than the number of submitters.

## *Key Stakeholder Group Feedback*

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### *Air Travel Industry*

The air travel industry noted the high level of volatility in traveller volumes, particularly in light of the recent suspension of QFT to Australia. Submitters felt that the current constraints on volumes and the increased cost of processing passengers were largely due to public health concerns. As such, the government should fund the cost of these measures, which was best represented by option 1.

Another topic of key concern for the industry was that the increases proposed in this document are just a few of the many increases in charges on travellers being proposed both domestically and overseas. Some industry members stated that the cumulative increase in costs across the board would result in further reduction to traveller volumes, which could potentially result in airlines choosing to re-allocate planes and crew to other destinations where demand is higher and costs are lower.

Some submitters acknowledged that while option 1 was their preferred option, it did not meet the government's objectives of a return to cost recovery. In that case their preferred option was for implementation to be delayed to 1 September 2023, or later when there was more stability, and recovered over three years, with taxpayers covering the deficit incurred to that date.

### *Cruise Industry*

The Cruise industry noted that international cruise travel is currently prohibited within New Zealand. However, despite this Customs and the Ministry for Primary Industries (MPI) are still attributing costs to their pathway and overall costs have increased despite the borders being closed for a year.

As with airlines, submitters acknowledged that while option 1 was generally their preferred option, it did not meet the government's objectives. In that case their preferred option was for implementation to be delayed to 1 September 2023, and recovered over six years, with taxpayers covering the deficit incurred to that date.

### *Tourism Industry*

Most submitters from the Tourism industry strongly opposed any sort of increase in costs at the border. Submitters noted that the border largely remains closed at this time for public health reasons while many tourism businesses were struggling because of the significant reduction in volumes.

The tourism industry was also concerned about the range of increases in charges on travellers being proposed both domestically and overseas. They were concerned that the cumulative increases in across the board would result in a significant further reduction in traveller volumes, which would further damage the industry.

One submitter that preferred option 1 acknowledged it did not meet the government's objectives. In that, case they considered the most acceptable option was for implementation to be delayed to 1 September 2023, or later when there was more stability and recovered over three years, with taxpayers covering the deficit incurred to that date.

The Bus and Coach Association New Zealand dissented from the general industry view. The association preferred new rates to come into effect in December 2021 with costs being recovered over three years (Option 2). They indicated this was because the increases in this option were prudent and deficits would be addressed.

#### *Other Submitters*

The Forest Owners Association submitted that travellers should fund the costs created by their travel at the time they are travelling. However, they also acknowledged that costs should ideally be recovered over a period of time long enough to minimise the cost per traveller. They noted that keeping costs reasonable will be important over this period of rebuilding and recovery as traveller numbers gradually increase.

A private submitter indicated that they also preferred the recovery of costs beginning on 1 December 2021, with costs recovered over three years as it was the best balance of equity between passengers and taxpayers.

PROACTIVELY RELEASED

## Stage 2 Cost Recovery Impact Statement

### Recovering the cost of border processing services

#### Agency Disclosure Statement

This Cost Recovery Impact Statement (CRIS) has been prepared by the New Zealand Customs Service (Customs) and the Ministry for Primary Industries (MPI). It analyses options to reset Customs' and MPI's border processing levies (levies) to fully recover the costs of processing travellers and recover deficits accrued between 1 July and 1 December 2021 (estimated to be \$50.6 million).

The analysis in this CRIS is limited by significant uncertainty about:

- the estimated number of levied travellers, mostly due to uncertainty about future policy changes that the New Zealand and other governments may make in response to the ongoing COVID-19 pandemic, along with uncertainty about airlines', cruise lines' and traveller's future decisions
- the estimated border processing costs, both due to the uncertainty about the number of levied travellers and the uncertainty about the Government's future COVID-19-related border requirements and how they will be implemented. For example:
  - current travellers need resource-intensive processes to protect New Zealand from the COVID-19 risks that they pose
  - in the future, innovations such as a traveller health declaration system might reduce the cost of processing each traveller.

This uncertainty means that there is a high likelihood that changing circumstances will affect the number of levied travellers and border processing costs. The levy rates presented in this CRIS are calculated using all-of-government estimates of the number of travellers that were approved for budgeting purposes in June 2021 and border processing costs estimated in June 2021.

As per standard practice, Customs and MPI will monitor the levies, including through annual reporting, and propose adjustments to levy rates as required to address over- or under-recovery of costs.

We consider that taking into account the uncertainty identified above, this CRIS contains sufficient analysis to inform Cabinet when considering Customs' and MPI's proposals for resetting levy rates.

Rates shown in this document are exclusive of any applicable Goods and Services Tax (GST).

Kathryn MacIver  
Group Manager Policy and Strategy  
New Zealand Customs Service

Bruce Arnold  
Director Cost Recovery  
Ministry for Primary Industries

7 September 2021

7 September 2021

## Contents

Executive summary .....	3
Status quo .....	5
Problem definition .....	9
Options .....	9
Assessment criteria .....	10
Assessment of Options .....	11
Options not considered .....	14
Impacts on travellers .....	15
Conclusions and recommendations .....	17
Ancillary proposals .....	18
Transitional arrangements for tickets paid before decisions are announced .....	20
Consultation .....	21
Implementation.....	22
Monitoring and review .....	23
<b>Appendix 1</b> – Legislative basis for the status quo .....	24
<b>Appendix 2</b> – Travellers exempt from the levies .....	27
<b>Appendix 3</b> – Customs’ border processing services .....	28
<b>Appendix 4</b> – MPI’s border processing services .....	31
<b>Appendix 5</b> – Border processing activities .....	33
<b>Appendix 6</b> – Comparison of border processing at airports before and during COVID-19.....	34
<b>Appendix 7</b> – Estimated number of levied travellers .....	37
<b>Appendix 8</b> – Customs’ border processing costs .....	38
<b>Appendix 9</b> – MPI’s border processing costs .....	40
<b>Appendix 10</b> – Levy rates under the status quo .....	41
<b>Appendix 11</b> – Impacts on levied travellers .....	42
<b>Appendix 12</b> – References.....	44

## Executive summary

1. Customs and MPI provide border processing services to protect New Zealand from risks and threats posed by travellers,<sup>1</sup> including biosecurity threats, prohibited goods, and health risks, while also facilitating secure and efficient travel.
2. Customs and MPI recover border processing costs<sup>1</sup> through levies under the Customs and Excise (Border Processing Levy) Order 2015 and the Biosecurity (Border Processing Levy) Order 2015 (the levy orders) respectively.
3. The current levy rates for non-cruise travellers and cruise travellers are set out in Table 1. 'Cruise' refers to travellers arriving or departing on a cruise ship. 'Non-cruise' refers to other travellers arriving or departing, almost all of whom travel by air.
4. When the Government introduced border restrictions to protect New Zealand from the COVID-19 risks posed by travellers, the number of levied travellers fell by 98 percent. As a result of the consequent fall in revenue, deficits for these services rapidly accumulated.
5. On 1 March 2021, in recognition of the extraordinary circumstances created by the emergence of COVID-19, Cabinet approved \$186 million of Crown funding for Customs and MPI to eliminate the deficits in border processing services to 30 June 2021. If there is no change to the status quo, an estimated additional \$254.4 million of Crown funding will be needed over the next four years to maintain required service levels.
6. The Government also directed Customs and MPI to consult on options to return to full recovery of border processing costs. Customs and MPI publicly consulted between 4 June 2021 and 2 July 2021 and met with industry stakeholders during the consultation process. Thirteen submissions were received, mostly from the airline, cruise and tourism industries. The main suggestion was to leave rates unchanged for the meantime with the Crown funding the deficits, as any increase could hamper these industries' economic recovery.
7. Taking account of submissions received, and in line with Cabinet's direction, this CRIS presents options to return to full cost recovery that:
  - a. address combined deficits of \$50.6 million estimated to accumulate between 1 July 2021 and 30 November 2021 (the interim deficits)
  - b. fund border processing services during the next levy period.
8. This CRIS assesses four options to return to full cost recovery from 1 December 2021:
  - Option 1: Recovering border processing costs over a three-year levy period<sup>1</sup> including the interim deficits.
  - Option 2: Recovering border processing costs over six years, including the interim deficits.
  - Option 3: Recovering border processing costs over three years with the Crown funding the interim deficits.
  - Option 4: Recovering border processing costs over six years with the Crown funding the interim deficits.

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<sup>1</sup> See Appendix 1 for the definitions of "traveller", "border processing costs" and "levy period".

9. This CRIS assesses the options using the cost recovery principles of equity and economic efficiency, and another criterion arising from submissions – stability – with submitters preferring small, regular rate changes.
10. All four options are superior to the status quo because the status quo would require Crown funding of \$254.4 million over the four years to 2024/25. The status quo is not equitable as taxpayers would be subsidising the costs of managing risks created by travellers.
11. Option 1 is preferred, as it is the most equitable between levied travellers and taxpayers. As border processing services are in place to manage risks created by travellers, fully funding these costs from those travellers, including the interim deficits, is more equitable than Crown funding.
12. Resource-intensive processes to mitigate the COVID-19 risks posed by travellers will likely be required at least for the short term. However, given the ongoing uncertainty it is more equitable to spread the costs on travellers over a three-year period, rather than a longer six-year period.
13. Option 1 has the highest levy rates, but there is a trade-off between equity and the size of the rate increases. Analysis indicates that all options, including Option 1, are likely to have little effect on travel decisions.
14. Table 1 sets out the current and proposed levy rates under the preferred option (Option 1).

**Table 1 – Proposed levy rates for non-cruise and cruise travellers**

	Current rate \$ excl GST	Proposed rate \$ excl GST	Change \$ excl GST
<b>Non-cruise</b>			
Arrival – Customs	6.43	16.59	+10.16
Arrive – MPI	8.50	16.92	+8.42
Departure – Customs	2.56	4.52	+1.96
<b>Total non-cruise</b>	<b>17.49</b>	<b>38.03</b>	<b>+20.54</b>
<b>Cruise</b>			
Arrival – Customs	10.40	15.66	+5.26
Arrive – MPI	3.81	10.58	+6.77
Departure – Customs	4.10	5.69	+1.59
<b>Total cruise</b>	<b>18.31</b>	<b>31.93</b>	<b>+13.62</b>

15. Customs and MPI also propose ancillary amendments to levy orders to facilitate adjustments to levy rates in the future. These amendments are:
  - a. setting maximum amounts (caps) at five percent above the proposed levy rates. The levy orders allow Customs and MPI to increase rates up to the caps if necessary<sup>2</sup>
  - b. providing the Director-General of MPI the ability to set the duration of future levy periods, including the start and end date, up to a maximum of 36 months, which mirrors an existing ability of the Chief Executive of Customs

<sup>2</sup> See Appendix 1 for more information about the caps.

- c. providing the Chief Executive of Customs and the Director-General of MPI the ability to start a new levy period when they reset levies, to better address any unexpected surpluses or deficits in a timely and equitable way.
16. Customs and MPI also propose that airlines are paid the difference between the current and new levy rates, for any tickets already sold before the announcement of the new rates. This would be available for six months following the announcement. This reflects that airlines are the collection agents for Customs and MPI and the levy orders require them to pay the rates that apply at the time of travel, rather than when they sell the tickets.
17. Subject to final Government decisions, the proposed option would be implemented by amendments to the levy orders with effect from 1 December 2021.
18. There is considerable uncertainty surrounding the estimated number of levied travellers and estimated costs, resulting in a high risk of over- or under-recovery during the next levy period. Customs and MPI will mitigate this risk by actively monitoring the memorandum accounts<sup>3</sup> for the levies and proposing adjustments to levy rates if necessary.<sup>4</sup>

## Status quo

### Introduction

19. Customs and MPI provide border processing services that protect New Zealand from risks and threats posed by travellers, including biosecurity threats, prohibited goods, and health risks, while also facilitating secure and efficient travel. Appendices 3 to 6 describe Customs' and MPI's border processing services.

