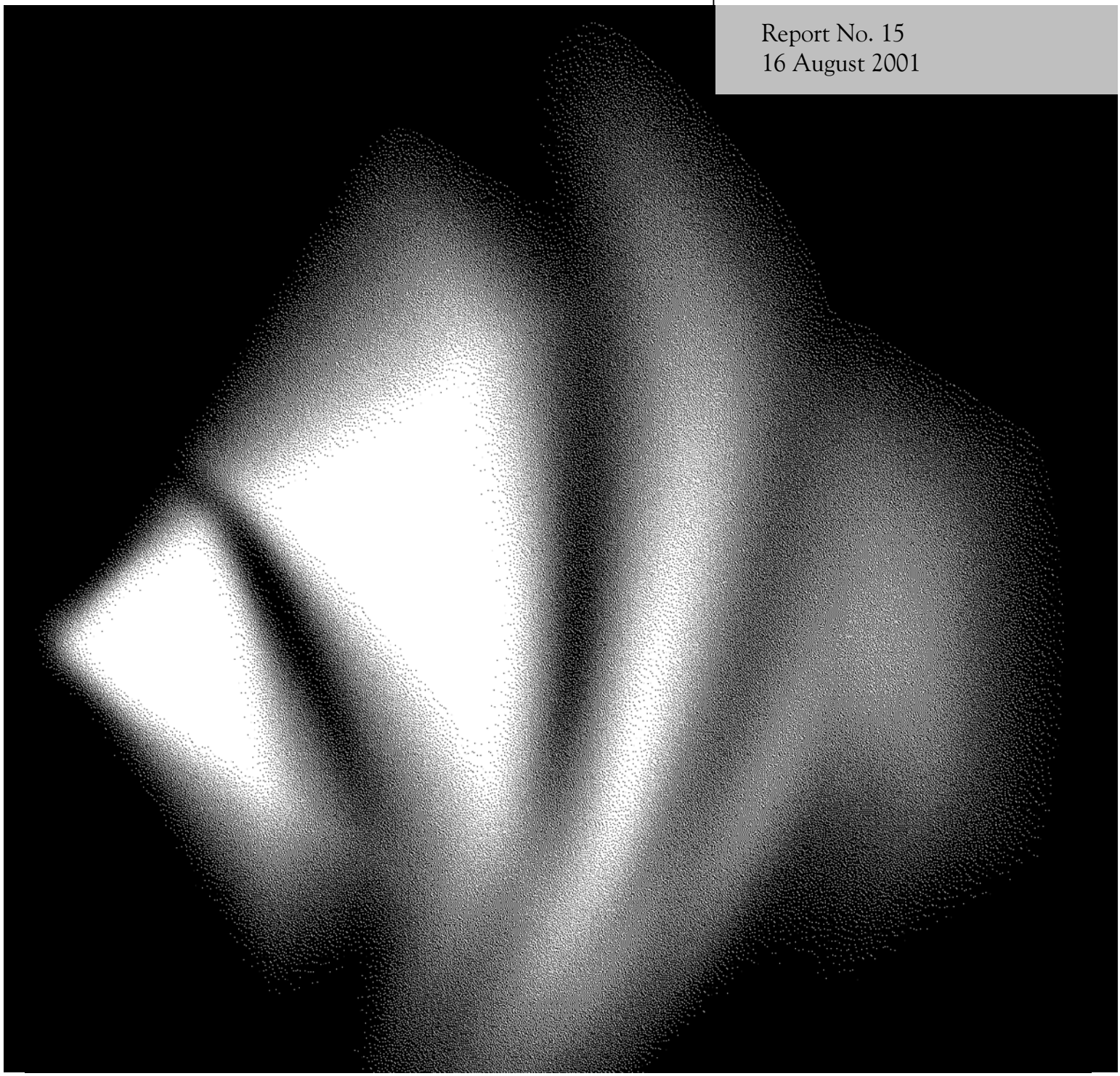
PRODUCTIVITY COMMISSION

Cost Recovery by Government Agencies

Inquiry Report

Report No. 15
16 August 2001



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The Productivity Commission

The Productivity Commission, an independent Commonwealth agency, is the Government's principal review and advisory body on microeconomic policy and regulation. It conducts public inquiries and research into a broad range of economic and social issues affecting the welfare of Australians.

The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.

Information on the Productivity Commission, its publications and its current work program can be found on the World Wide Web at www.pc.gov.au or by contacting Media and Publications on (03) 9653 2244.

Terms of reference

I, ROD KEMP, Assistant Treasurer, pursuant to Parts 2 and 3 of the *Productivity Commission Act 1998*, hereby refer the cost recovery arrangements of Commonwealth Government regulatory, administrative and information agencies — including fees charged under the *Trade Practices Act 1974* (TPA) — to the Commission for inquiry and report within twelve months of receipt of this reference. The Commission is to hold hearings for the purpose of the inquiry.

Background

2. This inquiry is principally a general review of cost recovery arrangements across Commonwealth regulatory, administrative and information agencies. In addition, the inquiry will incorporate the review of fees charged under the TPA which is required under the *Commonwealth Legislation Review Schedule.* The inquiry will take into account the analytical requirements for regulation assessment by the Commonwealth, including those set out in the *Competition Principles Agreement,* where relevant.

Scope of Inquiry

3. The Commission is to report on:
   - (a) the nature and extent of cost recovery arrangements across Commonwealth Government regulatory, administrative and information agencies, including identification of the activities of those agencies for which cost recovery is undertaken;
   - (b) factors underlying cost recovery arrangements across Commonwealth Government regulatory, administrative and information agencies;
   - (c) who benefits from the regulations, administrative activity and information to which cost recovery arrangements are applied;
   - (d) the impact on business, particularly small business, consumers and the community of existing cost recovery arrangements, including any anti-competitive effects and incentive effects;
   - (e) the impact of cost recovery arrangements on regulatory, administrative and information agencies, including incentive effects;
   - (f) the consistency of cost recovery arrangements with regulatory best practice;
   - (g) appropriate guidelines for:
     - (i) where cost recovery arrangements should be applied;
     - (ii) whether cost recovery should be full, partial or nil;
     - (iii) ensuring that cost-recovered activities are necessary and are provided in the most cost-effective manner;
     - (iv) the design and operation of cost recovery arrangements, including the treatment of small business;
     - (v) the review of cost recovery arrangements; and
     - (vi) where necessary, implementation strategies to improve current arrangements.
4. In reporting on matters in 3 above, the Commission should, where relevant, have regard to:
   - (a) implications of recent and emerging technologies; and
   - (b) legal constraints on the design and operation of cost recovery arrangements.

5. With respect to fees charged under the TPA, the Commission should have particular regard to:
   (a) those fees charged that restrict competition, or which impose costs or confer benefits on business; and
   (b) whether cost recovery arrangements that restrict competition should be retained in whole or part, taking into account whether the benefits to the community as a whole outweigh the costs, and whether the objectives of those arrangements can be achieved only by restricting competition.
6. In making its assessment of fees charged under the TPA:
   (a) the Commission is to have regard to environmental, welfare and equity considerations; economic and regional development; occupational health and safety; consistency between regulatory regimes and efficient regulatory administration; the interests of consumers generally; the competitiveness of business including small business; compliance costs and the paperwork burden on small business; and the efficient allocation of resources; and
   (b) the Commission should:
      (i) identify the rationale for fees charged under the TPA;
      (ii) clarify and assess the objectives of the fee arrangements;
      (iii) identify whether, and to what extent, the fee arrangements impose costs or confer benefits on business or restrict competition;
      (iv) identify any relevant alternatives to these fee arrangements;
      (v) analyse and, as far as reasonably practical, quantify the benefits, costs and overall effects of the arrangements and alternatives identified in (iv);
      (vi) identify the different groups likely to be affected by these arrangements and alternatives;
      (vii) list the individuals and groups consulted during the review and outline their views;
      (viii) determine a preferred option for the fee arrangements, if any; and
      (ix) examine mechanisms for increasing the overall efficiency, including minimising the compliance costs and paper burden on small business, of the arrangements and, where it differs, the preferred option.
7. The Commission should take account of any recent substantive studies relevant to the above issues.
8. In undertaking the review, the Commission is to advertise nationally, consult with key interest groups and affected parties, and produce a report.
9. The Government will consider the Commission's recommendations, and the Government's response will be announced as soon as possible after the receipt of the Commission's report.

ROD KEMP

16 August 2000

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Abbreviations

ABA	Australian Broadcasting Authority
ABARE	Australian Bureau of Agricultural and Resource Economics
ABC	Activity Based Costing
ABS	Australian Bureau of Statistics
ACA	Australian Communications Authority
ACCC	Australian Competition and Consumer Commission
ACCI	Australian Chamber of Commerce and Industry
ACLC	Annual carrier licence charge
ACS	Australian Customs Service
ACSMA	Australian Chemical Specialties Manufacturers Association
ADI	Authorised Deposit-taking Institution
AEC	Australian Electoral Commission
AFFA	Department of Agriculture, Fisheries and Forestry — Australia
AFGC	Australian Food and Grocery Council
AFMA	Australian Fisheries Management Authority
AGAL	Australian Government Analytical Laboratories
AGS	Australian Government Solicitor
AGSO	Australian Geological Survey Organisation
AICCC	AQIS Industry Cargo Consultative Committee
AMSA	Australian Maritime Safety Authority
ANAO	Australian National Audit Office
ANZFA	Australia New Zealand Food Authority
APMA	Australian Pharmaceutical Manufacturers Association
APMF	Australian Paint Manufacturers Federation
APRA	Australian Prudential Regulation Authority
AQIS	Australian Quarantine and Inspection Service

ARPANSA	Australian Radiation Protection and Nuclear Safety Agency
ARTG	Australian Register of Therapeutic Goods
ASA	Airservices Australia
ASFA	Association of Superannuation Funds of Australia
ASIC	Australian Securities and Investments Commission
ASIO	Australian Security Intelligence Organisation
ASMI	Australian Self-Medication Industry
ATO	Australian Taxation Office
ATSB	Australian Transport Safety Bureau
AUSLIG	Australian Surveying and Land Information Group
AUSTRAC	Australian Transaction Reports and Analysis Centre
Austrade	Australian Trade Commission
avgas	aviation kerosene
avtur	aviation turbine fuel
BASI	Bureau of Air Safety Investigation
BoM	Bureau of Meteorology
BTR	Bureau of Tourism Research
CAC Act	*Commonwealth Authorities and Companies Act 1997*
CAPM	capital asset pricing model
CASA	Civil Aviation Safety Authority
CCNCO	Commonwealth Competitive Neutrality Complaints Office
CER	Closer Economic Relations
CHC	Complementary Healthcare Council of Australia
CLERP	Corporate Law Economic Reform Program
COSBOA	Council of Small Business Organisations of Australia
CPA	Competition Principles Agreement
CRF	Consolidated Revenue Fund
CRIS	Cost Recovery Impact Statement
CSDC	Commonwealth Spatial Data Committee
CSIRO	Commonwealth Scientific and Industrial Research Organisation

CSO	Community service obligation
CTBTO	Comprehensive Test Ban Treaty Organisation
DCITA	Department of Communications, Information Technology and the Arts
DEH	Department of the Environment and Heritage (Environment Australia)
DETYA	Department of Education, Training and Youth Affairs
DEWRSB	Department of Employment, Workplace Relations and Small Business
DFAT	Department of Foreign Affairs and Trade
DHAC	Department of Health and Aged Care
DIMA	Department of Immigration and Multicultural Affairs
DISR	Department of Industry, Science and Resources
DoD	Department of Defence
DoF	Department of Finance (now DOFA)
DOFA	Department of Finance and Administration
DORC	depreciated optimised replacement cost
DTRS	Department of Transport and Regional Services
EAC	Efficiency Audit Committee
ECCB	exclusive capturable commercial benefit
ERC	Expenditure Review Committee
ERIC	Environmental Research and Information Consortium
FaCS	Department of Family and Community Services
FDA	Food and Drug Administration
FDC	Fully Distributed Cost
FMA Act	*Financial Management and Accountability Act 1997*
FTE	full-time equivalent
GBE	government business enterprise
GSV	Geological Survey of Victoria
ICAO	International Civil Aviation Organisation
IER	Industry Equalisation Reserve

IFSA	Investment and Financial Services Association
IGCC	Industry Government Consultative Committee
INSEE	L'Institut national de la statisque et des études économiques
IPA	IP Australia
ITU	International Telecommunication Union
IWGQ	Industry Working Group on Quarantine
JCPAA	Joint Committee of Public Accounts and Audit
LRIC	long run incremental cost
LRMC	long run marginal cost
MCA	Medicines Control Agency
MDA	Medical Devices Agency
MIAA	Medical Industry Association of Australia
MOU	Memorandum of Understanding
NCC	National Competition Council
NFF	National Farmers' Federation
NHPD	Natural Health Products Directorate
NICNAS	National Industrial Chemicals Notification and Assessment Scheme
NLA	National Library of Australia
NOHSC	National Occupational Health and Safety Commission
NRA	National Registration Authority for Agricultural and Veterinary Chemicals
NSC	National Standards Commission
NTGS	Northern Territory Geological Survey
OFLC	Office of Film and Literature Classification
OGTR	Office of the Gene Technology Regulator
OMB	Office of Management and Budget
ONS	Office for National Statistics
ORR	Office of Regulation Review
PACIA	Plastics and Chemicals Industries Association
PBRO	Plant Breeders Rights Office