### Legal basis for cost recovery

20. Since 1 January 2016, Customs and MPI have recovered border processing costs through levies under the Customs and Excise (Border Processing Levy) Order 2015 and the Biosecurity (Border Processing Levy) Order 2015 (the levy orders), made under section 140AA of the Biosecurity Act 1999 and section 413 of the Customs and Excise Act 2018. The levy orders provide for Customs and MPI to set levy rates to fully recover border processing costs, up to the maximum prescribed in the orders (the cap).
21. The levy rates for each levy period are based on the estimated number of levied travellers, estimated costs, and any accumulated deficits or surpluses from previous levy periods. Appendix 1 describes the legal basis for charging levies. Customs' current levy period ends on 30 November 2021, and MPI's levy period ends on 30 June 2022.

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<sup>3</sup> Customs and MPI operate memorandum accounts that record border processing costs and levy revenue.

<sup>4</sup> See Appendix 1 for a description of the legal basis for adjusting the levy rates during a levy period.

## The effect of COVID-19 on border processing services

### Estimated number of levied travellers

22. When the Government introduced border restrictions to protect New Zealand from the COVID-19 risks posed by travellers, the number of levied travellers fell by 98 percent. Despite the temporary establishment of quarantine-free travel<sup>5</sup> (QFT) arrangements, significant uncertainty remains about the future number of levied travellers and the Government's future decisions about border restrictions.
23. To help coordinate border agencies, the Border Executive Board<sup>6</sup> was established. On 10 June 2021, the Border Executive Board approved a scenario for international travel (moderate scenario) to be used by all border agencies for planning purposes. The scenario estimated the number of levied travellers would gradually increase and approach pre COVID-19 levels by the end of 2024. Table 2 shows the estimated levied travellers compared to before COVID-19, based on the moderate scenario.

**Table 2 – Estimated number of levied travellers compared to before COVID-19<sup>(1)</sup>**

	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
Non-cruise	26%	46%	87%	99%	100%	100%	100%
Cruise	-	21%	62%	99%	100%	100%	100%

<sup>(1)</sup> The number of levied travellers in each year is compared to the number from February 2019 to January 2020.

24. For comparison purposes, the Border Executive Board also considered pessimistic and optimistic scenarios. Appendix 7 provides more information about the estimated number of levied travellers.
25. The estimates were made before the current pause in QFT with Australia and the return to Alert Level 4 in August 2021. The scenarios assumed some pauses in QFT but an overall trend of an increasing number of levied travellers, approaching pre-COVID-19 levels by the end of 2024. Under the pessimistic scenario, the number of levied travellers would remain low during 2021/22 and would take one year longer to reach pre-COVID-19 levels. The Border Executive Board updates its scenarios every six months, so the next update would consider the impact of the QFT pause and COVID-19 alert levels.

### Customs' and MPI's estimated border processing costs

26. The COVID-19 pandemic has affected Customs' and MPI's border processing costs. Initially, Customs and MPI redeployed staff and reduced other border processing costs to mitigate against the significant drop in the number of travellers. Despite these measures, the cost savings were not equivalent to the fall in revenue. On 1 March 2021, Cabinet approved \$186 million of Crown funding for Customs and MPI to eliminate the deficits in border processing services to 30 June 2021.

<sup>5</sup> 'Quarantine-free travel' is defined in the COVID-19 Public Health Response (Air Border) Order (No 2) 2020.

<sup>6</sup> The Border Executive Board was established under the Public Service Act 2020 to deliver an integrated and effective border system and is hosted by the New Zealand Customs Service. The Board involves six agencies including the New Zealand Customs Service, Ministry of Business, Innovation and Employment, Ministry of Foreign Affairs and Trade, Ministry of Health, Ministry for Primary Industries and Ministry of Transport.

27. When QFT with Australia opened in April 2021, previously redeployed staff needed to return to the airports to manage the additional resource-intensive procedures required to mitigate the COVID-19 risk, including:
- separate zones for processing QFT flights (green zone) and other (red zone) flights, increasing the total resources that Customs and MPI required at airports
  - manual processing of travellers, and additional steps required to manage health risks.
28. As a result of the required additional resource, projected border processing costs have increased during the 2021/22 financial year compared to the 2020/21 financial year. Table 3 sets out Customs' and MPI's estimated border processing costs.

**Table 3 – Estimated border processing costs**

	2020/21 Budget \$m	2021/22 Estimate \$m	2022/23 Estimate \$m	2023/24 Estimate \$m	2024/25 Estimate \$m	2025/26 Estimate \$m	2026/27 Estimate \$m	2027/28 Estimate \$m
<b>Non-cruise</b>								
Customs	79.577	81.168	82.792	84.448	86.136	87.859	89.616	91.409
MPI	57.020	65.860	66.640	68.010	68.700	69.390	70.090	70.790
Total non-cruise	136.597	147.028	149.432	152.458	154.836	157.249	159.706	162.199
<b>Cruise</b>								
Customs	3.423	0.036	1.250	3.054	4.712	4.843	4.940	5.038
MPI	-	-	1.280	1.300	1.310	1.320	1.340	1.350
Total cruise	3.423	0.036	2.530	4.354	6.022	6.163	6.280	6.388
Total border processing costs	140.020	147.064	151.962	156.811	160.858	163.412	165.986	168.587

29. Future border processing costs are more uncertain than usual due to uncertainty about the Government's future decisions about border restrictions, affecting the number of levied travellers and therefore the number of staff Customs and MPI need. Costs are also uncertain due to uncertainty about future requirements for processing travellers to mitigate the COVID-19 risk they pose, and how those requirements will be implemented.
30. Appendix 8 has more information on Customs' border processing costs and Appendix 9 has more information about MPI's border processing costs.

## Cost recovery under the status quo

31. Under the status quo, Customs and MPI would set levy rates for the next levy period in accordance with the levy orders.<sup>7</sup> The resulting levy rates would be equal to their respective caps, except the rate for MPI cruise arrival. This is shown in Table 4.

**Table 4 – Status quo rates for the next levy period<sup>[1]</sup>**

	Current rate	Current cap	Status quo rate for next levy period
	\$ excl GST	\$ excl GST	\$ excl GST
<b>Non-cruise</b>			
Customs arrival	6.43	7.80	7.80
MPI arrival	8.50	8.80	8.80
Customs departure	2.56	3.10	3.10
Total non-cruise	17.49	19.70	19.70
<b>Cruise</b>			
Customs arrival	10.40	10.40	10.40
MPI arrival	3.81	17.90	7.47
Customs departure	4.10	4.10	4.10
Total cruise	18.31	32.40	21.97

<sup>[1]</sup> Levy period beginning 1 December 2021 for Customs' levies, and 1 July 2022 for MPI's levies.

32. The current levy rates are recovering less than estimated costs, with estimated deficits of \$50.6 million estimated to accumulate between 1 July 2021 and 30 November 2021 (the interim deficits). The levy rates adjusted under the status quo would not cover future border processing costs and the deficits would continue to accumulate indefinitely. This is shown in Table 5.

**Table 5 – Estimated deficits in memorandum accounts under the status quo<sup>[1]</sup>**

	Jun-21 \$m	Nov-21 \$m	Jun-22 \$m	Jun-23 \$m	Jun-24 \$m	Jun-25 \$m
Non-cruise	-	-50.609	-112.510	-199.287	-233.220	-252.886
Cruise	-	-0.015	-0.036	-1.250	-1.704	-1.508
Total	-	-50.624	-112.546	-200.537	-234.924	-254.394

<sup>[1]</sup> Combined Customs and MPI deficits for non-cruise and cruise border processing services.

33. Appendix 10 provides more information on the MPI and Customs levy rates and estimated memorandum account deficits under the status quo.

<sup>7</sup> Appendix 1 describes the method for determining levy rates in accordance with the levy orders.

## Problem definition

34. The COVID-19 pandemic has affected Customs' and MPI's border processing costs. When the Government introduced border restrictions to protect New Zealand from the COVID 19 risks posed by travellers, the number of levied travellers fell by 98 percent. Initially, Customs and MPI were able to redeploy staff and reduce border processing costs, but not by as much as the fall in revenue.
35. Recognising the extraordinary circumstances created by the emergence of COVID-19, on 1 March 2021, Cabinet approved \$186 million of Crown funding for Customs and MPI to eliminate the deficits in border processing services to 30 June 2021 [DEV-21-MIN-0011]. If there is no change to the status quo, an estimated additional \$254.4 million of Crown funding will be needed over the next four years to maintain required service levels.
36. On 1 March 2021, Cabinet invited the Minister of Customs and the Minister for Biosecurity to consult on the option of returning to full recovery of border processing costs from 1 December 2021 [DEV-21-MIN-0012]. This reflects the regulatory framework for recovering border processing costs.
37. This CRIS reflects Cabinet's direction and presents options to return to full cost recovery that:
  - a. address the \$50.6 million in combined interim deficits that are estimated to accumulate between 1 July 2021 and 30 November 2021
  - b. fund the border processing costs in the next levy period (estimated at \$461.6 million for a three-year levy period from 1 December 2021 to 30 November 2024, or \$955.1 million for a six-year levy period from 1 December 2021 to 30 November 2027).

## Options

38. This CRIS considers four options that would enable MPI and Customs to resume full cost recovery of border processing services from 1 December 2021. Each option presents a variation of:
  - a. who (travellers or taxpayers) should fund the interim deficits accruing between 1 July 2021 and 30 November 2021 (before it is practicable to reset rates)
  - b. the levy period – either a standard<sup>8</sup> three years or an extended six years.

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<sup>8</sup> Most levies administered by MPI have three-year levy periods.

39. Table 6 sets out the four options.

**Table 6 – Options to return to full cost recovery for border processing services**

Option	Levy period	Interim deficits funded by:
Option 1	Three years	Travellers
Option 2	Six years	Travellers
Option 3	Three years	Crown
Option 4	Six years	Crown

## Assessment criteria

### Cost Recovery Principles

40. Customs and MPI use cost recovery frameworks based on charging guidelines published by the New Zealand Treasury (2017), and the New Zealand Controller and Auditor-General (2008). These frameworks were described in Customs' and MPI's consultation document *Recovering the Cost of Border Processing Services* (Customs and MPI, 2021).
41. Under these frameworks, the levies should meet the following principles:
- a. equity – border processing services should be funded by the travellers who create the risks that these services are designed to mitigate. This CRIS considers:
    - “temporal” equity between travellers over the next six years: we assess this principle by considering whether the nature or cost of the service changes over time
    - equity between taxpayers and travellers: we assess this principle by considering the amount of Crown funding.
  - b. efficiency – border processing costs should be charged to ensure that maximum benefits are delivered at minimum cost. This includes:
    - administrative efficiency in collecting the levies, and compliance costs paying the levies
    - economic efficiency: the economic cost of any changes in levied travellers' behaviour as a result of imposing the levies at levels that over- or under-recover costs: we assess this by observing whether the levies act as a subsidy or a tax rather than recovering border processing costs.
  - c. transparency – border processing costs should be identified and allocated to the levy period in which those costs are incurred.
  - d. justifiability – the levies should only recover the reasonable costs of providing border processing services.

## Stability of options under different scenarios of the number of travellers

42. Customs and MPI have assessed the options based on the moderate scenario approved by the Border Executive Board on 10 June 2021 for budgeting and planning purposes. These estimates are uncertain due to the ongoing impact of COVID-19 and the timing and nature of the Government's future decisions on travel restrictions. Any assumptions made do not signal the Government's future policy decisions. Officials used the latest information from both New Zealand and internationally about travel patterns.
43. Another assessment criterion arising from submissions was stability – meaning a preference for small, regular rate changes that reflect the cost of services over large, infrequent corrections. We assess this criterion by considering the size of the adjustment that would be needed if the pessimistic scenario eventuated resulting in levy rates under-recovering costs.
44. Table 2 in Appendix 7 shows the assumptions underpinning the moderate and pessimistic scenarios.

## Assessment of Options

### Comparing the options against the status quo

45. Under the status quo, Customs and MPI would set levy rates for the next levy period using the method set out in the levy orders.<sup>9</sup> However, the new rates set under the status quo would not fully recover costs and would therefore result in deficits in border processing services accumulating indefinitely. The status quo fails to achieve full cost recovery and would require Crown funding of \$254.4 million over the four years to 2024/25. This is inconsistent with the principle of equity because it would involve taxpayers, rather than levied travellers, funding the costs of mitigating the risks created by travellers.
46. By comparison, Options 1 and 2 are estimated to fully recover costs over either a three or six-year period. These options would require temporary capital injections to cover the early period when there are few travellers but that would be repaid by the end of the levy period after the number of levied travellers gradually increases. Options 3 and 4 would recover costs from travellers over three and six years respectively, but require Crown funding to cover the interim deficits from 1 July 2021.
47. As Options 1, 2, 3 and 4 are all superior to the status quo, this CRIS goes on to compare Options 1 to 4.

### Funding the interim deficits accruing between 1 July 2021 and 30 November 2021

48. The four options propose funding of the interim deficits to either be covered by travellers through levies, or by the Crown.

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<sup>9</sup> Appendix 1 describes the method for setting rates for a new levy period.

49. An argument for the Crown to fund the interim deficits is that the Government chose to fund the accumulating deficits to 30 June 2021 but did not set new levy rates from 1 July 2021. As such, the deficits between 1 July 2021 and 30 November 2021 should be the Crown's to absorb. This was the primary argument put forward by industry submitters, and was generally their preferred option for who should fund the interim deficits.
50. The argument for travellers to fund the interim deficits is that it is appropriate for travellers to fund the cost of mitigating the risks that they pose. A key cost driver for current costs is the added steps needed to process travellers in a way that mitigates the COVID-19 risk they pose to New Zealand. It is likely that many travellers over the next three years will continue to require this level of service. As such, they should fund that level of cost.
51. It is standard practice when resetting rates to meet the estimated border processing costs to also adjust rates to account for any surplus or deficit that has accrued. Recovering the deficits from 1 July 2021 reflects this standard practice.
52. As border processing services are in place to manage risks created by travellers, officials consider that travellers fully funding these costs, including the interim deficits (Options 1 and 2) is more equitable than the use of Crown funding (Options 3 and 4).

### Recovering costs over three years or six years

53. Following on from the analysis above relating to funding the interim deficits, officials consider that Option 1 and Option 2 are the remaining viable options.
54. The options present either a standard<sup>10</sup> three-year levy period (Option 1) or an extended six-year levy period (Option 2). The levy rates calculated for both of these options incorporate the cost of funding the interim deficits.
55. The difference in the levy rates proposed under Option 1 (three years) compared to Option 2 (six years) is a total increase of \$9.31 for non-cruise travellers and \$7.51 for cruise travellers. This results in non-cruise and cruise rates that are a 32 percent higher under Option 1 compared to Option 2. Table 1 in Appendix 11 shows the components of the increase in levy rates for each option.
56. Customs and MPI are currently required to carry out additional processes to mitigate the COVID-19 risks posed by travellers. This includes a 'green zone' for processing QFT travellers and a 'red zone' for processing other travellers, and processing all travellers manually at booths rather than via eGates. Appendix 6 describes the additional processes currently required.
57. Given the ongoing impacts of COVID-19 there will likely be an ongoing need for these additional processes, at least for the short term. Saying that, the resource-intensive nature of border processing services currently provided is likely to change over the next three years, let alone the next six years. Customs and MPI consider that it is therefore more equitable to spread the costs on those travellers who create the need for the current resource-intensive services over the shorter three-year period.

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<sup>10</sup> Most levies set by MPI, and to date Customs' border processing levies, have three-year levy periods.

## Stability and economic efficiency of options

58. Following on from the analysis above relating to funding the interim deficits and recovering costs over three or six years, officials consider that Option 1 best meets the primary criterion of equity.
59. In response to submissions received, officials assessed the stability of Option 1 against the others under the pessimistic scenario, and considered the economic efficiency of Option 1.
60. Table 7 shows the changes to the levy rates for each option under the moderate and pessimistic scenarios.

**Table 7 – Adjustments to rates needed under pessimistic scenario<sup>[1]</sup>**

	Option 1	Option 2	Option 3	Option 4
Levy period	Three years	Six years	Three years	Six years
Interim deficits (Jul-Nov 21) funded by:	Travellers	Travellers	Crown	Crown
<b>Non-cruise</b>				
Levy rate	\$38.03	\$28.72	\$34.20	\$27.22
Adjustment needed under pessimistic scenario	+\$6.25	+\$4.04	+\$7.27	+\$5.62
Levy rates after adjustment	\$44.28	\$32.76	\$41.47	\$32.84
<b>Cruise</b>				
Levy rate	\$31.93	\$24.42	\$31.87	\$24.41
Adjustment needed under pessimistic scenario	+\$7.61	+\$4.22	+\$7.64	+\$4.23
Levy rates after adjustment	\$39.54	\$28.64	\$39.51	\$28.64

<sup>[1]</sup> If the pessimistic scenario eventuated and an adjustment was made from 1 July 2023. This table shows combined Customs and MPI arrival and departure levy rates.

61. Option 2 has the smallest adjustments to its levy rates under the pessimistic scenario. This reflects the benefit that a six-year period is less affected by transitory fluctuations. Currently, however, estimates of the number of travellers and border processing costs over a six-year period are very uncertain given uncertainty about:
- when and how borders restrictions will change
  - how airlines, cruise lines and travellers might respond to these changes
  - the cost and the timing of Customs and MPI's future investments in border processing services.
62. However, the adjustments needed for all four options under the pessimistic scenario are minor (the highest is just over \$7.50). Should the levy rates under the most equitable option (Option 1) require adjustment in line with the pessimistic scenario, they would only require a combined increase of \$3.39 more than required by Option 2.
63. These increases are estimated to have only a small impact on travel decisions, although airlines estimate the impact to be larger due to their alternative calculation of elasticity. We consider that Option 1 would avoid creating adverse economic effects because it would neither subsidise nor tax travel.

64. The material risk of under- or over-recovery arising from the uncertainty about the estimates of costs and the number of travellers will be mitigated by amendments to the levy orders (proposed later in this document) to provide the Chief Executive and Director-General with the ability to reset the levy rates, and by monitoring memorandum accounts and proposing adjustments to levy rates if necessary. The options involve either setting fees as per established principles and practices, or for the Crown to fund some or all border processing costs for a period.

## Options not considered

### Options that would require Crown funding

65. This CRIS has not considered options that would require Crown funding beyond 30 November 2021 as they are outside the scope of this CRIS. Ten of the 13 submitters supported options where levy rates remained unchanged until at least 2023/24, with the Crown funding the resulting deficits (estimated to be over \$200 million). Submitters said the Crown should fund at least some border processing costs because border processing services protect all New Zealanders from risks and threats, including the COVID-19 risks posed by travellers, and because the airline, cruise line and tourism industries are struggling.
66. As previously stated, Crown funding of border processing services is inconsistent with the principles of cost recovery. People choosing to travel pose risks to New Zealand such as biosecurity threats, prohibited goods and health risks, and border processing services mitigate these risks. As travellers pose the risks that necessitate those services, it is appropriate that they meet the costs of providing them, rather than having taxpayers subsidise the costs of their travel. This approach to charging is consistent with the equity principle described above.

### Options that defer resetting rates

67. This CRIS has not considered the option of delaying resetting rates, with future levied travellers funding the deficits that accumulate in the meantime. No submitter supported this option.
68. The levy orders stipulate that, if it is necessary to reset rates, they should be reset as soon as practicable.

### Reducing border processing services

69. This CRIS has not considered options where Customs and MPI temporarily reduce services until June 2023 to reduce costs. Industry stakeholders did not support service reductions.
70. Reducing services could involve:
- a. closing some airports to QFT flights
  - b. Customs and MPI reducing working hours enabling them to withdraw one or more shifts per day from airports.

71. Customs and MPI have not considered reducing services because it would have only a small impact on the increases in levy rates under the options in this CRIS, but would adversely affect the efficient operation of aircraft (eg aircraft scheduling), and could increase traveller cost and inconvenience:
- higher travel costs:** travellers who wanted to travel to the closed airport would need to arrive at a different airport then travel domestically
  - longer queuing time:** if some airports were closed or hours reduced, travellers would be channelled through the remaining airports during reduced hours. More travellers arriving at once would result in more queuing for Customs and MPI processing
  - reduced flight schedules:** airlines would need to change their flight schedules to avoid arriving or departing outside working hours.
72. Before considering reducing services Customs and MPI would need to carry out further consultation with industry and provide advice to Ministers. When we discussed options for reducing costs with industry stakeholders as part of the consultation process, they did not support either of the options in paragraph 70.

## Impacts on travellers

### Levy rates

73. The levies have a direct financial impact on levied travellers. Table 8 shows the combined levy rates under each option compared to the status quo.

**Table 8 – Combined levy rates under each option (\$ excl GST)<sup>[1]</sup>**

	Status quo	Option 1	Option 2	Option 3	Option 4
Levy period	Three years	Three years	Six years	Three years	Six years
Interim deficits funded by:	Crown	Travellers	Travellers	Crown	Crown
<b>Non-cruise</b>					
Rates	\$19.70	\$38.03	\$28.72	\$34.20	\$27.22
Change from status quo	N/A	+\$18.33	+\$9.02	+\$14.50	+\$7.52
<b>Cruise</b>					
Rates	\$21.97	\$31.93	\$24.42	\$31.87	\$24.41
Change from status quo	N/A	+\$9.96	+\$2.45	+\$9.90	+\$2.44

<sup>[1]</sup> Combined Customs and MPI arrival and departure levies. Appendix 11 shows a breakdown of the increases in rates.

74. Table 8 illustrates that a six-year levy period (Options 2 and 4) results in lower levy rates than a three-year period (Options 1 and 3) because the number of levied travellers is estimated to gradually increase so the current costs of resource-intensive processing can be spread across more levied travellers. Crown funding the deficits between 1 July 2021 and 30 November 2021 (Options 3 and 4) results in lower levy rates than if levied travellers funded the deficits (Options 1 and 2).

### Impact on travel decisions

75. Increases in levy rates could potentially reduce the number of levied travellers relative to the number who would have travelled in the absence of any change in levy rates. Table 9 shows how the levy rates under the options may reduce the number of levied travellers compared to the status quo.

**Table 9 – Estimated impact of the options on the number of levied travellers<sup>[1]</sup>**

	Option 1	Option 2	Option 3	Option 4
Levy period	Three years	Six years	Three years	Six years
Interim deficits funded by:	Levied travellers	Levied travellers	Crown	Crown
Non-cruise	-0.5%	-0.3%	-0.4%	-0.2%
Cruise	-0.2%	-0.04%	-0.2%	-0.04%

<sup>[1]</sup> Impact of the increase in combined Customs' and MPI's arrival and departure levy rates under the options compared to the status quo.

76. This table illustrates that the options may have little effect on the number of levied travellers compared to the status quo, and therefore the economic impact of using levy rates to either subsidise or tax travel would be minimal. The effect will likely be even less if levied travellers are deterred by current higher travel costs and risks of COVID-19 and travel disruption. The estimates are very uncertain, however, and the International Air Transport Association (IATA) suggests they should be much higher. Appendix 11 discusses these estimates in more detail.

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## Conclusions and recommendations

77. Table 10 summarises the assessment of the options.

**Table 10 – Summary assessment of the options<sup>[1]</sup>**

	Option 1	Option 2	Option 3	Option 4
Levy period	Three years	Six years	Three years	Six years
Interim deficits (Jul-Nov 21) funded by:	Travellers	Travellers	Crown	Crown
<b>Principles</b>				
<b>Equity</b>				
Levied travellers pay equally for similar service across time	✓	✗	✓	✗
Levied travellers fund border processing services rather than taxpayers	✓	✓	✗	✗
Deficits funded by levied travellers	✓	✓	✗	✗
<b>Stability</b>				
Adjustment needed if pessimistic scenario eventuates <sup>[2]</sup>				
Non-cruise	+\$6.25	+\$4.04	+\$7.27	+\$5.62
Cruise	+\$7.61	+\$4.22	+\$7.64	+\$4.23
<b>Economic efficiency</b>				
Levies subsidise or tax travel	-	-	✗	✗
<b>Impacts</b>				
<b>Impacts on levied travellers compared to the status quo</b>				
Increase in rates <sup>[3]</sup>				
Non-cruise	+\$18.33	+\$9.02	+\$14.50	+\$7.52
Cruise	+\$9.96	+\$2.45	+\$9.90	+\$2.44
Change in number of levied travellers				
Non-cruise	-0.5%	-0.3%	-0.4%	-0.2%
Cruise	-0.2%	-0.04%	-0.2%	-0.04%
<b>Crown funding<sup>[4]</sup> (\$million)</b>	Nil	Nil	\$50.624	\$50.624

<sup>[1]</sup> A tick indicates the best option. A cross indicates the worst option. A dash indicates no impact.