PBS	Portfolio Budget Statements
PC	Productivity Commission
PDUFA	*Prescription Drug User Fee Act 1992* (United States)
PM&C	Department of Prime Minister and Cabinet
PSA	*Prices Surveillance Act 1983*
RAM	Royal Australian Mint
RBA	Reserve Bank of Australia
RIS	Regulation Impact Statement
SCB	Statistics Sweden
SLASO	Space Licensing and Safety Office
SMA	Spectrum Management Authority
SPS	Sanitary and Phyto-Sanitary
SSA	ScreenSound Australia
sub.	submission
TBT	Technical Barriers to Trade
TGA	Therapeutic Goods Administration
TICC	Therapeutic Goods Administration — Industry Consultative Committee
TPA	*Trade Practices Act 1974*
TPP	Therapeutic Products Programme
trans.	Transcript
USO	Universal service obligation
WACC	Weighted average cost of capital
WIPO	World Intellectual Property Organisation
WMO	World Meteorological Organisation
WTO	World Trade Organisation

Glossary

Accrual accounting	An accounting framework which recognises revenues and expenses in the accounting period in which they occur, irrespective of when cash is paid or received.
Additional information products	Information products of a government agency that do not fall within the basic product set. These products typically are cost recovered.
Agency capture	A situation which occurs when a private interest group has an inappropriate level of influence or control over a public agency.
Appropriation	An authorisation from Parliament to withdraw funds from the Consolidated Revenue Fund.
Avoidable costs	The costs that would be avoided if an agency no longer provided a particular product.
Basic information product set	Information products of a government agency that are produced because of public good characteristics, significant positive spillovers and other Government policy reasons. These products typically are funded from general taxation revenue.
Beneficiary pays	The idea that those who benefit from the provision of a particular good or service should pay for it.
Benefit principle	A principle which suggests that economic efficiency would be improved by requiring people to contribute (through taxation) according to the value they place on the publicly provided goods and services they consume.
Benefit tax	A tax based on the benefit principle.

CAC Act	*Commonwealth Authorities and Companies Act 1997*, regulating the financial, ethical and reporting requirements of corporate public authorities with a separate legal existence outside the Commonwealth Public Service.
Cash accounting	An accounting framework which recognises revenues and expenses when cash is paid or received.
Charge	The price or cost imposed. In this report it is used as a generic term to cover all cost recovery imposts, including both fees for service and taxes.
Community Service Obligation	A situation where government requires a government business enterprise to engage in a non-commercial activity in order to meet a social objective.
Competitive neutrality	A policy principle which requires the prices charged by government businesses in actual or potential competition with the private sector to be adjusted to reflect the advantages and disadvantages of public ownership. Prices should at least cover costs (including a return on capital invested and all relevant taxes and charges).
Compliance costs	The costs associated with abiding by a regulation or with paying a tax.
Cost padding	The artificial inflation of costs, motivated by the knowledge that all costs can be recovered.
Cost recovery	A system of fees and specific purpose taxes used by government agencies to recoup some or all of the costs of particular government activities.
Cross-subsidy	Cross-subsidies occur when one group of users pays more than the cost of the goods and services they receive, and the surplus is used to offset the cost of goods and services provided to other users.
Deadweight cost	The cost to society of distortions of production and consumption decisions.

Demand management	The implementation of a pricing policy designed to instil cost consciousness in consumers and to allow producers to gauge the demand for their products.
Deprival value	The value of an asset, measured in terms of the services or benefits provided by the asset which an agency would forgo it if were deprived of the asset.
Direct costs	Costs that can directly and unequivocally be attributed to an activity (for example, labour and materials).
Earmarking	The assignment of revenue received from a specific tax or taxes to the financing of a particular governmental activity.
Externality	A situation where a decision to produce or consume has positive or negative welfare consequences for those not party to the decision.
Fee-for-service	A direct charge for the provision of a good or service. As a general principle, a fee should bear a direct relationship with the cost of providing the good or service, or could be open to legal challenge as amounting to a tax.
Financial contagion	A process whereby the failure of one financial institution leads to the failure of others, through a loss of confidence by customers
First mover disadvantage	The disadvantage associated with being the first to apply for an authorisation, licence or permit, when competitors can free ride.
FMA Act	*Financial Management and Accountability Act 1997*, which provides a framework for the management of public money and property.
Free-rider	An individual or firm who derives benefits at no cost from a good or service being provided at a cost to someone else.
Fully distributed costing	An accounting framework whereby the value of all resources used or consumed in the provision of an output — including direct, indirect and capital costs — is used in the costing of that output.

Gold plating	The adoption of unnecessarily high standards or facilities.
Governance	Refers to the processes that direct, control and hold to account agencies.
Hypothecating	See 'Earmarking'.
Incidence	The ultimate distribution of a tax between producers and consumers.
Incremental costs	The increase in costs attributable to the production of a particular type of product, which could include capital or overhead costs (sometimes used as a proxy for the marginal cost of producing an additional unit of that product).
Indirect costs	Costs that are not directly attributable to an activity and are often referred to as overheads (for example, corporate services).
Information gap	A situation where there is insufficient or inadequate information about such matters as price, quality and availability for businesses, investors and consumers to make informed decisions.
Levy	A form of tax. It is often used to refer to a tax that is imposed on a specific industry or class of persons, rather than a tax of general application.
Marginal cost	Increase in costs attributable to the production of an additional unit of a good or service.
Market failure	A situation where the characteristics of a market are such that its unfettered operation will not lead to the most efficient outcome possible.
Moral hazard	A situation when the application of a regulation creates incentives to act in a way contrary to the objectives of the regulation.
Natural monopoly	A situation where it is more efficient for one firm to supply all of a market's needs than it would be for two or more firms to do so.

Net appropriation	Appropriations under section 31 of the FMA Act, allowing FMA agencies to, in effect, retain cost recovery revenue.
Non-excludable	Describes a good or service which, once it is provided to one person, others cannot be prevented from also consuming it.
Non-rival	Describes a good or service for which consumption by one person will not diminish the amount available to others.
Private good	A good for which it is physically and economically feasible to identify and charge users (or beneficiaries) and to exclude non-purchasers. Therefore, if it is profitable to provide the good or service, the market will normally do so.
Public good	A good or service where provision for one person means the good or service is available to all people at no additional cost. Public goods are said to be non-rival and non-excludable. These goods are unlikely to be provided to a sufficient extent by the private market.
Regulated pays	The idea that those who, through their actions, create a risk that requires regulation, should pay for the cost of that regulation.
Regulatory creep	A situation where additional regulation is imposed without adequate scrutiny.
Section 20	See 'Special (standing) appropriation'.
Section 31	See 'Net appropriation'.
Special (standing) appropriation	An appropriation under section 20 of the FMA Act, under which components of the Consolidated Revenue Fund are set aside for specific purposes.
Spillover	See 'Externality'.
Tax	A compulsory exaction of money by public authority for public purposes, enforceable by law, and which is not a payment for services rendered. There are specific Constitutional requirements for imposing taxes.

User charge A charge for the provision of a specific good or service to an individual user, related to the quantity consumed.

EXECUTIVE SUMMARIES

Key messages

- The scale and scope of cost recovery by Commonwealth regulatory and information agencies have grown considerably in recent times.
  - Almost all agencies recover some of their costs.
  - The proportion of costs recovered is increasing.
  - More than $3 billion was raised in 1999-2000.
  - Cost recovery revenue grew by 24 per cent in real terms over the past 5 years.
- Many inquiry participants see a role for cost recovery, but many are dissatisfied with current cost recovery arrangements.
- Despite their frequency, cost recovery arrangements generally lack the attributes of good policy:
  - most arrangements are *ad hoc*, lack transparency and have poor accountability and review mechanisms.
- Many aspects of current cost recovery arrangements are inconsistent with sound economic principles:
  - this has the potential to distort the allocation of resources in the economy and, ultimately, to reduce living standards.
- Current arrangements often create perverse financial incentives that are incompatible with overarching government objectives. These can:
  - reduce competition and innovation; and
  - encourage regulatory creep and cost padding by agencies.
- Well designed cost recovery arrangements, by contrast, can promote economic efficiency and equity by:
  - instilling cost consciousness among agencies and users; and
  - ensuring those who use regulated products or request additional information bear the costs.
- The Commission has proposed detailed cost recovery Guidelines for reviewing existing arrangements and testing new proposals.
  - If implemented, the new Guidelines would enable all Commonwealth agencies to decide on the appropriateness of cost recovery for their activities, and the best approach to implementation.
  - Those paying would have greater confidence in the reasonableness of specific cost recovery arrangements.

Cost recovery principles

Cost recovery should be implemented for economic efficiency reasons, not merely to raise revenue.

For regulatory agencies, in principle, the prices of regulated products should incorporate all of the costs of bringing them to market, including the administrative costs of regulation.

Information agencies and the Government together should define a basic product set according to: public good characteristics, significant positive spillovers and other Government policy reasons. The basic product set should be funded from general taxation revenue. Additional information products should be classified into three broad categories and priced accordingly:

- dissemination of existing products at marginal cost;
- incremental products (which may involve additional data collection or compilation) at incremental (avoidable) cost; and
- commercial (contestable) products according to competitive neutrality principles.

In all cases, cost recovery should not be implemented where:

- it is not cost effective;
- it would be inconsistent with policy objectives; or
- it would unduly stifle competition and industry innovation (for example, through 'free rider' effects).

Operational principles for cost recovery include:

- using fees for service where possible;
- applying cost recovery to activities, not agencies;
- not using targets;
- not using cost recovery to finance other unrelated government objectives; and
- not using cost recovery to finance policy development, ministerial or parliamentary services, or meeting certain international obligations.

Design principles for cost recovery include:

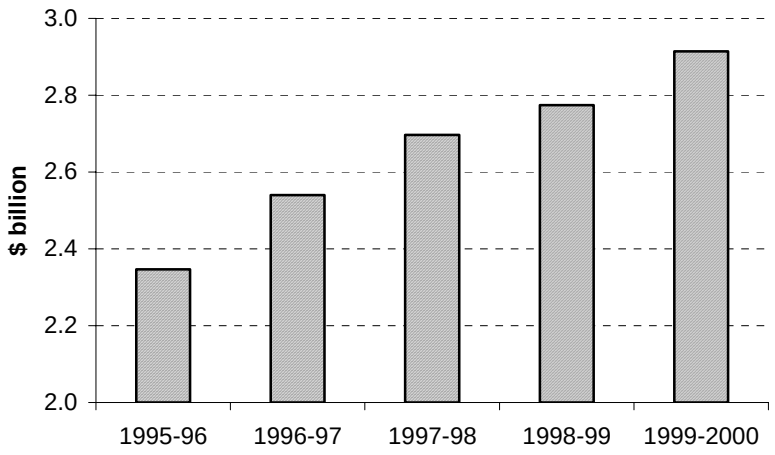
- generally, avoiding cross-subsidies;
- ensuring transparency and accountability; and
- undertaking industry consultation.

Overview

The scale and scope of cost recovery are increasing.

Regulatory and information agencies in the Commonwealth public sector are increasingly turning to cost recovery to fund their activities and products. New agencies are being created with a presumption in favour of cost recovery, and existing cost recovery arrangements have ratcheted upwards. The scale and scope of such arrangements have expanded to the point where the Commission estimates that cost recovery revenues were over $3 billion in 1999-2000. Since 1995-96, cost recovery revenue has grown by 24 per cent in real terms.

Real cost recovery revenue of Commonwealth regulatory and information agencies, 1995-96 to 1999-2000[a]



a In this graph cost recovery revenue for 1999-2000 is less than the $3.2 billion reported elsewhere due to the exclusion of agencies that did not report cost recovery revenues for each of the five years. Cost recovery revenue includes some inter-agency charges.

Cost recovery has important efficiency and equity implications …

Cost recovery, while substantial, has an importance beyond the dollars involved. It can have a significant impact on both actual and potential users of the services of regulatory and information agencies. It can have both positive and negative influences on the way in which Government agencies

operate. There is also the issue of equity between those who pay and those who do not.

… yet it lacks a good policy framework.

Notwithstanding its increased significance, cost recovery currently lacks the attributes of good policy — namely, a clear rationale, accountability, transparency, performance assessment and review. Inquiry participants indicated that this is an important and timely review.

What is cost recovery?

Cost recovery involves a link between the charge and the service provided.

Cost recovery differs from general taxation which raises revenue to fund a wide range of Government activities or products. Cost recovery, on the other hand, recovers some or all of the costs of a particular Government activity or product. Examples of cost recovered activities include the provision of some statistical information by the Australian Bureau of Statistics (ABS), the mandatory assessment of new drugs by the Therapeutic Goods Administration and the provision of aviation safety services by the Civil Aviation Safety Authority.