<sup>[2]</sup> Change to Customs and MPI levies for a new levy period from 1 July 2023 under the pessimistic scenario.

<sup>[3]</sup> Increase in combined Customs and MPI arrival and departure levies compared to the status quo.

<sup>[4]</sup> Excludes temporary capital funding.

78. All options are preferred to the status quo because it fails to meet the objective of fully recovering costs and would require over \$200 million in Crown funding.
79. Option 1 is more equitable than Options 2, 3 and 4 because:
  - a. A six-year levy period (Options 2 and 4) would result in levied travellers in six years' time contributing to the costs of current travellers' resource-intensive processing costs even though they are unlikely to need the same level of manual processing
  - b. Option 3 would involve taxpayers funding services established to mitigate the risks created by travellers. Charging levied travellers for deficits from 1 July 2021 to 30 November 2021 is equitable because by continuing to operate during that period, Customs and MPI will be able to continue to provide services needed by travellers after 1 December 2021.
80. Option 2 has the most stable rates because a six-year period is less affected by transitory fluctuations in the number of levied travellers. However, Option 1 is the most equitable, and should the levy rates require adjustment in line with the pessimistic scenario, Option 1 would only require a combined increase of \$3.39 more than required by Option 2.
81. For all options the increases in levy rates are estimated to have only a small impact on travel decisions, although airlines estimate the impact to be larger due to their alternative calculation of elasticity, detailed in Appendix 11. We estimate that Options 1 and 2 would avoid creating adverse economic effects because they would neither subsidise nor tax travel.
82. In conclusion, Customs and MPI prefer Option 1 because it is the most equitable both temporally and for taxpayers. There is a minor trade-off between equity and stability of rates under the pessimistic scenario. However, this is unlikely to have a material impact on future travel decisions. Overall, we consider that equity is more important than the stability and size of rate adjustments.

## Ancillary proposals

83. Customs and MPI propose three subsequent amendments to levy orders to support the implementation of the options in this CRIS, and enable effective ongoing management of cost recovery. These amendments are set out below.

### Caps

84. The levy orders provide for the Chief Executive and the Director-General to reset levy rates up to the caps. This provision simplifies the administrative process for changing levy rates up to a Cabinet-approved limit.
85. Currently, the levy orders specify caps that range from \$3.10 to \$17.90. Due to changes in the provision of services since they were set, each cap is currently a different percentage above the corresponding levy rate. For example, MPI's cap for cruise travellers is 370 percent above the levy rate of \$3.81, while Customs' caps for cruise travel are equal to the levy rates.

86. All options in this CRIS propose setting caps that are five percent above the proposed levy rates. The reason for not proposing higher caps is because we consider that further substantial increases to levy rates beyond those proposed in this CRIS should be made by Ministers rather than by officials. In addition, future rates might decrease as the number of travellers returns to pre-COVID-19 levels, and in response to innovations such as a traveller health declaration system which might reduce the cost of processing each traveller.
87. All submitters who commented on this proposal supported it.

### Duration of MPI's levy periods

88. MPI proposes to amend the Biosecurity (Border Processing Levy) Order 2015 to give the Director-General the ability to set the start date and duration of levy periods up to a maximum of six months. Currently, levy periods must start on 1 July and end on 30 June. The proposal mirrors provisions in the Customs and Excise (Border Processing Levy) Order 2015.
89. This proposal would have negligible impact on the Crown, levied travellers, or any of the principles in this CRIS. It aids MPI's administration of the system as it provides flexibility to deal with unforeseen circumstances such as those related to COVID-19.
90. No submitters opposed this proposal.

### Ability to start a new levy period if it is necessary to reset levy rates

91. Submitters stated that Customs and MPI should address any over- or under-recovery promptly.
92. The levy orders currently allow Customs and MPI to reset rates if the levies are likely to over- or under-recover costs, subject to conditions described in Appendix 1. However, the formula in the levy order does not consider any surpluses or deficits that have already occurred as a result of the levies being too high or low. This means that if Customs or MPI reset rates during the levy period, they would need to set new rates again at the start of the next levy period to fully recover those surpluses or deficits. Under this arrangement, a pragmatic approach would be to wait until the end of the levy period and change levy rates at the start of the new levy period, resulting in a sharper increase or decrease.
93. To address this problem, MPI and Customs propose that the levy orders provide the Chief Executive of Customs and the Director-General of MPI with the ability to end a levy period and begin a new one. This ability would remain consistent with the current conditions to reset rates, including the need to consult stakeholders in line with the legislative requirements, and notify any change in the New Zealand Gazette. This ability would allow MPI and Customs to address surpluses or deficits promptly and limit the duration that current levied travellers over- or under-pay costs, stabilising levy rates.

94. The uncertainty created by COVID-19 provides an example of how the proposal could result in smaller changes to levy rates than the current provisions of the levy orders. Option 1 in this CRIS is based on a moderate scenario, but if a pessimistic scenario eventuated, non-cruise memorandum accounts could accumulate \$100 million more deficits by June 2023 than currently estimated. Customs and MPI could adjust rates from 1 July 2023 as follows (subject to amending the levy orders to increase the caps):
- a. **current provisions:** the rates would increase by \$29.19 for the 17 months remaining in the levy period, but would still leave an estimated \$55.8 million deficits at the end of the levy period
  - b. **proposal:** the rates would increase by \$6.25 for a new three-year period and would return the memorandum account to zero by the end of the new levy period. The increase is much less than under the current provisions because there are estimated to be far more levied travellers in the three-year period starting July 2023.

## Transitional arrangements for tickets paid before decisions are announced

95. The levies are intended to be paid by levied travellers, reflecting the cost of mitigating the risks they create. Airlines and cruise lines are required to collect the levies from travellers on behalf of Customs and MPI and pay them on arrival or departure as this is the most efficient way of collecting the levies. Airlines and cruise lines pass on the levies by incorporating them into ticket prices.
96. Customs and MPI usually endeavour to provide six months' notice of levy rate increases, so that changes can be factored into ticket prices, which ensures that costs are borne by levied travellers and not by airlines or cruise lines. However, the current proposal would result in announcing the Government's decisions on levy rates less than two months in advance.
97. To ensure that airlines do not bear the cost increases, Customs and MPI propose to enable Customs to pay airlines, on behalf of both agencies, the difference between the current and new levy rates for travel within six months of the Government announcing the new rates by levied travellers carried on tickets purchased and fully paid before the announcement. This would be equitable because airlines cannot add the levy increase to tickets that levied travellers have already purchased and paid for. We propose this payment method because it addresses this transitional issue in a simple and targeted way.
98. Customs and MPI anticipate that this proposal is likely to cost the Crown less than \$1 million (and highly unlikely to cost more than \$3 million) as Managed Isolation and Quarantine places are limited, and the global pattern is to book much closer to the travel date than before COVID-19. The recent pause in QFT and return to COVID-19 Alert Level 4 could further reduce the number of levied travellers making forward bookings. A similar proposal would not be needed for cruise travel because foreign cruise ships are not currently permitted to arrive in New Zealand.<sup>11</sup>

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<sup>11</sup> COVID-19 Public Health Response (Maritime Border) Order (No 2) 2020 cl 9(1).

## Consultation

### Public consultation process

99. Customs and MPI released the consultation document, *Recovering the Costs of Border Processing Services*, on 4 June 2021 and invited submissions by 2 July 2021. Customs and MPI informed stakeholders about the consultation by:
  - a. publishing items in the *Customs Release* (Customs' weekly newsletter sent to 1,300 subscribers )
  - b. emailing representatives of the airline, cruise line, tourism and agriculture sectors.
100. Customs and MPI regularly convene a stakeholder reference group of representatives from the airline, cruise and tourism industries at which the group discusses border-related traveller topics. Customs and MPI met with this Group as a whole, and one-on-one with individual members, to answer any questions they had during the consultation period.
101. During consultation, the airline industry was affected by the pause in QFT with Australia and requested more time to make submissions. Customs and MPI granted an extension until 9 July 2021.
102. Customs and MPI received 13 submissions from the airline, cruise, tourism and agriculture sectors as well as one individual submission. Most submissions proposed retaining the current rates and having the Crown fund any deficits.
103. The Border Executive Board approved new scenarios containing updated traveller estimates during the consultation period for agency planning and budgeting purposes. Because these updates impacted on the levy rates proposed in the consultation document, those who had made submissions were contacted and provided with the updated information and its impact on levy rates, and given an opportunity to amend their submission if they wished to do so. No submitters changed their submission due to this follow-up.

### Themes in the submissions

104. Ten submitters strongly preferred leaving rates unchanged until at least 2023/24, and for the Crown to fund any deficits accrued for border processing services. The main reasons provided were:
  - a. border processing services deliver a 'public benefit' by protecting New Zealand from risks posed by travellers, including health risks related to COVID-19
  - b. the airline, cruise, and tourism industries are struggling, and levy increases could hamper their recovery and route profitability, affecting New Zealand's air connectivity
105. Customs' and MPI's costs have not reduced in proportion to the fall in the number of levied travellers.

106. In response to these submissions:

- a. Crown funding until 2023/24 would cost over \$200 million, be inconsistent with the Cabinet direction of returning to full cost recovery, and be inconsistent with the principle that levied travellers should fund the costs of mitigating the risks they pose to New Zealand (see paragraphs 65 and 66)
- b. the levies are not intended to subsidise the travel or tourism industries. The Government is supporting these industries directly through programs in the transport and tourism votes
- c. Customs and MPI initially redeployed staff which reduced costs, but had to bring staff back when QFT opened with Australia. A key reason costs have not reduced is the added steps needed to process travellers in a way that mitigates the COVID-19 risk that they pose to New Zealand (see Appendix 6).

### Consultation with other government agencies

107. The Treasury, Ministry of Transport, the Ministry of Business, Innovation and Employment (MBIE), the Ministry for Foreign Affairs and Trade and Te Puni Kōkiri were consulted. The Department of Prime Minister and Cabinet was informed.
108. Agencies supported the CRIS and their feedback was incorporated. The Ministry of Transport and MBIE noted the cumulative impact of the fees and levies that border and transport sector agencies charge for services or programmes related to travellers, as a key issue to consider.

### Implementation

109. Customs and MPI already have levy collection systems in place, and the industry has technology that interfaces with both Customs' and MPI's systems.
110. Implementing the preferred option would involve:
  - a. amending the levy orders with effect from 1 December 2021 to:
    - set the new levy rates and caps
    - provide Customs and MPI with the ability to reduce the duration of a levy period, enabling MPI to start the next levy period from 1 December 2021 and providing Customs and MPI with the flexibility to end the current levy period and start a new levy period if levy rates need to be reset in the future; and
    - provide MPI with the ability to set the duration of a levy period, enabling MPI to end the next levy period on 30 November 2024, and flexibility on duration when setting future levy periods.
  - b. notifying the levy order amendments in the New Zealand Gazette
  - c. Customs and MPI updating their systems to change the amounts charged
  - d. airlines and cruise lines updating their ticket pricing and associated documentation to reflect the new rates

- e. Customs and MPI communicating with their customers about the levy changes and the reasons for them
  - f. airlines advising the number of levied travellers who travelled on tickets sold before the Government announces the rate changes, and Customs paying airlines the difference between the current and new rates on behalf of both agencies
  - g. Customs and MPI seeking capital injections to support deficits until levy revenue gradually grows and eliminates the deficits.
111. We consider there are no material implementation risks. As part of consultation, Customs and MPI asked whether there were any implementation issues; submitters did not raise any.

## Monitoring and review

112. The proposed levy rates are based on the best estimates of the number of levied travellers and associated costs currently available. However, the current uncertainty about traveller and cost estimates makes it likely that material under- or over-recovery will occur if the levies are left unchanged until the end of the proposed levy period.
113. Customs and MPI will mitigate this financial risk by actively monitoring the memorandum accounts for the levies, and continuing to release annual performance reports detailing levy revenue, border processing costs, and any work done to improve the quality and efficiency of services.<sup>12</sup> In accordance with the levy orders, Customs and MPI will propose adjustments to levy rates as necessary to ensure they are at levels estimated to fully recover costs.<sup>13</sup> Customs and MPI would consult stakeholders before making any adjustment. If the proposed adjustment was above the caps, Cabinet approval to an amendment to the levy orders would be needed.
114. Customs and MPI will continue to regularly meet with their stakeholder reference group of airline, cruise and tourism industry representatives to engage in ongoing dialogue about border processing services, improvement initiatives and cost recovery at the border.

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<sup>12</sup> New Zealand Customs Service and Ministry for Primary Industries (2018); New Zealand Customs Service and Ministry for Primary Industries (2019); New Zealand Customs Service and Ministry for Primary Industries (2020).

<sup>13</sup> Appendix 1 describes the legal basis for resetting rates during a levy period.

## Appendix 1 – Legislative basis for the status quo

1. Since 1 January 2016, all travellers<sup>14</sup> other than exempt travellers, have been required to pay levies to Customs and MPI. Section 413 of the Customs and Excise Act 2018 and Section 140AA of the Biosecurity Act 1993 provide the legislative basis for charging the levies.
2. Two levy orders provide the specific authority to collect the levies:
  - the Customs and Excise (Border Processing Levy) Order 2015<sup>15</sup>
  - the Biosecurity (Border Processing Levy) Order 2015.<sup>16</sup>
3. The Customs and Excise (Border Processing Levy) Amendment Order 2021 carries over the current levy rates into the third levy period<sup>17</sup> starting 1 July 2021. The Chief Executive of Customs set the duration of this period to be five months ending on 30 November 2021 (Stevenson, 2021). The Chief Executive of Customs may extend this period up to 36 months by notice in the New Zealand Gazette.<sup>18</sup>
4. On 16 April 2021, MPI's levies were carried over at their existing rates for a period ending on 30 June 2022.<sup>19</sup>

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<sup>14</sup> In section 143(1) of the Customs and Excise Act 2018, 'traveller' means, "any person who arrives in New Zealand from, or departs from New Zealand for, any place outside New Zealand." In section 140AA(1) of the Biosecurity Act 1993, 'traveller' means, "any person who arrives in New Zealand from any place outside New Zealand."

<sup>15</sup> The Customs and Excise (Border Processing Levy) Order 2015 incorporates amendments made on 1 October 2018 and 26 March 2021.

<sup>16</sup> The Biosecurity (Border Processing Levy) Order 2015 incorporates amendments made on 1 July 2018, 1 October 2018 and 16 April 2021.

<sup>17</sup> 'Levy period' means a period prescribed by, or set in accordance with, the Customs and Excise (Border Processing Levy) Order 2015 or the Biosecurity (Border Processing Levy) Order 2015. Levy rates apply only for the levy period for which they are set.

<sup>18</sup> Customs and Excise (Border Processing Levy) Order 2015, cl 2A(b).

<sup>19</sup> Biosecurity (Border Processing Levy) Amendment Order 2021.

## Travellers who must pay the levies

5. The Customs and Excise (Border Processing Levy) Order 2015 provide for four levy rates,<sup>20</sup> for:
  - travellers arriving other than on a cruise ship (non-cruise traveller arrival)<sup>21</sup>
  - travellers arriving on a cruise ship
  - travellers departing other than on a cruise ship (non-cruise traveller departure)
  - travellers departing on a cruise ship.
6. The Biosecurity (Border Processing Levy) Order 2015 provides for two levy rates, for:<sup>22</sup>
  - travellers arriving other than on a cruise ship
  - travellers arriving on a cruise ship.
7. All travellers must pay these levies, other than two classes of exempt travellers.
  - levy-funded exempt travellers<sup>23</sup> – for example, children under the age of two years, and travellers other than passengers.<sup>24</sup> The border processing costs of levy-funded exempt travellers are funded by the levy
  - non-levy funded exempt travellers<sup>25</sup> – for example, travellers on a non-passenger commercial craft. The costs of non-levy funded exempt travellers are funded by the Crown.
8. Appendix 2 sets out the details of these exemptions.
9. Customs and MPI collect the levies from airlines and cruise lines on behalf of the levied travellers on their craft. For levied travellers who arrive or depart on other craft such as yachts, Customs and MPI collect the levies from the person in charge of the craft, or an agent of the owner or operator of the craft.<sup>26</sup>

<sup>20</sup> Customs and Excise (Border Processing Levy) Order 2015, cls 4 and 5.

<sup>21</sup> 'Non-cruise travellers' means travellers other than cruise ship travellers. Most non-cruise travellers arrive on flights operated by commercial airlines, but some arrive on charter flights or private aircraft, or on private marine craft such as yachts. 'Cruise ship' means "A ship, boat, or other vessel operated by a cruise line for an international cruise as part of its international cruise business." Customs and Excise (Border Processing Levy) Order 2015 cl 3; Biosecurity (Border Processing Levy) Order 2015 cl 3.

<sup>22</sup> Biosecurity (Border Processing Levy) Order 2015, cls 4 and 5.

<sup>23</sup> 'Levy-funded exempt traveller' is defined in Customs and Excise (Border Processing Levy) Order 2015, cl 3; Biosecurity (Border Processing Levy) Order 2015, cl 3.

<sup>24</sup> 'Passenger' means, "a person carried on a craft during a flight or voyage, other than a person— (a) who is employed or engaged under a contract of service or a contract for services; and (b) who, under that contract, provides services on the craft during the flight or voyage wholly for the purposes of the business of the craft". Customs and Excise (Border Processing Levy) Order 2015, cl 3; Biosecurity (Border Processing Levy) Order 2015, cl 3.

<sup>25</sup> 'Non-levy-funded exempt traveller' is defined in Customs and Excise (Border Processing Levy) Order 2015, cl 3; Biosecurity (Border Processing Levy) Order 2015, cl 3.

<sup>26</sup> Customs and Excise (Border Processing Levy) Order 2015, cl 12; Biosecurity (Border Processing Levy) Order 2015, cl 10.

## Setting levy rates for a new levy period

10. The levy orders enable the Chief Executive of Customs and the Director-General of MPI to set the levy rate for each levy period. Customs and MPI must consult representative groups of stakeholders as appropriate before adjusting the levy rates.<sup>27</sup> In the levy orders, the formula to calculate each levy rate is:<sup>28</sup>
- an estimate of the border processing costs<sup>29</sup> for the levy period, adjusted as described in paragraph 11 below
- divided by**
- an estimate of the number of levied travellers in the levy period.
11. The estimated costs are adjusted to take account of:<sup>30</sup>
- any estimated under- or over-recovery of costs for the previous levy period; and/or
  - any remaining under- or over-recovery of costs for the period before the previous levy period.
12. Each levy order specifies amounts that levy rates must not exceed (caps). If the formula in paragraph 10 would result in a rate that exceeds the cap, the rate would be set at the cap.

## Resetting levy rates during a levy period

13. The chief executive of Customs or the Director-General of MPI may reset rates during a levy period following circumstances that:
- occur after the existing levy rates were set
  - were not anticipated when setting those rates.<sup>31</sup>
14. They must consider the size of the likely over- or under-recovery if the rates are not reset, and the time remaining in the levy period. They must use the method described in paragraphs 10 to 12 (above) to reset the rates, and must notify them in the New Zealand Gazette.

<sup>27</sup> Customs and Excise Act 2018, s 413(4); Biosecurity Act 1993, s 140AA.

<sup>28</sup> Customs and Excise (Border Processing Levy) Order 2015, cls 6 to 9; Biosecurity (Border Processing Levy) Order 2015, cls 6 and 7.

<sup>29</sup> In the Customs and Excise (Border Processing Levy) Order 2015, 'border processing costs' means "costs incurred by Customs in, or for the purpose of, carrying out its functions under the Customs and Excise Act 2018 or any other enactment, in relation to relevant travellers and their accompanying baggage (or other goods in their possession or under their control, but excluding costs referred to in section 413(5) of the Customs and Excise Act 2018." Customs and Excise (Border Processing Levy) Order 2015, cls 6(4), 7(4), 8(4) and 9(4).

In the Biosecurity (Border Processing Levy) Order 2015, 'border processing costs' means "costs incurred by MPI in, or for the purpose of, exercising its powers or performing its functions under the Biosecurity Act 1993 in relation to relevant travellers and the goods in their possession or under their control (including as part of their personal effects or baggage), but excluding costs referred to in section 140AA(5) of the Biosecurity Act 1993." Biosecurity (Border Processing Levy) Order 2015, cls 6(4) and 7(4).

<sup>30</sup> Customs and Excise (Border Processing Levy) Order 2015, cls 6 to 9; Biosecurity (Border Processing Levy) Order 2015, cls 6 and 7.

<sup>31</sup> Customs and Excise (Border Processing Levy) Order 2015, cl 10; Biosecurity (Border Processing Levy) Order 2015, cl 8.

## Appendix 2 – Travellers exempt from the levies

Tables 1 and 2 shows the travellers exempt from paying the levies. In these tables, there are two classes of exempt traveller.

**Table 1 – Levy-funded<sup>32</sup> exempt travellers<sup>33</sup>**

- (a) a traveller under the age of 2 years:
- (b) a traveller who arrives in, or departs, New Zealand on an international aircraft otherwise than as a traveller:
- (c) a traveller who arrives in, or departs, New Zealand on a cruise ship otherwise than as a traveller:
- (d) a traveller who—
  - (i) arrives in New Zealand on an aircraft
  - (ii) is not required to report to a Customs officer at an arrival hall because the traveller is in transit to a place outside New Zealand:
- (e) a traveller who, having arrived in New Zealand as referred to in paragraph (d), departs New Zealand on an aircraft for the place outside New Zealand without having been required to enter a departure hall:

**Table 2 – Non-levy funded<sup>34</sup> exempt travellers**

- (f) a traveller who arrives in, or departs, New Zealand on any of the following:
  - (i) a craft being operated by the New Zealand Defence Force or the defence forces of any Government other than that of New Zealand:
  - (ii) a craft being used wholly for diplomatic or ceremonial purposes of any Government:
  - (iii) a craft being used wholly for the purposes of a mission being carried out or organised by any Government that is a humanitarian mission or a mission in response to an emergency or a crisis:
  - (iv) a craft being used for the purposes of an official expedition of a Contracting Party.<sup>35</sup>
  - (v) a non-traveller commercial craft
- (g) a traveller who arrives in New Zealand after having been rescued at sea:
- (h) a traveller who arrives in New Zealand wholly for the purpose of seeking temporary relief from stress of weather:
- (i) a traveller who, having arrived in New Zealand as referred to in paragraph (h), departs New Zealand as soon as is reasonably practicable:
- (j) a traveller who departs New Zealand on a craft on a journey—
  - (i) that is not intended to go beyond the exclusive economic zone
  - (ii) that is not intended to include a meeting with any craft or persons entering the exclusive economic zone from a point outside New Zealand:
- (k) a traveller who arrives in New Zealand on a craft—
  - (i) that has returned to New Zealand after a journey that did not extend beyond the exclusive economic zone
  - (ii) that did not meet during that journey with any other craft or persons entering the exclusive economic zone from a point outside New Zealand.

<sup>32</sup> Levied travellers fund the costs related to these exempt travellers.

<sup>33</sup> The numbering of Table 1 and 2 follows the numbering used in clause 11 of the Customs and Excise (Border Processing Levy) Order 2015.

<sup>34</sup> The Crown funds the costs related to these exempt travellers

<sup>35</sup> Antarctica (Environmental Protection) Act 1994, s7(1).