Cost recovery involves fees for service and taxes earmarked to a particular activity or agency.

The most direct forms of cost recovery are where particular users are charged a fee based on the cost of providing the Government product consumed. Less direct forms include special levies or earmarked taxes to fund a specific Government activity. The link between the revenue raised and the funding of a specific activity distinguishes taxes imposed for cost recovery from general taxation. The fact that cost recovery is usually not undertaken with a view to generating a profit distinguishes it from the pricing objectives of government business enterprises.

Background to inquiry

The rationale for existing cost recovery arrangements is not always clear.

Many Commonwealth regulatory and information agencies use charges to recover some of their costs, and some have been doing so for a long time. The Civil Aviation Safety Authority, for example, has been recovering the costs of aviation safety regulation since 1956. Despite this, there is

still a general lack of clear policy guidelines governing the implementation of cost recovery.

In practice, the rationale for charging arrangements is not always apparent. Nor is it always clear why some agencies recover costs for certain activities while comparable agencies do not. Some charges appear to be arbitrary or accidents of history. Faced with a policy (and legislative) vacuum, agencies have often been left to fend for themselves, relying on outdated and inadequate Department of Finance and Administration publications, *ad hoc* reviews and consultants' advice for guidance.

Agencies have been operating in a policy vacuum.

Charges, taxes, levies and fees

These terms are often used interchangeably in the discussion of cost recovery. However, they can have quite distinct legal meanings. They are used in this report in accordance with the following definitions.

A charge is a generic term covering all cost recovery arrangements.

A tax is **'**a compulsory exaction of money by public authority for public purposes, enforceable by law, and is not a payment for services rendered'. There are specific Constitutional requirements for imposing taxes. Many cost recovery charges are legally taxes.

A levy is a form of tax. The term is often used to refer to a tax that is imposed on a specific industry or class of persons, rather than a tax of general application. Many cost recovery arrangements imposed as taxes are labelled as 'levies'.

A fee-for-service is a direct charge for the provision of a service. The general principles are that: a fee must reflect the costs of the service provided; and the service must be rendered to, or at the request of, the party paying the account. If these principles are not met, then a purported fee-for-service may amount to a tax, and legislation imposing the fee could be open to Constitutional challenge.

While the views of industry vary considerably, many participants from industry and Government agreed that it was sometimes appropriate to recover the costs of Government activity through charges.

Many participants see a role for cost recovery.

However, there is a general industry perception that current cost recovery charges are not always warranted or are too high.

But there are also critics.

Selected industry views on cost recovery

Many participants see a role for cost recovery of some Government activities:

> The economic rationale for … user charges is to improve the efficiency with which departments and agencies make use of limited resources. (Australian Chamber of Commerce and Industry, sub. 70, p. 4)
>
> Industry does not begrudge paying for effective and timely regulatory support. (Medical Industry Association of Australia, sub. DR122, p. 2)
>
> Regulation can engender public confidence in the industry and the products that are produced. Accordingly, the Working Party believes that cost recovery is a reasonable principle to pursue. (Chemicals and Plastics Action Agenda, sub. 15, p. 5)

Others argue that full cost recovery charges are not always warranted:

> [The Australian Chemical Specialties Manufacturers Association] … does not oppose the principle of cost recovery. However, we are strongly opposed to the inconsistent, inefficient and unaccountable systems that have grown in scale and scope in recent years as cost recovery principles are put into practice. (sub. DR164, p. 2)
>
> … virtually every area of regulatory activity provides some public benefit. Therefore, it is inappropriate for the costs involved to be totally recovered from the private sector. (Australian Chamber of Commerce and Industry, sub. 70, p. 28)
>
> It is Avcare's contention that in the case of [Australia New Zealand Food Authority] cost recovery for [certain items], the Government is in fact double dipping and implementing cost recovery that cannot be justified. (Avcare, trans. p. 927)

or that cost recovery could create undesirable incentives:

> Cost recovery has acted to restrict innovation and competition in Australian industry. (Australian Chamber of Commerce and Industry, sub. DR136, att. p. 6)
>
> [The Therapeutic Goods Administration's] fees and charges, being the highest in the world as a result of the Government's 100 per cent cost recovery policy, are unacceptable because we believe:
> - they are a barrier to trade;
> - they potentially stifle competition;
> - they create undue burden on start-up companies; and
> - they prevent the public from access to medical devices and higher quality health care. (Cochlear, sub. 49, p. 10)
>
> As a small business, we believe ABS charges for computer data are irrational and excessive. These excessive charges result in very low levels of use ... Innovation and competition are strongly discouraged … High prices will deter many potential users with genuine needs for data … sales reflect only a small part of the demand. (Cumpston Sargeant, sub. 77, pp. 1–2)

The Commission was asked to review the issues and develop guidelines.

Against this background, the Government asked the Commission to undertake a review of the nature and extent of cost recovery arrangements of Commonwealth agencies. The terms of reference have three main parts:

- a review of existing cost recovery arrangements by regulatory, administrative and information agencies;

- the development of cost recovery guidelines on how and where cost recovery should apply; and
- a review of cost recovery arrangements under the *Trade Practices Act 1974*, as part of the legislative review required by the Competition Principles Agreement.

Regulatory and information agencies are the focus.

While the inquiry covers regulatory, administrative and information agencies, all agencies in the Commonwealth public sector are administrative in some sense, and thus the more useful distinction is between regulatory and information agencies. Regulatory agencies administer regulations. Information agencies collect, compile and disseminate information as their prime purpose. They include cultural and archival institutions.

The Commission surveyed many agencies.

Unfortunately, little information on cost recovery is published by regulatory and information agencies directly, or through budget documents. Cost recovered revenues often are not distinguished from other revenues. Thus the Commission surveyed 127 agencies to establish the nature and extent of cost recovery in the Commonwealth public sector.

Better information on cost recovery needs to be made available.

The proper scrutiny of cost recovery requires that better information be available to users and the Government on an ongoing basis. The Commission has made various recommendations to address these needs.

Cost recovery in practice

A wide range of cost recovery arrangements exists.

The information the Commission received revealed a wide range of cost recovery practices. Some regulatory agencies recover little or none of their costs, others recover the costs of some activities and not others, and some recover all, or more than, their costs.

Given that cost recovered revenues may fluctuate from year to year, some agencies may under or over collect in any given year. The Therapeutic Goods Administration, for example, has a cost recovery target of 100 per cent of agency

expenses, but recovered only 85 per cent of expenses in 1999-2000.

Cost recovery in selected regulatory agencies, 1999-2000[a]

Agency	*Cost recovery revenue*	*Cost recovery/total expenses*
	$m	%
Australian Communications Authority	44 (54)	90 (111)
Australian Maritime Safety Authority	52	67
Australia New Zealand Food Authority	1	6
Australian Prudential Regulation Authority	61 (75)	104 (128)
Australian Quarantine Inspection Service	137	77
Australian Securities and Investments Commission	201 (361)	139 (249)
Civil Aviation Safety Authority	60	71
National Industrial Chemicals Notification and Assessment Scheme	4	100
National Registration Authority for Agricultural and Veterinary Chemicals	18	109
Therapeutic Goods Administration	41	85

a Figures in parentheses include transfers to third parties.

Some regulatory agencies recover more than their own costs

In other cases, agencies recover significantly more than their own costs. Often, this occurs because their charges are being used to fund related services supplied by other agencies. The Australian Prudential Regulation Authority, for example, raises some funds to help finance related services provided by the Australian Tax Office and the Australian Securities and Investments Commission (ASIC). Similarly the Australian Communications Authority raises some funds from telecommunications carriers to help finance Australian Competition and Consumer Commission costs of regulating the telecommunications industry.

... to fund other Government commitments.

When such transfer payments are removed, most agencies are not over recovering. A notable exception is ASIC, whose cost recovery charges are used by the Government to fund a variety of other commitments including compensation payments to the States and the Northern Territory. Even after deducting these payments, ASIC's net cost recovery revenues are significantly greater than its own expenses.

Information agencies tend to supply most or all of their basic products free.

Information agencies generally recover small proportions of their total costs. Typically, these agencies distinguish between basic products, which are funded through general

taxation revenue, and additional products, which may be cost recovered.

Cost recovery in selected information agencies, 1999-2000

Agency	*Cost recovery revenue*	*Cost recovery/ total expenses*
	$m	%
Australian Bureau of Agricultural and Resource Economics	11	51
Australian Bureau of Statistics	22	8
Australian Geological Survey Organisation	12	17
Australian Surveying and Land Information Group	5	14
Bureau of Meteorology	35	17
National Library of Australia	9	17
ScreenSound Australia	2	4

Regulatory and information agencies have different degrees of discretion in setting charges. Information agencies, on the whole, have considerable latitude in setting their fees, although they are sometimes constrained by international agreements. Further, some regulatory and information agencies have had cost recovery targets imposed on them. Generally, information agencies have lower targets (for example, the Australian Geological Survey Organisation has a 30 per cent target) than those of regulatory agencies (for example, the Therapeutic Goods Administration and the Australian Prudential Regulation Authority have 100 per cent targets).

Cost recovery targets are currently imposed on some agencies.

Regulatory agencies employ a wide variety of fees-for-service and earmarked taxes (including levies) to recover their costs. On the other hand, information agencies that cost recover do so largely by way of fees (for products or for access).

Regulatory charges may be fees or taxes, whereas information agencies use fees.

The legal foundation for cost recovery varies, with some uncertainty about the legal standing of some cost recovery charges. Under the Constitution, taxes (often described as levies) require explicit and stand-alone legislative backing. Under certain circumstances — for example, where charges are not directly related to the costs of providing a service to a particular user — fees may be subject to challenge as inappropriately amounting to taxation.

Appropriate legal authority is essential.

Agencies' rationales for cost recovery

Agencies recover costs for a variety of reasons

The lack of a coherent policy governing cost recovery, along with the different circumstances in which agencies operate, is reflected in the diversity of rationales that agencies mentioned in response to the Commission's questionnaire. These rationales included:

- raising agency revenue;
- increasing efficiency;
- managing demand;
- expediting approval processes;
- expanding the volume and/or range of services;
- addressing equity or distributional issues;
- conforming with international agreements; and
- abiding by competitive neutrality requirements.

… but these are not always explicit.

Some agencies also provided explicit rationales for *not* recovering the costs of certain activities or products. But, many agencies did not provide any rationale for their arrangements beyond attributing their introduction or existence to Government policy or administrative decisions.

Cost recovery by regulatory agencies is inconsistent.

Regulatory agencies, as a group, have not been consistent in identifying which activities should be cost recovered.

Information agencies tend to have clearer rationales.

In comparison, information agencies, on the whole, have developed structured objectives for their cost recovery arrangements. However, there is an inherent tension between cost recovery and information agencies' overall objective of providing information.

Impact on agencies

Agencies face mixed incentives.

Cost recovery can create both positive and negative incentives for the agencies involved, and this has important implications both for the desirability of introducing cost recovery and for its appropriate design.

Cost recovery can improve agency efficiency by instilling cost consciousness and promoting demand responsiveness. But it can also weaken Government scrutiny through normal budget processes. To the extent that agencies become in effect self-funding, there is less incentive for their respective portfolio departments and expenditure review processes to subject them to close scrutiny.

Efficiency may be encouraged, but budget scrutiny may weaken.

According to a number of participants, cost recovery has led to regulatory creep and cost padding. These can occur when cost recovery revenues are earmarked to the agency and when the agency is a monopolist (as is the case for most regulatory agencies and some information agencies). Further, cost recovery may also encourage agencies to pay less attention to non-cost recoverable activities.

Regulatory creep and cost padding are risks.

Thus, the treatment of cost recovered revenues in the budget framework can have important effects on agency incentives. Under the Constitution, most regulatory and information agencies must pay revenue raised through cost recovery into the Commonwealth's Consolidated Revenue Fund, and then be funded through budget appropriations. In practice, many agencies have access to mechanisms that 'earmark' cost recovery revenues to their use. The most common are net appropriation agreements (that is, section 31 agreements under the *Financial Management and Accountability Act 1997*).

The budget framework is important.

Impact on users

Even where agencies are operating efficiently and, in the case of regulatory agencies, where the regulation is appropriate, cost recovery may have impacts on users of Government goods and services.

Cost recovery may make information agencies more responsive to market demands; it has often made some services possible that otherwise would not have been undertaken. The adaptation of ABS surveys and the tailoring of meteorological services for particular users are examples

Cost recovery can help information agencies respond to users.

of such services. However, inappropriate cost recovery can significantly restrict access to information.

Distinguishing the impacts of cost recovery from those of regulations is difficult

In the case of regulatory agencies, it is often difficult to distinguish the impacts of cost recovery from the effects of the regulations themselves, or from market conditions. Nonetheless, some participants expressed concerns about the effects of cost recovery on industry and individual consumers.