## Appendix 3 – Customs’ border processing services

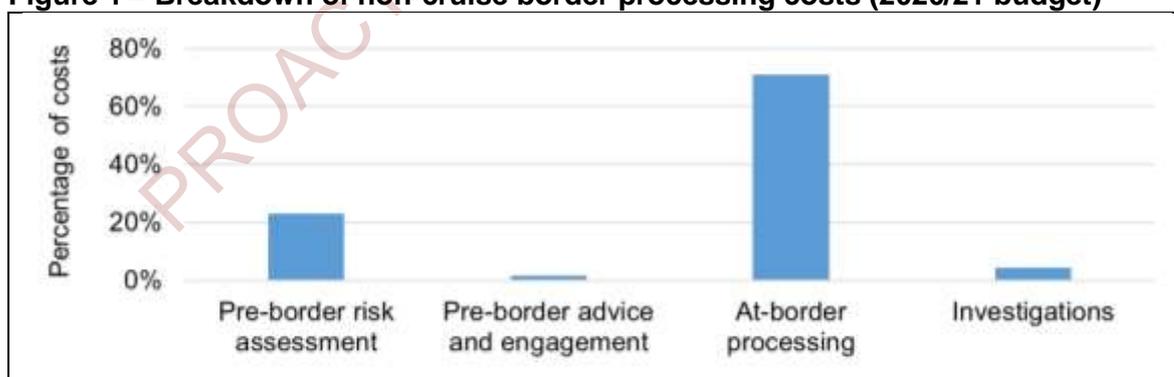
### Description of Customs’ and MPI’s border processing activities

1. The Customs and Excise (Border Processing Levy) Order 2015 defines 'border processing costs' as "costs incurred by Customs in, or for the purpose of, carrying out its functions under the Customs and Excise Act 2018 or any other enactment, in relation to relevant travellers and their accompanying baggage (or other goods in their possession or under their control, but excluding costs referred to in section 413(5) of the Customs and Excise Act 2018."
2. Customs delivers border processing services to protect New Zealand from risks related to travellers, including risks related to prohibited goods, and the risk of travellers bringing COVID-19 into New Zealand.

### Activities that make up Customs’ border processing services

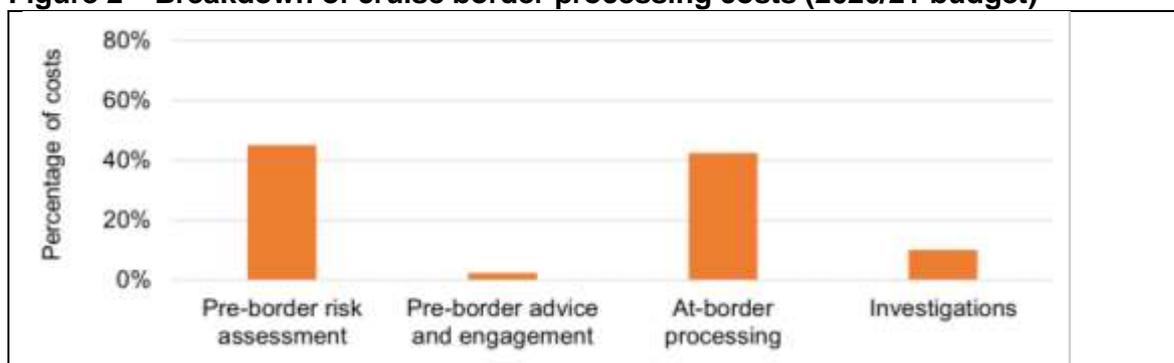
3. Customs’ border processing services involve:
  - assessing risks before travellers arrive at the border
  - advice to travellers and engagement with industry before travellers arrive at the border
  - processing travellers at the border
  - investigations of illegal activity.
4. Figure 1 shows a breakdown of border processing costs for non-cruise travellers as budgeted in 2021 before the COVID-19 pandemic. It highlights that at-border processing is the costliest part of non-cruise border processing services, followed by pre-border risk assessment. Appendix 5 provides more detail about border processing activities.

**Figure 1 – Breakdown of non-cruise border processing costs (2020/21 budget)**



5. Figure 2 shows a breakdown of border processing costs for cruise travellers. It highlights that Customs' costs related to cruise travel differs from non-cruise travel, with relatively more costs incurred by pre-border risk assessment and investigations of illegal activity.

**Figure 2 – Breakdown of cruise border processing costs (2020/21 budget)**



## Changes in Customs' border processing services

### Improvements in Customs' services before the COVID-19 pandemic

6. Since the levy rates last changed on 1 July 2018, Customs has continued to improve its border processing services. These improvements contribute to Customs' ability to protect New Zealand from risks and threats, and Customs' productivity in processing legitimate travellers.
7. The improvements in the way Customs protects New Zealand from risks included:
- an expanded capability to identify and target risks early
  - a mobile app to provide frontline officers with better access to information when interacting with travellers and more structured and consistent data for risk targeting
  - equipment to more quickly detect traces of illicit substances while processing travellers
  - expanded use of eGates before the COVID-19 pandemic. In 2019, ePassport holders from 13 countries could use eGates, up from five countries in 2017.
8. Improvements to Customs' productivity in processing legitimate travellers included:
- expanded use of eGates
  - use of the mobile app and the trace detection equipment to improve the speed that Customs can inspect travellers of interest.
9. Customs has also improved its understanding of the costs of its activities after developing an activity-based costing methodology. This methodology involves assigning Customs' resources to either:
- operational activities directly related to Customs' services, or
  - corporate services such as finance, or
  - business-sustaining activities such as statutory reporting.

10. The activity-based costing methodology assigns corporate services activities to the operational activities that use those services, and spreads business-sustaining costs across all services. This methodology provides a more transparent and accurate understanding of the costs of services. Customs implemented this methodology during 2019/20 and it resulted in the allocation of more costs to border processing services than previously. PriceWaterhouseCoopers reviewed the methodology and found it to be “comprehensive and based on sound logic and reasoning” (Pollard, 2019).
11. More information on these service improvements can also be found in the annual performance reports on the levies.<sup>36</sup>

#### **Current and future non-cruise border processing services**

12. When the Government imposed border restrictions to mitigate the threat of COVID-19, the number of levied travellers fell by 98 percent. Customs and MPI estimate the number of levied travellers will gradually increase and approach pre-COVID-19 levels by 2024.
13. Processing travellers has become much more resource-intensive. Before COVID-19, most travellers went through eGates, with Customs or MPI requiring only a few travellers to undergo secondary processing. During COVID-19, Customs and MPI process travellers QFT flights separately from other (red zone) travellers, and Customs now processes all travellers at booths rather than via eGates. Appendix 6 describes this further.
14. Customs is continuing to innovate to make border processing services more cost-efficient and effective to protect New Zealand against the risks that travellers pose. Border agencies are exploring a traveller health declaration system for travellers to share their COVID-19 health credentials (vaccination and test certificates) with border agencies before travelling to New Zealand.

#### **Future cruise border processing services**

15. Currently, cruise travellers are not permitted to arrive in New Zealand.<sup>37</sup> When cruise travellers are permitted in the future, border processing activities may change because of health risks related to COVID-19. Customs has not yet determined the nature of those activities. However, as an illustrative example, Customs officers may be present when travellers are disembarking more often than was previously the case, depending on where the cruise ship is arriving from.

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<sup>36</sup> See the “Monitoring and review” section for more about performance reports.

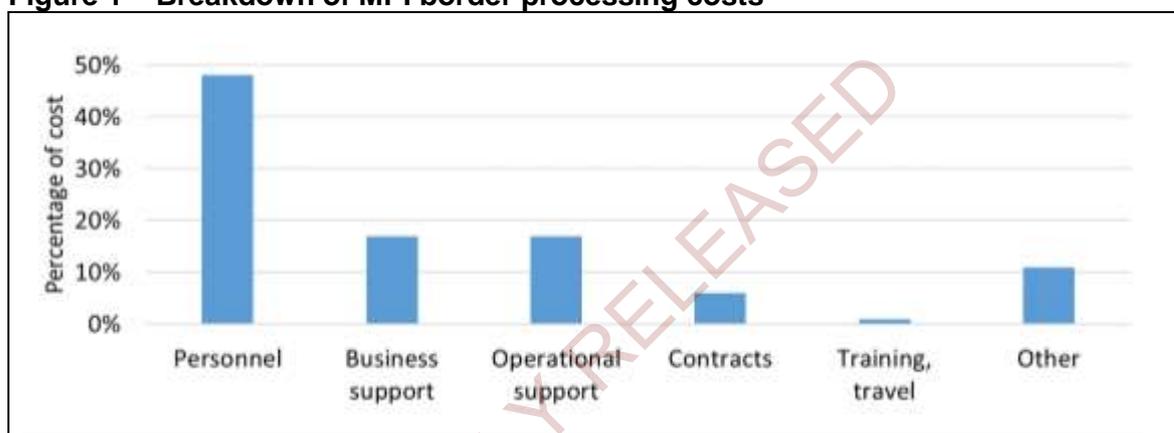
<sup>37</sup> COVID-19 Public Health Response (Maritime Border) Order (No 2) 2020 cl 9(1).

## Appendix 4 – MPI’s border processing services

### Activities that make up MPI’s border processing services

1. MPI delivers border processing services to mitigate the biosecurity threats posed by arriving travellers.<sup>38</sup> MPI’s activities at the border include assessment of arrival documentation against biosecurity requirements, verification for compliance, and detector dog or X-ray searches as needed. Supporting activities include training, property and intelligence analysis. Appendix 5 provides further detail about Customs’ and MPI’s border processing activities.
2. MPI’s main cost drivers for processing travellers entering New Zealand are personnel costs, along with operational and business support costs, as set out in Figure 1.

**Figure 1 – Breakdown of MPI border processing costs**



### Changes in MPI’s border processing services

#### Improvements before the COVID-19 pandemic

3. In recent years, the biosecurity risk to New Zealand has been steadily increasing. The causes include increasing volumes and diversity of trade and tourism, climate change, population growth and increasing public and consumer expectations.
4. MPI has recently invested in the biosecurity system to ensure it continues to manage the growing scale and complexity of these risks. While this has resulted in ongoing improvements, a 2019 independent review commissioned by MPI, found that still more needs to be done in response to the rapidly expanding range and intensity of these risks (Delane, 2019).

<sup>38</sup> MPI’s border processing services are provided by Biosecurity New Zealand, a business unit within MPI.

5. MPI is working to make sure the border system continues to be ready to respond to future challenges. This includes:
  - a. working with other border sector agencies to make better use of intelligence, data analysis and risk-based profiling
  - b. harnessing new tools and innovative technologies
  - c. increasing public and business participation in the system.
6. Other investments and initiatives MPI are making include:
  - a. further investment in X-ray technology
  - b. updating aged software
  - c. reviewing where MPI allocates its effort at the border to mitigate biosecurity risks.
7. MPI measures its effort and investment across three key performance areas:
  - a. **risk** - measured by compliance with biosecurity requirements
  - b. **cost** - measured by cost per traveller
  - c. **customer experience** - measured by average processing time.
8. In the last few years there has been investment in significant technology improvements to deliver faster, less intrusive and more effective X-ray screening of baggage. This new technology enables MPI to detect risk goods that previously went undetected.
9. In addition, there was significant investment in additional frontline border staff in 2019/20. This was the first significant increase to staffing levels in several years, despite strong growth in the number of travellers in the same period.

#### Current and future MPI border processing services

10. During QFT, MPI manages travellers from red zone flights separately from those travelling via QFT flights. Redeployed MPI staff returned to border processing duties as needed to meet the increasing demand.
11. The maritime border remains closed to international cruise travel. As travel through this pathway resumes, MPI will continue to ensure it provides robust border biosecurity services. Like the non-cruise pathway, these services will likely need to take account of additional health risks related to COVID-19.

## Appendix 5 – Border processing activities

Customs' and MPI's border processing costs that can be recovered by the levies are limited to costs related to relevant travellers and their baggage and other relevant goods. Table 1 illustrates the types of activities that give rise to these costs.

**Table 1 – Illustrative list of border processing activities**

Customs	MPI
<p><b>Pre-border risk assessment and related activities</b></p> <ul style="list-style-type: none"> <li>• liaising with other government agencies about protecting against border risks related to travellers</li> <li>• patrolling the coastline</li> <li>• gathering intelligence on incoming travellers</li> <li>• modelling and analysis of information</li> <li>• processing electronic data related to travellers</li> <li>• identifying travellers of interest.</li> </ul>	<p><b>Pre-border risk assessment and related activities</b></p> <ul style="list-style-type: none"> <li>• screening for targeted interventions and identifying travellers of biosecurity interest.</li> </ul> <p><b>Pre-border processing of travellers and their goods</b></p> <ul style="list-style-type: none"> <li>• en-route biosecurity processing where possible.</li> </ul> <p><b>Planning</b></p> <ul style="list-style-type: none"> <li>• co-ordinating resourcing and tasking of border activities.</li> </ul>
<p><b>Pre-border advice and engagement</b></p> <ul style="list-style-type: none"> <li>• providing advice to travellers</li> <li>• liaising with industry, including planning and problem solving about processing travellers.</li> </ul>	<p><b>Pre-border advice and engagement</b></p> <ul style="list-style-type: none"> <li>• managing craft applications for arrival at non-approved Places of First Arrival.</li> </ul>
<p><b>At-border processing of travellers and their goods</b></p> <ul style="list-style-type: none"> <li>• primary processing (manual and via eGate): validating identity, completing health-related and immigration processes, identifying travellers of interest, including questioning and using detector dogs</li> <li>• secondary processing: interacting with travellers of interest, including questioning, X-ray and search.</li> </ul> <p>Search traveller craft, including using detector dogs.</p>	<p><b>At-border processing of travellers and their goods</b></p> <ul style="list-style-type: none"> <li>• assessing arrival documentation against biosecurity requirements</li> <li>• verifying compliance to biosecurity requirements of travellers</li> <li>• using intervention tools, e.g. communications, searches, detector dogs, X-ray.</li> </ul> <p>Collecting information related to pathways and effectiveness of interventions.</p>
<p><b>Investigations and compliance</b></p> <ul style="list-style-type: none"> <li>• disrupting illegal activity before travellers of interest arrive in New Zealand</li> <li>• monitoring travellers of interest after they have completed at-border processing</li> <li>• carrying out investigations resulting in enforcement action</li> <li>• dealing with goods seized from travellers.</li> </ul>	<p><b>Investigations and compliance</b></p> <ul style="list-style-type: none"> <li>• reviewing and managing high-risk travellers</li> <li>• verifying the process for disposing risk goods seized from travellers</li> <li>• investigating non-compliance</li> <li>• compliance monitoring and analysis to measure performance of pathways.</li> </ul>

## Appendix 6 – Comparison of border processing at airports before and during COVID-19

This appendix describes the border processing of travellers at airports before and after the outbreak of COVID-19.

### Before COVID-19

#### For all travellers

- ▶ Travellers disembarked their aircraft and made their way to the Customs' processing area.
- ▶ Customs carried out primary processing through eGates or Customs' booth.
- ▶ Passengers were screened by MPI either using dogs and/or scanning equipment as appropriate.
- ▶ Customs or MPI also carried out secondary processing if required; otherwise, the passenger continued to the exit.
- ▶ MPI collected the arrival cards and Customs balanced the flights and sent the cards to Statistics New Zealand. Statistics New Zealand recorded data from the cards and forwarded the cards to the Ministry of Business, Innovation and Employment (MBIE).

### During COVID-19

#### For QFT travellers other than airline staff<sup>39</sup>

- ▶ Travellers disembark their aircraft and make their way to the Customs' processing area.
- ▶ Customs may assist in reminding passengers of their obligation to wear a face covering.
- ▶ Customs checks pre-departure COVID-19 tests and carries out primary processing at a booth. eGates are closed. Customs may then refer them to the Ministry of Health if required.
- ▶ If the Ministry of Health requires the traveller to go into quarantine, the Ministry of Health holds the traveller until after processing the entire flight, then passes these travellers to the Police or Customs to escort them to where they will await their transportation to quarantine.
- ▶ If the traveller is not required to go into quarantine, Customs or MPI may carry out secondary processing. Otherwise, the traveller can continue through to exit.
- ▶ MPI collects all cards, Customs then scans all arrival cards and sends the scans to the Ministry of Health and Statistics New Zealand. Customs sends the physical cards to MBIE.
- ▶ When a COVID-19 case appears in the jurisdiction where the flight departed from, the QFT process can change substantially. For example, Customs may need to ask additional questions.

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<sup>39</sup> This appendix describes the process at Auckland International Airport. Some processes may differ between airports.

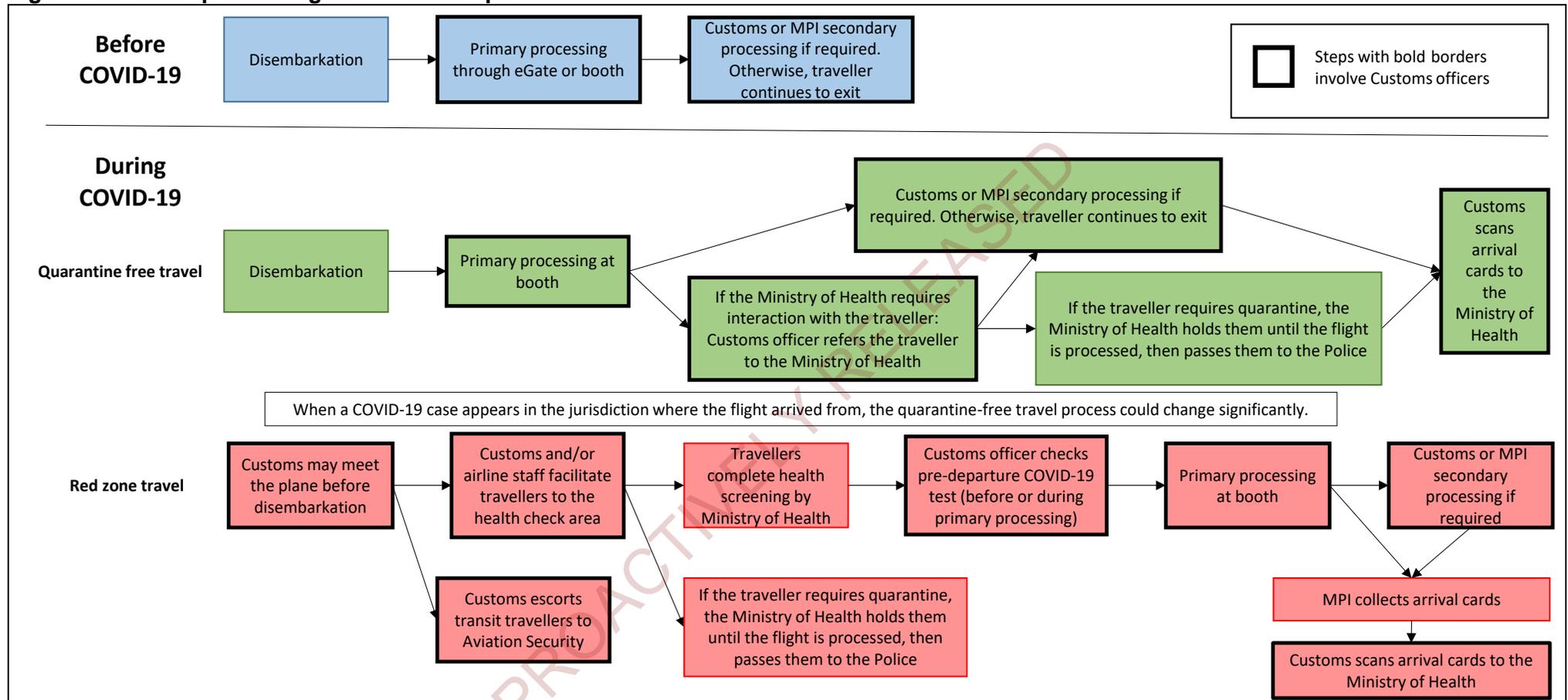
**For other (red zone) travellers other than airline staff**

- › Customs keeps each flight separate throughout the process.
- › Before travellers disembark from a flight, Customs may liaise with the airline staff regarding physical distancing, masks, and about transit travellers and travellers with exemptions.
- › If transiting, Customs escorts transit travellers to Aviation Security.
- › Customs facilitates remaining travellers to the health check area.
- › If the Ministry of Health requires the traveller to go into quarantine, the Ministry of Health holds the traveller until after processing the entire flight, then passes these travellers to the Police or Customs to escort them to their transportation to quarantine.
- › Customs checks pre-departure COVID-19 tests and carries out primary processing at a booth. eGates are closed.
- › Customs carries out secondary processing if required. This includes secondary processing for travellers whose health-related documentation is non-compliant. This secondary processing can take 15 to 30 minutes and result in no further action, a formal warning, or an infringement notice if found to be non-compliant.
- › MPI collects all cards, Customs then scans all arrival cards and sends the scans to the Ministry of Health and Statistics New Zealand. Customs sends the physical cards to MBIE.

Figure 1 illustrates the main elements of the border processing at airports, leaving out some details for the sake of simplicity.

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Figure 1 – Border processing activities at airports



## Appendix 7 – Estimated number of levied travellers

- The levy orders use estimated number of levied travellers and the estimated costs to clear them to calculate levy rates. Customs and MPI have estimated the number of levied travellers based on a moderate scenario approved by the Border Executive Board on 10 June 2021 for budgeting and planning purposes.
- Table 1 shows the estimated number of levied travellers.

**Table 1 – Estimated number of levied travellers<sup>[1]</sup>**

	Baseline million	2020/21 million	2021/22 million	2022/23 million	2023/24 million	2024/25 million	2025/26 million	2026/27 million	2027/28 million
<b>Non-cruise</b>									
Arrive	6.949	0.240	1.837	3.176	6.020	6.868	6.949	6.949	6.949
Depart	6.905	0.281	1.846	3.205	6.000	6.827	6.905	6.905	6.905
Relative to before COVID-19	100%	3%	26%	46%	87%	99%	100%	100%	100%
<b>Cruise</b>									
Arrive	0.285	-	-	0.060	0.178	0.283	0.285	0.285	0.285
Depart	0.284	-	-	0.060	0.177	0.283	0.284	0.284	0.284
Relative to before COVID-19	100%	-	-	21%	62%	99%	100%	100%	100%

<sup>[1]</sup> Estimated as at 10 June 2021. "Baseline" is February 2019 to January 2020 (before the COVID-19 outbreak).

- These estimates are uncertain due to the uncertainty about the timing and nature of the Government's future decisions on travel restrictions. Any assumptions made do not signal the Government's future policy decisions. Officials used the latest information from both New Zealand and internationally. Table 2 shows the assumptions underpinning the moderate and pessimistic scenarios.

**Table 2 – Assumptions about traveller restrictions**

Assumption	Moderate	Pessimistic
Borders partially or fully open	January 2023	July 2023
Quarantine-free cruise for Australia and Cook Islands	July 2022	N/A
Cruise traveller capacity restrictions lifted	July 2023	July 2024

- The estimates were made before the current pause in QFT with Australia and the return to Alert Level 4 in August 2021. The scenarios assumed some pauses in QFT but an overall trend of an increasing number of levied travellers, approaching pre-COVID-19 levels by the end of 2024. Under the pessimistic scenario, the number of levied travellers would remain low during 2021/22 and would take one year longer to reach pre-COVID-19 levels.
- The traveller estimates used in this CRIS differ from the consultation document's because the Border Executive Board updated its estimates during the consultation period.
- Customs and MPI allowed submitters to comment on the updated estimates. Air industry submitters said that the updated estimates closely align with their forecasts. Cruise industry submitters were concerned about officials' assumptions about future travel restrictions for the cruise industry.

## Appendix 8 – Customs’ border processing costs

### Estimated border processing costs

1. Customs’ border processing costs<sup>40</sup> are funded from the Vote Customs Output Class *Travellers Clearance and Enforcement*.
2. Table 1 sets out Customs’ estimated border processing costs. The estimates incorporate the effect of the updated estimates of the number of levied travellers (discussed above).

**Table 1 – Customs’ estimated border processing costs**

	2019/20 Budget \$m	2019/20 Actual \$m	2020/21 Budget \$m	2021/22 Estimate \$m	2022/23 Estimate \$m	2023/24 Estimate \$m	2024/25 Estimate \$m	2025/26 Estimate \$m
Non-cruise	79.190	74.000	79.577	81.168	82.792	84.448	86.136	87.859
Cruise	2.610	2.600	3.423	0.036	1.250	3.054	4.712	4.843
Total	81.800	76.600	83.000	81.204	84.042	87.501	90.848	92.702

### Non-cruise costs

3. Customs’ best estimate of non-cruise border processing costs is the same as the costs that Customs budgeted for immediately before the impact of the COVID-19 pandemic as part of preparing for Budget 2020, and adjusted for consumer price inflation (estimated at two percent) to maintain their real value.
4. Customs is taking this approach because of the uncertainty over what future border processing will involve and how much it will cost. Customs budgeted \$79.6 million for 2020/21 immediately before the impact of the COVID-19 pandemic. Over the coming year, Customs expects to know more about how much it will cost to process travellers in a COVID-19 environment.
5. After the Government imposed border restrictions to protect New Zealand from COVID-19, Customs redeployed staff to other services such as enforcing the COVID-19 Public Health Response (Maritime Border) Order 2020,<sup>41</sup> and other steps to reduce its costs. Customs did not charge any costs of redeployed staff (including their overhead costs) to memorandum accounts for the levies. The only costs that Customs charge to border processing services are costs related to travellers.
6. As a result, instead of the \$79.2 million budgeted for 2019/20 for non-cruise border processing, Customs’ actual costs were \$74.0 million. In March 2021, Customs estimated that its non-cruise border processing costs for 2020/21 would be \$61.7 million, \$17.9 million less than the \$79.6 million budgeted for this year.