… but in some cases cost recovery may create barriers to entry

In some cases, cost recovery charges may act as barriers to the market entry of new firms or products. This may occur because the lack of property rights over regulated products creates 'free rider' problems. This is mainly relevant in the case of pre-market regulation. Charging, for example, could discourage firms from applying for variations in food standards that would also benefit all other subsequent suppliers. Alternative approaches might need to be considered: either a levy on all firms that stand to benefit or, where this is not cost effective, general taxation funding.

… and discourage innovation.

Even where the absence of property rights is not an inhibiting factor, the level of cost recovery may prevent or discourage firms' entry into markets. Cost recovery also has the potential to impede the entry of new, more technologically advanced products into the market. The difficulty in assessing these impacts is in not knowing what might have happened in the absence of cost recovery. The possible impacts of cost recovery must also be weighed against other factors such as high compliance costs and small market size.

Small businesses receive some concessions.

The design of cost recovery arrangements can have particular effects on small business; for example, a flat fee may have a greater impact on a small firm than would a levy based on turnover or sales. Some agencies have introduced sliding fee scales and exemptions for very small firms or products with low levels of demand. However, the more that charges are uncoupled from the underlying cost structures, the less efficient those arrangements would be.

Final consumers are seldom directly affected by Commonwealth cost recovery charges. Notable exceptions include visa and passport applications and some licensing of individuals (for example, pilot licences). Most of the impact on consumers occurs indirectly through firms passing on cost recovery fees and charges to their customers. In practice, this means that cost recovery charges are usually borne jointly by the firm and its customers, depending on the competitive circumstances.

Most impacts on consumers are indirect.

Why have cost recovery?

Cost recovery can provide an important means of improving the efficiency with which Government services are produced and consumed. Charges for goods and services consumed can give important messages to users or their customers about the costs of the resources involved.

Cost recovery can improve economic efficiency.

The degree to which users of Government services respond to price signals will vary according to their level of discretion in paying cost recovery charges. The customers of information agencies can generally choose whether to purchase a product, and how much to purchase.

Its effects may be more pronounced where consumption is discretionary

Regulated firms may also react to the amount of cost recovery charges they incur, such as where charges are related to their output. But, in the case of pre-market regulation, firms basically have only a binary choice: to participate in the market and be regulated, or to decline to participate. They cannot choose how much regulation to consume at this stage. Charging for regulatory services can nevertheless have impacts on resource flows in the economy by altering industry costs and thus influencing industry size.

… but it may also affect resource allocation in regulated industries.

To the extent that cost recovery reduces the call on general taxation revenue, efficiency losses from higher general taxation are avoided. However, if cost recovery is not linked to the supply of a particular activity and is undertaken merely to raise revenue, then it is likely to have more adverse effects on efficiency than those of funding through general taxation.

Cost recovery may be more efficient than raising the general level of taxation.

Improving efficiency is a fundamental principle

From these considerations a fundamental principle emerges, namely that cost recovery should be implemented for efficiency reasons, not merely to raise revenue.

… and improving equity a supporting principle.

Cost recovery may also have equity effects. It may improve 'horizontal' equity by ensuring that those who use regulated products or request additional information, bear the costs. This suggests that an important supporting principle is that cost recovery should improve equity by reducing the dependence on general taxation.

Generally the administrative costs of regulation should be recovered.

For regulatory agencies, these broad principles suggest that the prices of regulated products should incorporate all of the costs of bringing those products to market, including the administrative costs of regulation. This applies both where the regulation provides benefits to consumers and/or producers, and where it specifically addresses negative spillover effects that may occur (for example, regulation that decreases the risk of pollution).

Charging regulated firms will often be more practical than charging consumers.

One way of making consumers of regulated products recognise the regulatory costs involved would be to charge them directly. However, this approach often would be impractical. Charging regulated firms may be a more cost effective option if they are able to pass on some or all of the costs. In this case, consumers of regulated products would still ultimately pay. Where it is also impractical to charge the regulated firms, there may be a case for taxpayer funding of the regulatory activity.

Cost recovery for information agencies should be limited to additional products

For information agencies, the above principles would suggest that cost recovery is inappropriate where information products have a high degree of 'public good' characteristics or where there are significant positive spillovers. Information products that meet these tests would be budget funded as part of a basic product set. Other information products may nonetheless be included in the basic product set if the Government decides that there are explicit policy reasons for doing so. Additional information products would be assessed for cost recovery.

Deciding whether information products should be in the basic product set or not will require a mix of economic

analysis and policy considerations. To this end, information agencies and the Government together should define the basic product set.

… which can be classified into three categories.

Additional information products should be classified into three broad categories and priced accordingly:

- dissemination of existing products at marginal cost;
- incremental products (which may involve additional data collection or compilation) at incremental (avoidable) cost; and
- commercial (contestable) products according to competitive neutrality principles.

Charges for additional products should not attempt to claw back the costs of providing the basic product set.

But sometimes there are reasons not to cost recover.

For both regulatory and information activities or products, cost recovery may not be warranted where:

- it is not cost effective;
- it would be inconsistent with policy objectives; or
- it would unduly stifle competition and industry innovation (for example, through 'free rider' effects in the case of regulation).

Operational principles

Cost recovery should:

The operational principles that apply to all cost recovery arrangements follow from these general principles.

… be implemented using fees for service wherever possible;

Economic efficiency will be improved by linking cost recovery charges as closely as possible to the costs of activities or products. This will be best achieved by using fees-for-service reflecting efficient costs wherever possible. Where this is not possible, specific taxation measures (such as levies) may be appropriate but only where the basis of collection is closely linked to the costs involved.

… and apply to activities not agencies.

Most agencies undertake a range of activities that have different objectives and characteristics. The nature of these activities can be very different and the cost recovery issues

arising from each also will differ. Therefore, cost recovery arrangements should apply to specific activities, not to the agency that provides them.

It should not:

… be distorted by externally imposed targets;

This implies that the practice of requiring agencies to recover a specific proportion of their total costs ('targets') should be discontinued. Externally imposed targets, even for individual activities, can create perverse incentives, such as information agencies losing sight of their public interest obligations and regulatory agencies focusing on new ways in which to extend their revenue raising activities.

… or used to finance unrelated Government activities;

'Over-recovery', whereby an agency is required to recover more than the costs of a particular activity so as to fund other unrelated Government commitments, is particularly inappropriate.

… or activities undertaken for Government.

Cost recovered activities should exclude activities undertaken for the Government (such as policy development, Ministerial or Parliamentary services), or to comply with certain international obligations. These public interest duties would be undertaken even in the absence of regulation.

Partial cost recovery is generally inappropriate.

The principles also suggest that partial cost recovery is generally inappropriate — either the costs of an activity or product are recovered in full or funded from general taxation revenue. Deviating from this rule would involve making subjective decisions about the degree of public and private benefits involved.

Design principles

The design of cost recovery is also important.

The design of cost recovery arrangements can have a significant effect on efficiency. Once an in-principle decision to implement cost recovery is made, a number of design principles apply.

It should avoid cross-subsidies between user groups

Cross-subsidisation can undermine efficiency and generally should be avoided. Some cross-subsidies may be acceptable where an industry levy is used to fund activities that benefit the industry as a whole (or its customers), or where charging

individual firms a fee-for-service is impractical or inconsistent with policy objectives.

It is generally inappropriate for regulatory agencies to have automatic access to cost recovery revenues from compulsory regulatory activities without adequate budgetary and Parliamentary scrutiny.

… and restrict automatic access to cost recovery revenues.

It is also imperative that external systems are implemented to strengthen agency accountability and encourage agency efficiency. Several instruments are available for this purpose, such as Department of Finance and Administration output pricing reviews, and internal or external (Australian National Audit Office) performance audits. These might be supported by the use of agency-specific 'efficiency dividends', price monitoring, benchmarking, mutual recognition and market testing.

Accountability for performance is imperative.

Cost recovery should be subject to the same public administration principles that apply to all Government activity. Governance arrangements are an important means of encouraging agencies to adopt these principles and to fulfil their obligation to deliver efficiently produced services.

Better governance

Some industry participants have made strong claims for a greater say in the operation of agencies that cost recover, invoking a 'user pays, user says' argument. While this creates a risk of undue influence (or 'agency capture'), a degree of industry consultation is desirable to help drive agency efficiency. Those expected (or required) to pay have a clear interest in the costs, efficiency and quality standards of activities, and this interest should be harnessed.

… should include industry consultation.

The Commission supports the strengthening of consultative arrangements where necessary and suggests the adoption of the following criteria for consultative committees: stakeholder representation; an independent chairperson; the ability to monitor agency efficiency; access to adequate information; and transparent processes.

Criteria for stakeholder consultation are needed.

Guidelines

The terms of reference of this inquiry asks the Commission to report on appropriate guidelines for cost recovery. The evidence and analysis available to the Commission support the need for such guidelines to fill the current policy vacuum.

The Commission has produced Guidelines for Commonwealth regulatory and information agencies.

Given the different issues involved, the Commission has produced separate (but consistent) Guidelines for regulatory and information agencies based on the principles outlined above. The Guidelines feature a series of decision trees that assist departments and agencies to identify those activities or products for which cost recovery is appropriate, and to determine the best arrangements for its implementation. They also address the need for ongoing monitoring and review of cost recovery arrangements.

While the Guidelines may have broader application, they were not written with the intention of being applied to government business enterprises or infrastructure services provided by the Government. While the Guidelines apply to the cost recovery arrangements of agencies that serve both private and public sector users, they are not designed to address pure inter-agency charging arrangements. But, where such arrangements exist between agencies (one of which recovers costs from the private sector), they should be transparent.

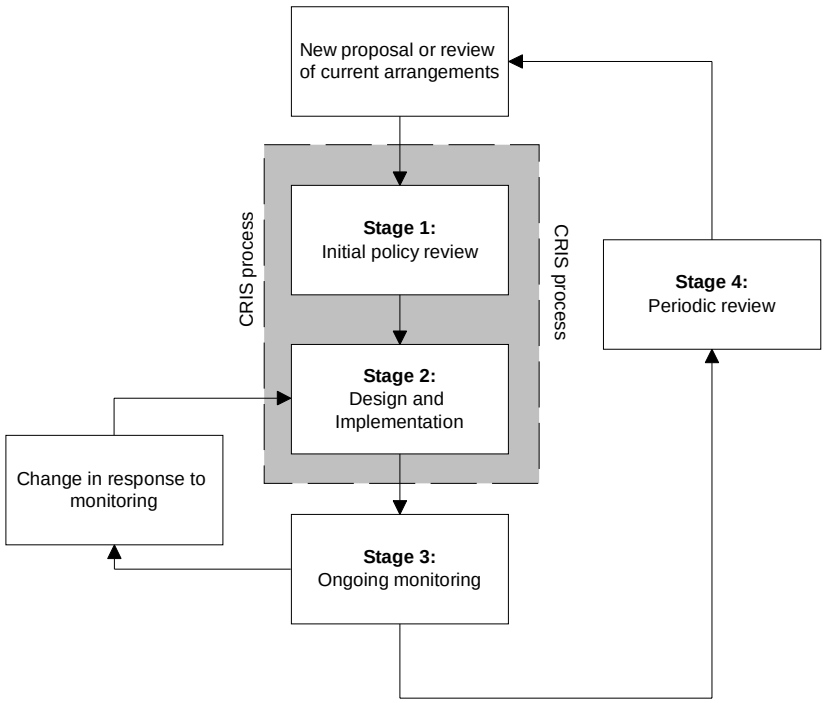
The Guidelines involve the production of a Cost Recovery Impact Statement.

The Guidelines establish a four-stage process. A feature of this process is the production of a Cost Recovery Impact Statement (CRIS) for all significant cost recovery arrangements. The CRIS would encapsulate the initial policy and implementation reviews, and be submitted to the appropriate decision maker for approval. Where a Regulation Impact Statement (RIS) is already required it should deal with cost recovery, in lieu of a separate CRIS. A CRIS report should:

- address all of the issues posed in the Guidelines unless a particular issue is not relevant to an agency;
- involve stakeholder consultation;
- be signed off by the agency;
- be assessed by an independent body; and

- together with the independent assessment, be publicly available.

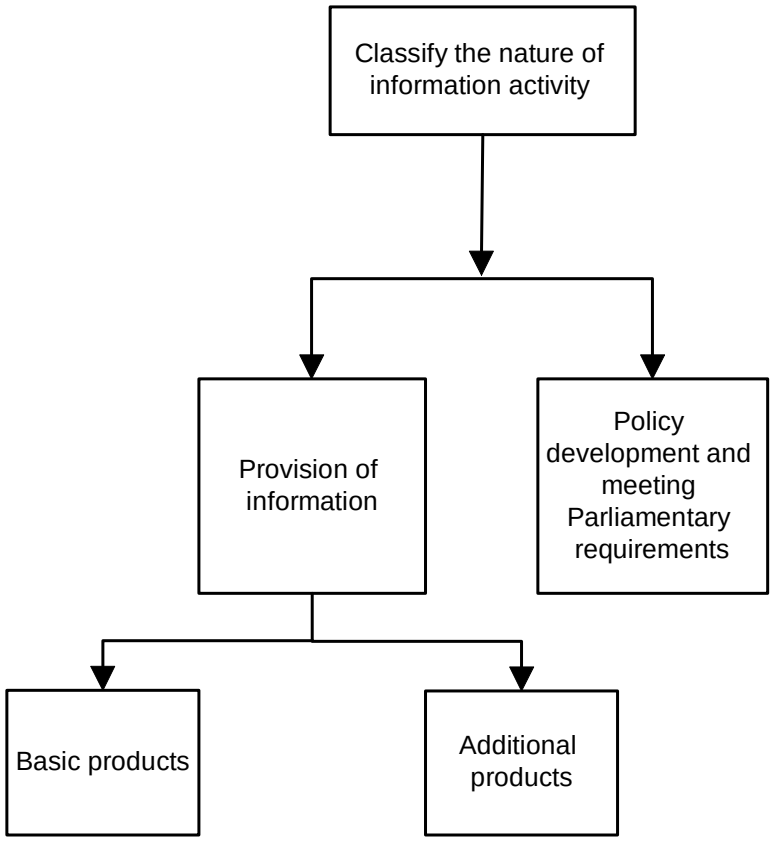
Processes for assessing cost recovery



An important part of this process requires both information and regulatory agencies to classify their activities. At a broad level information agencies need to distinguish the provision of products to information users from meeting general policy requirements of Parliament. Further distinctions should then be drawn between basic products (funded from general taxation revenue) and additional products (potentially cost recovered).

Agencies need to classify their activities.

Classification of information activities

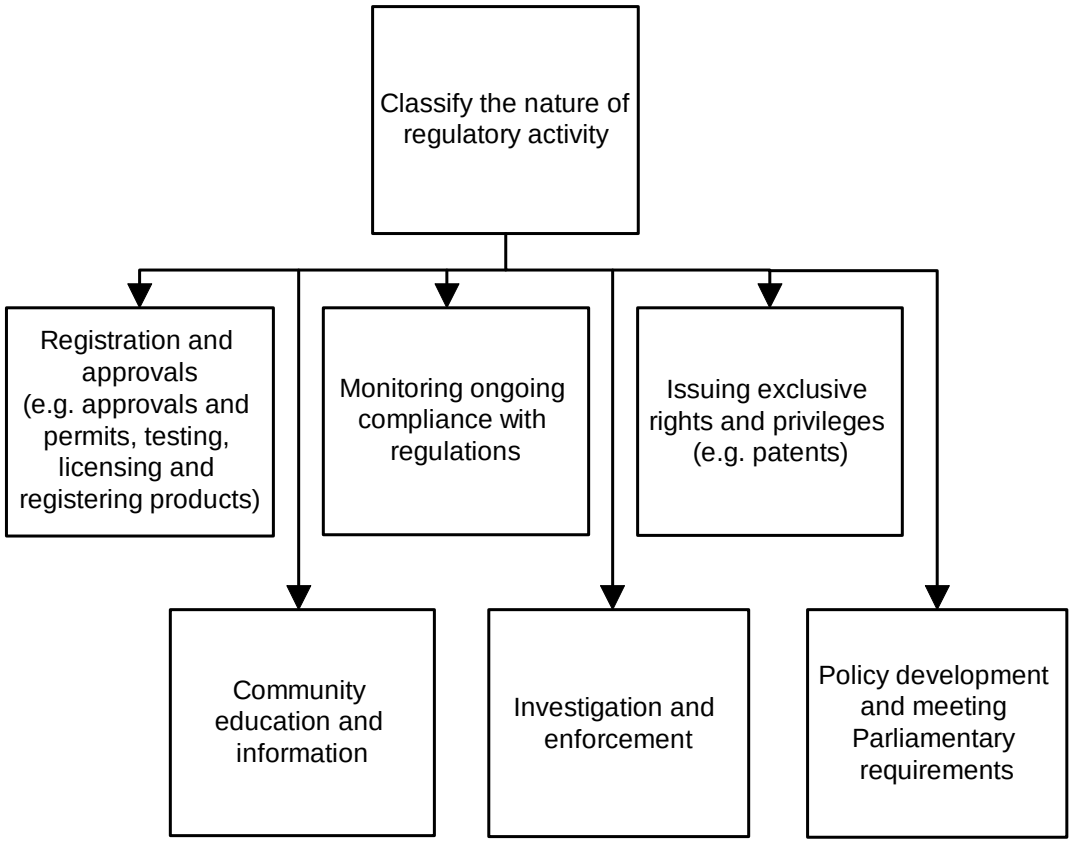


Classifying regulatory activities is complex.

Regulatory agencies potentially undertake a variety of activities. The general principles suggest that registration, monitoring compliance and issuing of exclusive rights would be assessed for cost recovery, while other activities usually would be funded from general taxation revenue.

If it is decided, based on these classifications, that cost recovery may be appropriate, then further steps are necessary. These include assessing the nature of the cost recovery arrangements, estimating the relevant costs and identifying which parties to charge. The Guidelines provide more details of these processes.

Classification of regulatory activities



Cost recovery under the Trade Practices Act

The inquiry includes a review of cost recovery under the Trade Practices Act.

The inquiry incorporates a review of fees charged under the *Trade Practices Act 1974*. This review stems from the Government's commitment under the Competition Principles Agreement to review legislation that restricts competition. This aspect of the inquiry attracted very little attention from participants.

ACCC charges under the Act

Under the Act, the Australian Competition and Consumer Commission (ACCC) charges for arbitration functions; various applications (including applications for authorisations and notifications, and those relating to conference agreements by international shippers); copying of

registers; and discretionary services such as conducting workshops and some publications.

… do not raise much revenue.

The ACCC collected around $1.2 million in charges under the Act in 1999-2000 — around 2 per cent of its total operating revenue of $58.4 million. Around half of this revenue was earned from charging for discretionary products and is earmarked for the ACCC's use.

Cost recovery should not apply to many ACCC activities.

Many ACCC activities associated with general compliance and enforcement should not be cost recovered, and in no case is the ACCC charging for services where it should not.

Current charges appear to comply with CPA tests.

Current charges under the Act are not inconsistent with the competition tests under the Competition Principles Agreement. They do not appear to have a significant impact on business or competition. The fees associated with ACCC regulatory functions appear to be very small compared with the overall costs of compliance with the Act.

But the ACCC practice of setting charges at lowest expected cost

The ACCC recovers only the lowest expected cost of providing arbitrations, some applications, notices and copies of some registers. This policy is designed to minimise the possibility of these charges being legally interpreted as taxes.

… is nevertheless inconsistent with the Guidelines.

The charges should reflect costs more closely.

However, this practice is inconsistent with the proposed Guidelines. Where cost recovery is warranted, the Guidelines suggest that fees be more closely matched to the cost of services provided. Subject to the completion of a Cost Recovery Impact Statement, the ACCC should adopt a cost reflective approach to setting charges for those activities for which it is appropriate to charge. Any departure from this general principle should be justified in the CRIS.

Some implementation issues

The Government should move quickly to release an endorsed set of guidelines

The Commission has produced cost recovery Guidelines for the Government's consideration. As an important first step, the Government should adopt a formal cost recovery policy that endorses the Guidelines recommended by this inquiry. A second step would be to integrate those Guidelines with existing financial and regulatory processes.

The prompt release of endorsed guidelines would enable the Government to move quickly into the recommended individual reviews of existing cost recovery arrangements. It would also provide a framework for assessing new cost recovery proposals. The review of existing arrangements would be a substantial task but should be completed within five years. This would require the Government to develop a schedule of reviews.

… and review existing cost recovery arrangements over the next five years.

Each review would result in the production of either an enhanced Regulation Impact Statement (RIS) or a Cost Recovery Impact Statement (CRIS). It would involve stakeholder consultation, be subject to independent scrutiny, and be conducted as transparently as possible. These reviews would not be costless, so to achieve net benefits from the process, only significant cost recovery arrangements should be examined.

Reviews should involve stakeholder consultation, independent scrutiny and transparent processes.

Ongoing monitoring of cost recovery also needs to be improved. Cost recovery revenue should be identified separately and reported in Portfolio Budget Statements and agency annual reports.

Better methods for monitoring cost recovery are also needed.

How would the Commission's proposals affect the community?

Throughout this inquiry participants expressed concern about the cost recovery practices of Commonwealth agencies. The community is right to be dissatisfied with the lack of logic and inconsistency of the current arrangements. Effective implementation of the proposed Guidelines for cost recovery would produce tangible benefits for Australian industry and the community.

Implementation of the Commission's recommendations would have benefits of:

It would improve economic efficiency by directly linking charges to the costs of activities or products. It would also provide mechanisms by which agency efficiency can be improved.

… efficiency;

It would improve equity by ensuring that costs are borne by users rather than non-users.

… equity;

… rigour;	It would provide a clear and consistent framework within which to review and implement cost recovery, thus reducing the risk of inappropriate practices.
… transparency;	It would promote greater transparency and accountability of cost recovery objectives and processes.
… and user confidence.	It would provide those paying cost recovery charges with greater confidence in the general basis on which costs are recovered, the charges they are paying, and the reasonableness of the cost base from which charges are derived.
The impact on the budget is uncertain	Implementing the Commission's recommendations and adopting the Guidelines would affect the budget. Cost recovery on an activity or product (rather than agency) basis and removing cost recovery targets are likely to reduce cost recovery revenues. Net budget outlays may also have to increase to replace the cost recovery of unrelated Government objectives, policy development, Ministerial and Parliamentary services and meeting certain international obligations. On the other hand, the adoption of cost reflective pricing may increase cost recovery revenues in some cases.
… but is likely to be small compared with the benefits.	These effects will only become clear as existing cost recovery arrangements are reviewed according to the Guidelines over the next five years. While there may in due course be a small negative impact on the budget, what is more important is that cost recovery policy is soundly based. Only then will the economic and social benefits be realised.

Recommendations and findings

Chapter 3 Legal and fiscal framework

RECOMMENDATION 3.1

All cost recovery arrangements should have clear legal authority. Agencies should identify the most appropriate authority for their charges and ensure that fees-for-service are not vulnerable to challenge as amounting to taxation.

FINDING

There is currently a lack of transparency and accountability in many cost recovery arrangements. It is difficult to identify from existing sources the overall level of cost recovery by Commonwealth regulatory and information agencies. Publicly available data are incomplete and inconsistent, and the Department of Finance and Administration is unable to identify cost recovery receipts separately from other revenue.

Moreover, at the individual agency level, it is difficult to establish the objectives, costing and revenue raising of many cost recovery arrangements.

RECOMMENDATION 3.2

Revenue from the Commonwealth's cost recovery arrangements should be identified separately in budget documentation and in the Consolidated Financial Statements. It should also be identified separately in each agency's Annual Report and in Portfolio Budget Statements.

FINDING

The absence of current cost recovery guidelines has led agencies to rely on outdated publications such as the Guidelines for Costing of Government Activities *(DoF 1991),* ad hoc *reviews and consultants' advice.*

FINDING

Regulation Impact Statements assess proposed regulation but have not dealt directly with many cost recovery proposals.

Chapter 4 Current cost recovery arrangements

FINDING

There is no clear, current Government policy on cost recovery.

FINDING

The rationales for cost recovery of most information agencies are generally better developed and articulated than those of regulatory agencies.

FINDING

Cost recovery arrangements exist, to some extent, in most Commonwealth regulatory and information agencies. However, there is little consistency in the application of these arrangements. Generally, there is no uniform approach as to which activities or products are subject to cost recovery and which are not.

RECOMMENDATION 4.1

The Commonwealth Government should adopt a formal cost recovery policy for agencies undertaking regulatory and information activities. This policy should implement the cost recovery Guidelines recommended by this inquiry.

Chapter 5 Effects of cost recovery

FINDING

Not all cost recovery arrangements are consistent with agency policy objectives.

FINDING

Cost recovery charges for some regulated products may have impeded market entry, particularly for products with small sales and/or a short market life. However, barriers to entry arising from cost recovery charges are difficult to distinguish from those arising from the regulations themselves or from general market factors.

FINDING

Where there are no exclusive capturable benefits, direct regulatory charges may inhibit the introduction of new products.

FINDING

Australian consumers pay some cost recovery charges directly and may be affected indirectly through higher prices or less choice of products.

Chapter 6 Cost recovery under the *Trade Practices Act 1974*

FINDING

Current Trade Practices Act charges appear to have little if any impact on competition and economic efficiency and hence are not inconsistent with the competition tests under the Competition Principles Agreement. They do not appear to:

- *restrict access to the activities for which they are charged;*
- *impose a significant burden on firms (they appear to be relatively small compared to the transaction costs and potential private benefits); or*
- *substantially affect small to medium firms.*

RECOMMENDATION 6.1

Subject to the completion of a Cost Recovery Impact Statement, the Australian Competition and Consumer Commission should adopt a cost reflective approach to setting charges for those activities for which it is appropriate to charge. Any departure from this general principle should be justified in the Cost Recovery Impact Statement.

RECOMMENDATION 6.2

The Australian Competition and Consumer Commission should improve public information on the costs that Trade Practices Act charges are intended to recover.