<sup>40</sup> See Appendix 1 for a definition of “border processing costs”.

<sup>41</sup> The COVID-19 Public Health Response (Maritime Border) Order 2020 strengthened maritime border controls to reduce the risk of COVID-19 entering New Zealand through the maritime border.

7. In 2021/22, while QFT with Australia was open, Customs recalled staff to airports because of the resource-intensive processing needed to protect against the COVID-19 risk posed by QFT travellers. Customs estimated its non-cruise costs will be \$81.2 million for 2021/22, the same as Customs budgeted before COVID-19 adjusted for inflation.
8. Future border processing costs are more uncertain than usual because of uncertainty about the Government's future decisions about:
  - a. border restrictions, affecting the number of travellers and therefore the number of staff Customs will need
  - b. a traveller health declaration system that could reduce the amount of manual processing each traveller will need.
9. The Government has recently decided to fund some border processing costs for a limited time, the cost of up to an additional 62 staff in 2021/22 if they are needed to help check more pre-departure tests than Customs can currently carry out.

### **Cruise costs**

10. Customs is not currently carrying out any activities related to cruise travellers.
11. Although Customs estimates that its costs will increase with the estimated increase in the number of cruise travellers, the relationship is not linear. For example, Customs' risk assessment activity related to cruise travellers changes dynamically over time, depending on Customs' judgement about the risks posed by cruise travellers.

### **Customs will regularly update its cost estimates**

12. Customs will update its cost estimates every year when it reports on the performance of the levies. Customs would propose adjustments to levy rates if changes in traveller or cost estimates would lead to under-recovery or over-recovery of costs.

## Appendix 9 – MPI’s border processing costs

### Estimated MPI costs of traveller biosecurity processing

1. MPI’s border processing costs<sup>42</sup> are funded from the Vote Agriculture, Biosecurity, Fisheries and Food Safety Output Class *Border Biosecurity Monitoring and Clearance*.
2. Table 1 sets out the estimated MPI costs of traveller biosecurity processing. The estimates incorporate the effect of the updated estimates of the number of travellers (discussed above) and adjusted for consumer price inflation (estimated at two percent) to maintain their real value.

**Table 1 – Estimated MPI cost for border biosecurity services**

	2019/20 Budget \$m	2019/20 Actual \$m	2020/21 Budget \$m	2021/22 Estimate \$m	2022/23 Estimate \$m	2023/24 Estimate \$m	2024/25 Estimate \$m	2025/26 Estimate \$m
Non-cruise	65.920	66.480	57.020	65.860	66.640	68.010	68.700	69.390
Cruise	1.540	1.280	0.000	0.000	1.280	1.300	1.310	1.320
Total	67.460	67.760	57.020	65.860	67.920	69.310	70.010	70.710

3. The cost of MPI’s border processing services in 2019/20 was \$0.9 million higher than budgeted.
  - a. This was largely due to the cost of exiting staff who chose to retire early.
  - b. These services are budgeted at approximately \$57.6 million for 2020/21 and are estimated to increase to \$69.9 million in 2023/24, reflecting the planned investment in new technology to improve border scanning capability of travellers.
  - c. MPI is currently reviewing how it delivers border processing services. While this review may potentially result in changes, MPI’s cost estimates in this document are based on the current service delivery model.
4. COVID-19’s ongoing impacts on international travel creates uncertainty in these cost estimates. This uncertainty underpins the importance of MPI regularly monitoring and updating their estimates of travellers and costs and proposing adjustments to levy rates if necessary, to recover estimated costs. MPI operates memorandum accounts that record border processing costs and levy revenue. When MPI resets levy rates, the new rates consider any surpluses or deficits that have accumulated in the memorandum accounts. If the number of levied travellers exceed MPI’s estimates resulting in a surplus in the memorandum accounts, MPI would adjust the levy rate downwards to eliminate that surplus.
5. MPI will continue to monitor costs and the number of levied travellers and provide updates through the annual performance reports on the levies. MPI would consult stakeholders if monitoring indicates the need for a significant increase to levy rates beyond the proposed caps.<sup>43</sup>

<sup>42</sup> See Appendix 1 for a definition of “border processing costs”.

<sup>43</sup> See the section “Monitoring and review” for more about monitoring levy rates.

## Appendix 10 – Levy rates under the status quo

1. At the end of the current levy periods<sup>44</sup> (30 November 2021 for Customs and 30 June 2022 for MPI), Customs and MPI would reset rates for new three-year levy periods using the method set out in the levy orders. The rates would be the lower of:
  - a. rates calculated in accordance with the levy orders to fully recover costs based on estimates of the number of levied travellers and border processing costs; or
  - b. the caps.
2. Table 1 shows current levy rates, and rates for the next levy period under the status quo.

**Table 1 – Rates for next levy period under the status quo**

	Current rates	Cap	Next rate under status quo
	\$ excl GST	\$ excl GST	\$ excl GST
<b>Non-cruise</b>			
Arrival – Customs	6.43	7.80	7.80
Arrive – MPI	8.50	8.80	8.80
Departure – Customs	2.56	3.10	3.10
<b>Cruise</b>			
Arrival – Customs	10.40	10.40	10.40
Arrive – MPI	3.81	17.90	7.47
Departure – Customs	4.10	4.10	4.10

3. Table 2 shows Customs' and MPI's estimated revenue under the status quo. Estimated revenue is less than estimated costs because Customs and MPI cannot increase rates beyond the caps.

**Table 2 – Estimated levy revenue, costs and deficits under the status quo**

	2021/22	2022/23	2023/24	2024/25
	\$m	\$m	\$m	\$m
<b>Non-cruise</b>				
Revenue	34.518	62.655	118.525	135.170
Costs	147.028	149.432	152.458	154.836
Annual deficits	-112.510	-86.777	-33.933	-19.666
Accumulated deficits to June	-112.510	-199.287	-233.220	-252.886
<b>Cruise</b>				
Revenue	-	1.316	3.900	6.218
Costs	0.036	2.530	4.354	6.022
Annual deficits	-0.036	-1.214	-0.454	0.196
Accumulated deficits to June	-0.036	-1.250	-1.704	-1.508
<b>Total accumulated to June</b>	<b>-112.546</b>	<b>-200.537</b>	<b>-234.924</b>	<b>-254.394</b>

<sup>44</sup> 'Levy period' means a period prescribed by, or set in accordance with, the Customs and Excise (Border Processing Levy) Order 2015 or the Biosecurity (Border Processing Levy) Order 2015. Levy rates apply only for the levy period for which they are set.

## Appendix 11 – Impacts on levied travellers

### Combined levy rates

1. Table 1 shows the impact of the options on levy rates.

**Table 1 – Impact of options on levy rates<sup>[1]</sup>**

Option	Levy period	Status quo	Increases to fund costs in levy period	Increases to fund interim deficits	New rates
<b>Non-cruise</b>					
Option 1	three years	\$19.70	+\$14.50	+\$3.83	\$38.03
Option 2	six years	\$19.70	+\$7.52	+\$1.50	\$28.72
Option 3	three years	\$19.70	+\$14.50	Nil	\$34.20
Option 4	six years	\$19.70	+\$7.52	Nil	\$27.22
<b>Cruise</b>					
Option 1	three years	\$21.97	+\$9.90	+\$0.06	\$31.93
Option 2	six years	\$21.97	+\$2.44	+\$0.01	\$24.42
Option 3	three years	\$21.97	+\$9.90	Nil	\$31.87
Option 4	six years	\$21.97	+\$2.44	Nil	\$24.41

<sup>[1]</sup> Impact on the combined Customs and MPI arrival and departure levies.

### Impacts on the number of levied traveller

2. Table 2 shows how the options might affect travel decisions, compared to the status quo.

**Table 2 – Potential change in number of levied travellers<sup>[1]</sup>**

	Option 1	Option 2	Option 3	Option 4
Levy period	Three years	Six years	Three years	Six years
Interim deficits funded by:	Travellers	Travellers	Crown	Crown
Non-cruise	-0.5%	-0.3%	-0.4%	-0.2%
Cruise	-0.2%	-0.04%	-0.2%	-0.04%

<sup>[1]</sup> Impact of the combined Customs' and MPI's arrival and departure levies compared to the status quo.

3. Within these overall impacts, the impacts are greater for some travellers and less for others. For example, the impact is greater for travellers from Australia visiting friends and family because their cost of travel is less than for the average visitor, and they were more price sensitive than average visitor before COVID-19. Table 3 shows this impact.

**Table 3 – Potential change in travellers from Australia visiting friends and family<sup>[1]</sup>**

	Option 1	Option 2	Option 3	Option 4
Non-cruise	-1.3%	-0.6%	-1.0%	-0.5%

<sup>[1]</sup> Impact of the combined Customs' and MPI's arrival and departure levies compared to the status quo.

4. The results in Tables 2 and 3 follow the method used to estimate the impact of establishing the levies (McWha & Murray, 2015). Briefly, the impact on the number of levied travellers is a function of the price of travel and the elasticity of demand. The analysis used Statistics New Zealand data on visitors by country of residence in 2019 (Statistics New Zealand, 2021), estimates of the cost of travel published by the Ministry of Business, Innovation and Employment, and elasticities estimated by Schiff and Becken (2011). All these estimates and data pre-dated the COVID-19 pandemic.
5. The results are subject to considerable uncertainty. These estimates are based on a simple model of how markets respond to small changes in travel costs. The model ignores other factors that may affect people's decision to travel. The estimates are also based on price elasticities – the degree to which fewer people will travel if the price increases – that have a wide range of uncertainty.
6. As a result of the COVID-19 pandemic, levied travellers might respond differently to price changes compared to before COVID-19 (Song & Choi, 2020; Suau-Sanchez, Voltes-Dorta & Cugueró-Escofet, 2020). For example, travel decisions might be affected by:
  - current and possible future border restrictions that limit travel
  - requirements such as pre-departure COVID-19 tests or being vaccinated
  - additional costs and risks of travel, such as the cost of obtaining pre-departure tests, the risk of lockdowns while travelling, and the risk of catching COVID-19
  - people financially affected by the pandemic having less discretionary income
  - innovations affecting business travel such as more use of videoconferencing
  - potential changes to the services airlines and cruise lines might offer in the future.
13. These factors may reduce price-sensitive discretionary travel by more than non-discretionary travel. If that were the case, the impact of levy increases might be less than the estimates shown above.

### Submissions

14. IATA suggested that levy increases would result in much larger reductions in the number of levied travellers than Customs and MPI estimated in the consultation document. As an example, they said that the reduction in the number of travellers from Australia could be one third greater than estimates that Customs and MPI had consulted on, and the reduction in the number of travellers from the United Kingdom could be three times greater.

### Customs' and MPI's response

15. Estimates of impact are inherently uncertain because it is difficult to accurately estimate the effect of small price changes on levied travellers' behaviour. Differences between our estimates and IATA's estimates include:
  - we used estimates of price elasticity published in peer-reviewed academic literature, while IATA used their own elasticity estimates
  - we used an established methodology developed by economic consultants. Customs and MPI used this methodology in 2015 when the government introduced the levies, and MBIE has used it to estimate the impact of the International Visitor, Conservation and Tourism Levy
  - our methodology assumes levied travellers consider the total cost of their travel when deciding whether to travel. IATA's methodology assumes that levied travellers only consider airfares and do not consider other travel-related costs.

## Appendix 12 – References

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