Chapter 7 Improving the design of cost recovery

RECOMMENDATION 7.1

Cost recovery arrangements that are not justified on grounds of economic efficiency should not be undertaken solely to raise revenue for Government activities.

RECOMMENDATION 7.2

Cost recovery arrangements should apply to specific activities or products, and not to the agency as a whole.

RECOMMENDATION 7.3

Cost recovery of activities should exclude those undertaken for the Government (such as policy development, and Ministerial or Parliamentary services), or to comply with certain international obligations.

FINDING

Some agencies have been required to meet cost recovery targets. This has led to some agencies inappropriately recovering costs for activities (such as policy development, and Ministerial or Parliamentary services, and complying with certain international obligations), and may have distorted work priorities.

RECOMMENDATION 7.4

The practice of the Government setting targets that require agencies to recover a specific proportion of total agency costs should be discontinued.

FINDING

Cost recovery can be a useful tool for conveying price signals.

FINDING

Information agencies generally have attempted to link their cost recovery arrangements with the objectives of the agency itself, by distinguishing between basic and additional information products. However, it is often difficult to define clearly the boundary between the two.

RECOMMENDATION 7.5

Agencies and the Government together should define a basic information product set. This should be a dynamic process, with basic information products determined by reference to:

- ***'public good' characteristics;***
- ***significant positive spillovers; and***
- ***other Government policy reasons.***

RECOMMENDATION 7.6

The basic information product set of agencies should be funded from general taxation revenue.

RECOMMENDATION 7.7

As a general principle, the costs of providing information products that are additional to the basic product set should be recovered. However, cost recovery should not be implemented where:

- ***it is not cost effective;***
- ***it would be inconsistent with policy objectives; or***
- ***it would unduly stifle competition and industry innovation.***

RECOMMENDATION 7.8

Additional information products should be classified into three broad categories and priced accordingly:

- ***dissemination of existing products at marginal cost;***
- ***incremental products (which may involve additional data collection or compilation) at incremental (avoidable) cost; and***
- ***commercial (contestable) products according to competitive neutrality principles.***

RECOMMENDATION 7.9

As a general principle, the administrative costs of regulation should be recovered, so that the price of each regulated product incorporates the cost of efficient regulation. Cost recovery should not be implemented where:

- ***it is not cost effective;***
- ***it would be inconsistent with policy objectives; or***
- ***it would unduly stifle competition and industry innovation.***

RECOMMENDATION 7.10

Cost recovery charges should be linked as closely as possible to the costs of activities or products. Fees-for-service reflecting efficient costs should be used wherever possible. Where this is not possible, specific taxation measures (such as levies) may be appropriate but only where the basis of collection is closely linked to the costs involved.

Chapter 8 Improving agency efficiency

FINDING

Many information agencies have automatic access (for example, through net appropriation agreements) to cost recovery revenue from the sale of additional information products. This revenue is not subject to close budgetary and Parliamentary scrutiny. It is, however, subject to a degree of market discipline, which can help drive agency efficiency.

FINDING

Many regulatory agencies have automatic access (for example, through net appropriation agreements) to cost recovery revenue from compulsory regulatory activities. This revenue is not subject to close budgetary and Parliamentary scrutiny, or to market discipline.

RECOMMENDATION 8.1

Agencies should not have automatic access to cost recovery revenue from compulsory regulatory activities. Funding for these activities should be subject to the same budgetary and Parliamentary scrutiny as activities funded from general taxation revenue.

RECOMMENDATION 8.2

Agencies with significant cost recovery arrangements should have adequate mechanisms in place to promote meaningful consultation with stakeholders. Consultative committees should include the following characteristics:

- ***stakeholder representation;***
- ***a chairperson independent of the agency;***
- ***ability to monitor agency efficiency;***
- ***access to adequate information on agency processes and costs; and***
- ***transparent reporting processes.***

FINDING

Improving agency efficiency can reduce the cost burden on those subject to cost recovery and taxpayers alike. Mechanisms such as efficiency dividends, benchmarking, market testing and third party competition can help drive agency efficiency. Harmonisation of standards and mutual recognition can also encourage regulatory agency efficiency by improving the contestability of assessment and approval processes.

FINDING

The confidential nature of output pricing reviews limits the ability of stakeholders to promote agency efficiency.

RECOMMENDATION 8.3

All existing, new and amended cost recovery arrangements of a significant nature should be assessed against the Guidelines recommended by this inquiry. All significant cost recovery arrangements should then be subject to periodic review, at least every ten years.

RECOMMENDATION 8.4

The Regulation Impact Statement process should be clarified to make it explicit that, where a regulation under review includes a significant cost recovery element, the Regulation Impact Statement should apply the Guidelines recommended by this inquiry.

RECOMMENDATION 8.5

A Cost Recovery Impact Statement process should be applied to all significant cost recovery arrangements not covered by a Regulation Impact Statement. These include:

- ***existing cost recovery arrangements;***
- ***new cost recovery proposals for regulations that affect individuals, not businesses;***
- ***new cost recovery proposals of information agencies; and***
- ***periodic reviews.***

RECOMMENDATION 8.6

An independent review body should be appointed to assess whether Cost Recovery Impact Statements adequately address the cost recovery Guidelines.

RECOMMENDATION 8.7

Agencies that cost recover should publish Cost Recovery Impact Statements and the assessment of the independent review body on their websites and include a summary in their Annual Reports. Cost Recovery Impact Statements should also be made available to Parliament through tabling or publication in Portfolio Budget Statements.

Chapter 9 Implementation

RECOMMENDATION 9.1

All existing significant cost recovery arrangements should be reviewed against the Guidelines within five years. The Department of Finance and Administration should prepare a review schedule.

PART ONE

1 About this inquiry

The Commonwealth Government has asked the Productivity Commission to review cost recovery arrangements across the Government's regulatory, administrative and information agencies, and to develop guidelines for the future application of cost recovery.

1.1 What is cost recovery?

Until recently, most government activities, other than those of government business enterprises, were largely funded from general taxation revenue. However, governments increasingly have been recovering some or all of the costs of particular activities by more direct means. Commonwealth agencies' cost recovery charges can include fees, levies and specific-purpose earmarked taxes.

Cost recovery charges may be imposed for a number of reasons, including:

- to provide incentives to improve the efficiency of government service provision;
- to influence demand for government goods and services ('products');
- to provide resources for government agencies additional to those resources available from general taxation revenue; or
- to improve the equity of the distribution of the costs of government activities.

Cost recovery charges can be implemented in different ways, but tend to fall into two broad categories: fees and taxes. Fees include fees-for-service (which include charges for the provision of both goods and services) and royalties, whereas taxes include levies, excises and customs duties.

Cost recovery is different from general taxation even though it includes some specific-purpose taxes. General taxation raises revenue to fund a wide range of government activities, with no direct link between the source of the tax and the expenditure of the revenue raised. Cost recovery, on the other hand, is the recovery by government of some or all of the costs of a particular activity. The most direct form of cost recovery involves charging the users of a government product a fee based on the cost of providing that product. Less direct forms of cost recovery include special levies or taxes that raise revenue from a defined group of users to

fund specific government activities. The direct link between the revenue and the funding of a specific activity distinguishes such 'cost recovery' taxes from general taxation.

There have been various attempts to apply an analytical framework to cost recovery by Commonwealth Government agencies. These have been done largely on a case by case basis, without an overarching framework. The former Department of Finance (now the Department of Finance and Administration) released a number of guides, including the *Guidelines for Costing of Government Activities* (DoF 1991) and the *Guide to Commercialisation* (DoF 1996). The Australian National Audit Office has also completed a number of reports that have shaped the cost recovery arrangements of Government agencies. Further, several reports have been undertaken on particular agencies and industries, such as the *Report of the Independent Inquiry into Aviation Cost Recovery* (Bosch 1984), *Cost Recovery for Managing Fisheries* (IC 1992) and two reviews of the cost recovery activities of the Bureau of Meteorology (Slatyer 1996 and Slatyer 1997).

The lack of a consistent framework is evident. The rationale for charging arrangements is not always clear and not always explained in legislation. Some charges appear arbitrary or to be accidents of history. Further, it is not always clear why some agencies impose cost recovery for some activities while comparable agencies do not.

1.2 Purpose of the inquiry

A major purpose of this inquiry is to develop principles and guidelines for the future application of cost recovery by the Commonwealth Government. To be relevant and useful, the guidelines need to address the full variety of issues and circumstances likely to confront Commonwealth agencies.

The inquiry has three main tasks:

- a review of existing cost recovery arrangements by 'regulatory, administrative and information agencies';
- the development of guidelines; and
- a review of the cost recovery arrangements under the *Trade Practices Act (1974*) as part of the legislative review required by the Competition Principles Agreement between the Commonwealth and the States and Territories.

Review of existing cost recovery arrangements

The inquiry terms of reference require the Commission to undertake a review of the nature and extent of cost recovery arrangements by Commonwealth regulatory, administrative and information agencies, identifying the activities subject to cost recovery, the beneficiaries of those activities, and the factors underlying the arrangements.

The Commission is also required to evaluate the effect of these cost recovery arrangements on firms (particularly small business), consumers and the community, as well as on the agencies, and to examine the extent to which cost recovery arrangements meet best practice regulatory principles.

Development of guidelines for the future

The terms of reference direct the Commission to develop principles and guidelines for where and how cost recovery should be applied. The guidelines are also required to cover the design of cost recovery arrangements, including providing incentives for cost-effective service delivery.

The effects of new technology and legal constraints on the design and operation of cost recovery schemes are also considered. The digital revolution and the provision of services over the Internet are likely to affect the charging of many Government services.

The terms of reference relate to cost recovery arrangements by Commonwealth Government 'regulatory, administrative and information agencies'. While these provide the focus for the Guidelines developed in this report, the Guidelines could also be applied more generally. For example, they may have some relevance to State and local governments, which undertake a significant amount of cost recovery. They may also be useful to government agencies developing inter-agency charging arrangements.

The Commission has produced separate Guidelines for information and regulatory agencies. These are contained in part 2 of this report.

Review of fees charged under the *Trade Practices Act 1974*

The inquiry also incorporates a review of fees charged under the *Trade Practices Act 1974*. This part of the inquiry stems from the Government's commitment under the Competition Principles Agreement to review legislation that restricts competition. Thus, in addition to its own policy guidelines set out below, the

Commission must consider the Competition Principles Agreement requirement that legislation should not restrict competition unless it can be demonstrated that:

- the benefits of the restriction to the community as a whole outweigh the costs; and
- the objectives of the legislation can be achieved only by restricting competition.

This section of the terms of reference (paragraphs 5 and 6) contains many detailed criteria for the review of the Act, but there is substantial common ground between these criteria, the remaining terms of reference, the Commonwealth's standard requirements for regulation assessment and the Commission's own policy guidelines.

1.3 Scope of the inquiry

This inquiry encompasses a wide variety of cost recovery arrangements of Commonwealth Government agencies. The inquiry includes regulatory, administrative and information agencies that recover none of their costs, as well as those that recover some, all or more than full costs.

Agencies and activities

The terms of reference require the Commission to examine the cost recovery arrangements of regulatory, administrative and information agencies. This requires some distinction between different types of agency. All agencies in the Commonwealth public sector are administrative in some sense. So a more useful distinction is that between regulatory and information agencies. 'Regulatory agency' is a term that can encompass all agencies whose prime purpose is the administration of regulations.

'Information agency' is also a broad term. Virtually all agencies supply some information, but in many cases only information about the programs they administer. 'Information agency' is used to describe agencies whose prime purpose is the collection, compilation and dissemination of information. These include agencies such as the Australian Bureau of Statistics, the Bureau of Meteorology and cultural institutions and archives such as the National Library of Australia and ScreenSound Australia. Other agencies that may be described in other ways (such as intelligence agencies or research institutes) may nevertheless have significant roles in providing information, so they too have been considered in the review and Guidelines. Some agencies, such as the Australian Securities and Investments

Commission, are predominantly regulatory but also have a significant role in the provision of information.

The Commission found it useful to focus on activities and products rather than on agencies. The rationale for cost recovery of one activity or product might differ substantially from the rationale that applies to another activity or product, even within the same agency.

Policies and legislation

A wide variety of government policies have introduced arrangements that include cost recovery. This inquiry reviews the cost recovery arrangements themselves, not the overarching policies to which they relate. The inquiry examines the cost recovery arrangements of the Australian Quarantine Inspection Service, for example, but does not review the merits of quarantine policy. Nevertheless, it is difficult to evaluate the cost recovery arrangements of regulatory agencies without regard to the underlying regulatory processes. The design of cost recovery arrangements can provide both positive and negative incentives to those subject to regulation and the regulatory agencies. Consequently, this report's concerns include *how* regulatory or information activities should be undertaken but not *whether* they are undertaken. The Commission is also required under its policy guidelines to consider measures that reduce the regulation of industry where this is consistent with the social and economic goals of the Commonwealth, and to ensure good regulatory practices are followed.

This inquiry covers cost recovery arrangements authorised by specific legislation, as well as those implemented by regulation or administratively. The public inquiry process provides an opportunity for these arrangements to be reviewed in an independent, open and transparent manner.

Activities not covered by this inquiry

The Commission considers that some activities are outside the scope of this inquiry. One of the most notable exemptions concerns intra-government charging.

The focus of this inquiry is on recovering the costs of providing Commonwealth Government goods and services — that is, it is primarily concerned with charges collected from the private (and other non-government) sectors of the economy, not from other government agencies. Where one Commonwealth agency recovers costs exclusively from another Commonwealth agency (or agencies), cost recovery can be regarded as an alternative means of allocating budget funding. Although cost

recovery principles may be relevant to the design of these arrangements, they are not explicitly under review. However, where an agency supplies the same or similar goods or services to both the public and private sectors, there are sound economic and equity arguments for charging both groups in the same way.

Other payments to Commonwealth agencies that are not considered to be 'cost recovery' include:

- commercial arrangements by government business enterprises in contestable markets, such as telephony charges by Telstra, workers compensation payments to Comcare and payments under Commonwealth insurance schemes such as the Export Finance Insurance Corporation. (Commercial activities of regulatory and information agencies are under reference if they are related to cost recovery activities);
- general taxation (including the Medicare levy) as distinct from the many specific-purpose levies implemented through tax legislation which are covered by this inquiry;
- repayments of loans to the Commonwealth under policies for various purposes (for example, industry restructuring via the Rural Adjustment Scheme);
- asset sales, including the sale of rights to access resources such as radio frequency spectrum, fish stocks and mineral resources;
- fines and pecuniary penalties, whether imposed by courts or administratively under legislation; and
- payments by customers to non-Commonwealth organisations and firms for products where Commonwealth policies may affect the prices (for example, the Pharmaceutical Benefits Scheme and the co-payment of medical fees under Medicare).

Some payments to the Commonwealth would be excluded on more than one of these grounds.

1.4 Commission's approach

This is the first comprehensive inquiry into the cost recovery arrangements of Commonwealth Government regulatory, administrative and information agencies. Previous inquiries tended to focus on particular agencies and arrangements. Some agencies, such as the Australian Quarantine and Inspection Service and the Bureau of Meteorology, have been the subject of numerous reviews, while other agencies have had little scrutiny. The Commission has been concerned with drawing general lessons from current practices to guide the development of future arrangements,

rather than with reviewing or assessing in detail all existing approaches to cost recovery. Adoption of the recommended Guidelines should result in greater consistency in agencies' approach to cost recovery, while allowing sufficient flexibility to account for their particular circumstances.

The Commission is responsible for providing independent analysis and advice to the Commonwealth Government. In undertaking this inquiry, the Commission is bound by its Act and the terms of reference to use processes that are open and public. The public inquiry process is outlined in appendix A. The Commission is also bound by its Act to follow certain policy guidelines (box 1.1). These policy guidelines require the Commission to consider measures that will improve overall economic performance and encourage the growth of efficient and competitive industries. The Commission must also recognise the interests of all parties likely to be affected by proposed measures. Broadly, this means the Commission must look at what is best for the community as a whole, not just for particular industries or groups. Accordingly, the proposed Guidelines do not focus on achieving narrow outcomes, such as simply improving the Commonwealth Government's budgetary position or reducing firm costs.

The terms of reference also direct the Commission to have regard for the Competition Principles Agreement principles. These principles have much in common with the Commonwealth's analytical requirements for regulation assessment, which the terms of reference also require the Commission to follow. Assessment of regulations requires clarification of the objectives of the legislation, identifying whether and to what extent the charging arrangements impose costs or confer benefits on firms or restrict competition, and, in light of this, identifying relevant alternatives. The Commission is required to analyse and, as far as reasonably practical, quantify the benefits, costs and overall effects of the cost recovery arrangements and any alternatives proposed on the broader economy as well as the industries and different groups likely to be directly affected, including consumers and small business.

1.5 Conduct of the inquiry

Many individuals and organisations took the opportunity to participate in this inquiry. The Commission received 173 submissions[1] and 75 participants appeared in two rounds of public hearings. After the release of the draft report on 12 April 2001, the Commission conducted two workshops to test the recommendations and

[1] Submission DR173 from the Australian Securities and Investments Commission was received the day before the inquiry reporting date. The Commission was therefore unable to address specifically the issues raised in the submission.

Guidelines contained within the draft report. One workshop was held for regulatory agencies and the other for information agencies (see appendix A). This report reflects the many comments received by the Commission in response to the draft report. The success of an inquiry of this nature is partly due to the willingness of participants to inform the Commission of their views on the issues under review. The Commission is grateful for the contributions received.

Box 1.1 **Productivity Commission policy guidelines**

The Commission must have regard to the need:

(a) to improve the overall economic performance of the economy through higher productivity in the public and private sectors in order to achieve higher living standards for all members of the Australian community; and

(b) to reduce regulation of industry (including regulation by the States, Territories and local government) where this is consistent with the social and economic goals of the Commonwealth Government; and

(c) to encourage the development and growth of Australian industries that are efficient in their use of resources, enterprising, innovative and internationally competitive; and

(d) to facilitate adjustment to structural changes in the economy and the avoidance of social and economic hardships arising from those changes; and

(e) to recognise the interests of industries, employees, consumers and the community, likely to be affected by measures proposed by the Commission; and

(f) to increase employment, including in regional areas; and

(g) to promote regional development; and

(h) to recognise the progress made by Australia's trading partners in reducing both tariff and non-tariff barriers; and

(i) to ensure that industry develops in a way that is ecologically sustainable; and

(j) for Australia to meet its international obligations and commitments.

Source: *Productivity Commission Act 1998,* s.8.

Many users of the outputs of Commonwealth agencies made submissions that allowed the Commission to understand the effect of current cost recovery arrangements on industry and the community. Many Commonwealth Government agencies made submissions that allowed the Commission to understand the rationale for and operation of the current cost recovery arrangements.

The terms of reference require the Commission to report on the nature and extent of current cost recovery arrangements. The Commission has been hampered in this task by a lack of consistent and readily available information on cost recovery

arrangements. In an attempt to address this lack of information, the Commission undertook a survey of the cost recovery practices of Commonwealth Government regulatory and information agencies.

The survey covered quantitative and qualitative aspects of current cost recovery arrangements, including the amount of revenue raised; the size of this revenue relative to other sources of revenue; and the rationale for, and legal and institutional framework and operation of, these measures. Selected results from this survey are reported in chapter 4 and appendix B. Appendix J lists those agencies the Commission approached to participate in the survey and identifies those that responded. A more detailed report on the survey's results is available in hard copy from the Commission or can be accessed electronically on the Commission's website (www.pc.gov.au).

Case studies of particular agencies were undertaken to provide a more detailed consideration of current arrangements. These case studies relate to:

- information agencies such as the Australian Bureau of Statistics and the Bureau of Meteorology. Information agencies are different from regulatory agencies in many respects, and may require a different approach to cost recovery (see appendix C);
- public health and safety regulatory agencies such as the Therapeutic Goods Administration, the Civil Aviation Safety Authority and the National Registration Authority for Agricultural and Veterinary Chemicals. Public health and safety agencies are an example of regulatory agencies (see appendix D);
- the Australian Communications Authority, which is an example of an agency that both issues exclusive rights to use a community resource (in this case, radiocommunications spectrum) and regulates the users of that resource (see appendix E); and
- financial regulatory agencies such as the Australian Prudential Regulation Authority and the Australian Securities and Investments Commission (see appendix F).

1.6 Structure of report

In the first part of this report, the underlying economic rationale and legal and fiscal framework for cost recovery are discussed (see chapters 2 and 3 respectively). Current cost recovery arrangements are outlined (see chapter 4) and their effects are examined (see chapter 5). The fees charged under the Trade Practices Act are reviewed (see chapter 6). Proposals for improving the design of cost recovery arrangements and improving the efficiency of cost recovery agencies are presented

(see chapters 7 and 8). Some implementation issues for the Government are also identified (see chapter 9). Part 2 of this report contains the Commission's proposed Guidelines for cost recovery. Separate Guidelines are presented for information and regulatory agencies.

2 Economics of cost recovery

Chapter one introduced the concept of cost recovery and how it differs from general taxation. But why recover costs at all? Why not fund all government supplied goods and services (products) from general revenue sources such as the taxation system? The broad answer to these questions is that funding government activities and products through cost recovery can have quite different economic effects from financing them through general taxation. Because cost recovery can be used to make firms and consumers pay more directly for the products they receive from the government, it can be used as a tool for improving economic efficiency and equity. Cost recovery may also make possible offsetting cuts in taxation or the provision of additional government products.

2.1 Provision of government products

The private sector provides most products in Australia. Where markets are working well, efficient levels of production and pricing result. However, for a variety of social, cultural and economic reasons, governments (including the Commonwealth Government) also supply a large range of products, and regulate the way in which the private sector supplies particular products. For many government activities, it is neither possible nor appropriate to charge groups directly for those activities. Therefore, most Commonwealth Government activities are funded from general taxation through the budget. Expenditure on the social security system, defence and transfers to State Governments for the provision of social services such as hospitals and schools are major areas of activity financed through general taxation revenue. Applying full cost recovery to these types of government activities would not make sense economically or socially.

At the other end of the spectrum, the government supplies products that are not very different from those that private markets might (or could) supply. With many former government business enterprises now privately owned, government provision of private goods has shrunk considerably in recent years. Nevertheless, government agencies still supply some products that have private good characteristics. Government business enterprises aside, public agencies may be able to take advantage of economies of scope to produce such products as complements to their more traditional, public policy focused, products. Where government

agencies are providing products with private goods characteristics, it is usually appropriate to apply cost recovery.

While the reasons for government activities are many and varied, they often include the intention to address market failures. These arise from 'public good' characteristics, information problems, 'externality' or 'spillover' effects and/or monopoly characteristics (box 2.1). Thus, the Commonwealth Government is involved in providing defence (for public good reasons), pre-market assessment and labelling of some products (to address information failures), environmental protection (for spillover reasons), and regulation (or ownership) of natural monopolies (to control or avoid monopoly pricing).

Alternatively, where possible, the government may be able to devise a system of property rights to help private markets address market failures (for example, fishing licences). Or, where there are significant negative spillover effects, the government may simply ban certain products altogether (for example, a ban on an industrial process or use of a particular chemical). The presence of market failure — and the government's chosen response to it — can have implications for whether cost recovery should be applied and in what way.

2.2 Reasons for cost recovery

Cost recovery can be a means of improving the efficiency with which the government uses resources. It is also a means of raising revenue, although, in some circumstances, using cost recovery for this purpose may compromise the effects on economic efficiency.

Cost recovery may also have equity effects. In a public finance context, equity has both horizontal and vertical dimensions. Horizontal equity refers to treating people in similar situations in similar ways; for example, people with similar incomes paying similar amounts of tax to provide for government supplied products. In terms of cost recovery, horizontal equity can mean that those who benefit from government information products or have contributed to the need for regulation, pay the associated costs. Equity is improved by reducing the cost to general taxpayers, many of whom do not use the information products or consume the products of regulated firms.

Vertical equity refers to those with greater means contributing proportionately more than those with lesser means to the cost of government supplied products. Cost recovery could have vertical equity impacts if it results in different charging arrangements applying to different people or firms. However, in such cases, it may

be more appropriate to target vertical equity through subsidies to specific groups, rather than by weakening the economic integrity of cost recovery.

Box 2.1 **Market failure and government**

Government regulatory and information activities may address market failures arising from 'information gaps', 'public good' characteristics, 'spillovers', or 'natural monopoly' characteristics.

Public goods exist where provision for one person means the product is available to all people at no additional cost. Public goods are said be non-rivalrous (that is, consumption by one person will not diminish consumption by others) and non-excludable (that is, it is difficult to exclude anyone from benefiting from the good). Common examples include flood-control dams, national defence and street lights. Given that exclusion would be physically impossible or economically infeasible, the private market is unlikely to provide these goods to a sufficient extent. The nature of public goods makes it difficult to assess the extent of demand for them. It is ultimately a matter of judgement whether demand is sufficient to warrant government provision.

Private goods are the opposite — that is, rivalrous and excludable. If it is physically and economically feasible to identify and charge consumers and to exclude non-purchasers, then a private market will normally develop, provided it is profitable to do so.

Spillovers or **externalities** occur where an activity or transaction has positive (benefits) or negative (costs) economic welfare effects on others who are not direct parties to the transaction. An example of a positive spillover is disease immunisation, which protects the individual, but also lowers the general risk of disease for everyone. Governments often subsidise activities that have significant positive spillovers. Negative spillovers may include pollution, or a large building that blocks sunlight to its neighbours. Legal restrictions and/or pricing mechanisms can regulate such activities. Public goods and spillovers are similar analytically — spillovers have public good characteristics in that they are non-rivalrous and non-excludable (Brown and Jackson 1990, p. 38).

Information failures occur where there is insufficient or inadequate information about such matters as price, quality and availability for firms, investors and consumers to make informed decisions. In some instances, markets can address these problems through intermediary products — for example, consumers purchasing advisory services. But where the issues are highly technical, the government may perceive a role to complement or verify market supplied information — for example, government licensing, registration and labelling regulations for chemicals and pharmaceuticals.

Natural monopoly occurs where it is more efficient for one firm to supply all of a market's needs than it would be for two or more firms to do so. It arises where there are significant economies of scale resulting from fixed costs which are large relative to the variable costs of supply. Monopolies may charge excessive prices, so regulation or government ownership is often adopted.

Improving the allocation of resources

Generally, cost recovery can be regarded as an attempt to charge firms and consumers more directly for the government provided products they consume. By requiring a payment for products supplied, users will better recognise the costs of the resources involved and gain an incentive to adjust their consumption in line with their willingness to pay. It may be more efficient, for example, to charge people who would otherwise collect personal sets of government publications which they may only rarely use (instead of sharing them, reading them online or borrowing them from a library). The cost of resources used in producing a product includes the foregone opportunity of using those resources elsewhere, so pricing based on costs helps to ensure resources are allocated more efficiently within the economy.

By charging for their products, government agencies also receive some signals about which products are in demand and which are not. This will complement other non-financial indicators and help agencies adjust their mix of outputs.

The pricing of government products can have an impact on the role and structure of government. If governments provide products free of charge, users are likely to demand more than they would otherwise. In such an environment, people will demand more of the seemingly costless products of most interest to them. As Bird has stated:

> An important advantage of pricing is thus to curb the demand for expanded public sector activities by making their real costs apparent to the prospective beneficiaries in a meaningful fashion. Correct pricing can alleviate … the pressures to expand government … If beneficiaries are not willing to pay what the expansion of a service will cost, then it should not be expanded; if they are, it should be … (Bird 1976, p. 35)

Pricing of private goods

The resource allocation arguments are at their simplest where government agencies supply private goods, that is goods (or services) that have the characteristics of rivalness and excludability that might normally create incentives for private providers to enter the market (box 2.1). In such circumstances, not charging the marginal cost of producing that product would create distortions in its production and consumption (see appendix H). Where an agency competes with the private sector, its ability to price above competitive levels would be limited, but under-pricing may still be an issue, due to its impacts on competition and hence resource allocation (competitive neutrality considerations are discussed below).

Pricing by statutory monopolies

In many instances, government agencies are statutory monopolies, so they have the potential to charge prices above competitive levels. This could lead to over-recovery of costs and the misallocation of resources. It could also create poor incentives for agencies to control their cost base. Investing in facilities of an unnecessarily high standard (sometimes called 'gold plating'), or cost padding may result. Methods for improving the technical efficiency of statutory monopolies include using market testing for activities or products which can be contracted out, and benchmarking with similar organisations or activities (see chapter 8).

Paying for non-discretionary activities

The potential for cost recovery charges to influence resource allocation depends to some extent on the degree of discretion users have about consuming the product in question. Where consumers voluntarily choose to purchase a product (for example, ABS publications or customised surveys) and how much to purchase, pricing can be expected to influence demand.

Cost recovery of regulation may also influence resource allocation, but in different ways. In the case of pre-market regulation, firms either participate in the market (and are regulated) or decline to participate at all. Cost recovery would have efficiency effects if regulatory charges influenced these decisions. Alleged examples include ranges of complementary health care products not registered in Australia, and claims that some new environmentally friendly chemicals are not being sold here (see chapter 5). This would affect resource allocation at the industry level through a contraction in supply of regulated products. Regulatory charges may also influence the decisions of firms already in the market. Where regulatory charges are related to output or sales, unit costs will rise and firms may react by producing less of the regulated product.

Making beneficiaries pay

The 'beneficiary pays' principle has been widely cited as a major rationale for developing and implementing cost recovery. It is based on the notion that those that benefit from the provision of a particular activity or product should pay for it. This has both economic and equity dimensions. It encourages those who benefit from the activity or product to recognise that there are resource costs involved, and it decreases the taxation burden on those who do not benefit. Its weaknesses include the practical difficulties that may be present in identifying beneficiaries and charging them, and in addressing situations where 'benefits' arise through

alleviating negative impacts on others. (Externalities or spillovers are discussed below.)

The beneficiary pays principle clearly covers users who voluntarily purchase government supplied products because they have a willingness to pay that equals or exceeds the purchase price — that is, where there is a market for private goods such as government publications. But it can also apply to the provision of public goods where direct charges are not feasible or desirable (box 2.2).

Box 2.2 **The benefit principle and earmarked taxes**

The concept of beneficiary pays has its origins in the public finance economics concept of the benefit principle. This principle suggests that economic efficiency would be improved by requiring people to contribute (through taxation) according to the value they place on the public goods and services they consume. In practice, it is almost always impossible to estimate these values. Individuals have an incentive to understate their valuation, the result being that less revenue would be raised than would be necessary to supply the products that society demands.

The benefit principle has given rise to the term 'benefit taxes'. Levies imposed on a particular group for the supply of a particular product that benefits them are examples.

Another term that arises in this field is 'earmarked (or hypothecated) taxes'. Earmarking is the assignment of revenue received from a specific tax to the financing of a particular government activity. An important distinction between earmarked taxes and benefit taxes is that the activity being taxed in the former case is not necessarily related to the activity being financed, although it may be more easily justifiable when it is (Bird 1976, pp. 23, 27; Anderson 1991). Benefit taxes are earmarked taxes, but not all earmarked taxes are necessarily benefit taxes.

Government supplied products often benefit particular groups in society. An example is air safety regulation. To some extent, users of aviation services reward the good safety practices of airlines with their patronage and the prices they pay. But significant information problems make it difficult for air travellers to make informed choices. The cost of making the wrong choice may be catastrophic. For these and other reasons, governments invariably take on the task of air safety regulation. But who should pay for this regulation? And what may be the effects on economic efficiency?

Arguably, the consumers of aviation services are the main beneficiaries of air safety regulation and should pay for most, if not all, of its provision. This arrangement would give better signals about how much consumers value air safety. (Spillover effects such as improved safety for those living under flight paths are discussed below.)

Alternative approaches to funding air safety regulation include a ticket tax or, as is the case in Australia, a tax on aviation fuel. Neither will be a perfectly efficient way of raising the revenue needed to fund air safety regulation. But, by making the beneficiaries pay a little more directly than they otherwise would, these measures may be preferable on economic efficiency and equity grounds to funding air safety regulation through general taxation revenue.

Dealing with spillover effects

One weakness in the beneficiary pays principle is that if beneficiaries paid for only the benefits they received, they may not recognise the possibility of spillover effects on others (box 2.1). Spillover effects may be positive or negative. An example of a positive spillover effect is an information product which benefits firms or individuals other than those who directly consume it.

A negative spillover occurs when the actions of one person or firm lead to third parties incurring actual or potential costs. The most common example of actual costs is pollution. Potential costs arise from activities or products that carry a risk of damage to the environment or the health and safety of the community (such as the production and use of potentially dangerous chemicals) or from financial activities that carry risks of economic instability or 'financial contagion'. Where the actual or potential risks to society are deemed to be unacceptable, the activity or product may be banned. Where the risks are considered acceptable (but are not zero), the source may be regulated to minimise or at least reduce them. Other ways of addressing negative spillovers include private negotiation between parties, common law remedies, taxation measures and the creation of property rights (box 2.3).

Spillover effects may have an influence on the way in which cost recovery is implemented and who is charged. Where a government supplied activity or product has positive spillovers, subsidies to decrease the costs to users may be appropriate. Where the government regulates to address negative spillovers, there may be an argument on economic efficiency grounds for incorporating the costs of administering the regulation into the prices of regulated products so the costs become apparent to producers and consumers. This approach can also improve equity by decreasing the taxation burden for those who neither contribute to the negative spillover nor benefit from the products with which it is associated. (The impacts of spillovers on the cost recovery practices of information and regulatory agencies are discussed below.)

Box 2.3 **Alternative means of addressing spillovers**

One approach to dealing with negative spillover effects is for those affected to sue the creator of the spillover at common law. Where the parties are identifiable and the costs are measurable, this approach may encourage firms to moderate their behaviour to minimise external effects. However, these conditions may be absent, making this process inefficient, uncertain and slow. Further, where incentives are weak, the process may not prevent the spillover from occurring.

A largely theoretical approach to dealing with negative spillovers would be to tax those firms that give rise to the spillover effects to align the private and social costs of their actions.[1] This arguably would prompt the firms involved to adjust their production processes. However, this approach is fraught with numerous problems, not the least being to identify whom, what and how much to tax. Measuring the dollar value of spillovers and translating that into a corrective tax system is virtually impossible in many situations.

Spillover effects can sometimes be addressed through the creation of a system of property rights. In the cases of pollution, polluters may be given rights to emit a specified amount of pollutants, with the overall output being deemed acceptable to society. If these rights are tradeable and enforceable, the most efficient producers will end up holding the most rights, thus ensuring the allowable amount of pollution is associated with a maximum amount of production. Alternatively, those affected by the pollution could in effect enter the market to pay the polluter to stop polluting.

In many cases covered by this inquiry, regulatory agencies are addressing issues in which property rights are ill defined or the potential harm is too great to wait for market or legal solutions. Most people have a general expectation of access to safe drugs for example, but this cannot be translated into a property right *per se*. Thus, regulation remains the main instrument for addressing spillovers in many cases.

Government intervention to address spillovers will not always be warranted. If the costs of regulating, creating and enforcing property rights or imposing taxes are higher than the estimated benefits derived from these actions, then it may be more efficient to refrain from intervening. The misallocation of resources may need to be substantial before intervention produces net benefits to society.

Revenue raising

Cost recovery charges raised $3.2 billion in 1999-2000. Given that general Commonwealth Government revenues in 1999-2000 were estimated to have been $166.6 billion (excluding government business enterprises and inter-agency

[1] Such taxes go beyond the scope of cost recovery *per se*. The New Zealand guidelines, for example, exclude 'the setting of taxes (over and above cost recovery) to limit negative externalities (harmful effects that extend beyond the people directly involved) associated with a particular activity' (New Zealand Treasury 1998, p. 3).

transfers), cost recovery is a relatively minor, but not insignificant source of revenue.

In the context of cost recovery, the term 'revenue raising' is sometimes interpreted to mean only the revenue raised that is surplus to expenditure. The Commission considers that anything above zero cost recovery should be regarded as a revenue raising measure, because it is an alternative to other government revenue raising measures such as general taxation.

Raising revenue through either cost recovery or general taxation has efficiency effects. As explained above, cost recovery can improve the efficiency with which products are used and produced. By decreasing the level of general taxation needed to finance government activities or products, cost recovery also decreases the costs of tax administration and compliance, and the 'deadweight' or efficiency costs of tax related distortions to economic decisions. As Freebairn and Zillman stated, tax systems may distort many decisions:

> Taxation distorts decisions on work versus leisure, on spending now or in the future, on the choice of which goods and services to produce and consume, on the form of business organisation, and so forth, with resulting efficiency costs. (2000b, p. 11)

Available international estimates indicate that the average efficiency cost of general taxation revenue is around 30 cents for every dollar raised. This includes the costs of collection (approximately 1 cent), compliance (approximately 10 cents), and the distorting effects of taxation on production and consumption decisions (approximately 20 cents) (Stiglitz 2000; Sandford 1995 in Freebairn and Zillman 2000b, pp. 10–11).

Comparing one efficiency effect with another suggests that even cost recovery arrangements that are less than perfect may still improve economic efficiency overall, relative to higher general taxation. However, the greater the separation between the activity or product provided and the charge (for example, some earmarked tax arrangements), the less tenable the cost recovery arrangements become on economic efficiency grounds. If there is no connection — such that an earmarked tax has no effect on production or consumption decisions — then the choice between general taxation and the specific earmarked tax boils down to which is the least distorting way of raising revenue. The choices between alternative revenue sources is therefore far from simple in terms of the overall effects on economic efficiency.

However, not all cost recovery arrangements are designed from the ground up with economic efficiency in mind. The risk is that the political and financial pressures to raise revenue may have led to the imposition of cost recovery where it was not warranted on economic efficiency grounds.

2.3 Competition issues

Cost recovery may affect competition in different ways. The types of charges used by regulatory agencies may affect firms differently and, where an agency is in competition with a private sector provider, competitive neutrality considerations may be important.

Cost recovery charges are one of the costs that firms may have to incur to enter a regulated market. An issue for this inquiry is whether such charges may be so high as to constitute a barrier to entry, thus affecting competition.

The way in which regulations and cost recovery arrangements are designed may also have an impact on competition between firms in an industry. In some cases, where regulation is in place or its introduction is imminent, it may be in the industry's interest to influence the nature and extent of that regulation. While firms in an industry may collectively prefer less regulation to more, there may be opportunities for sections of the industry, including individual firms, to shape the regulations and the charging structure to their benefit. By influencing regulatory design to have a greater adverse effect on competitors or new firms than on themselves, firms may be able to tilt the regulatory playing field in their own favour. Discouraging competition and allocating resources to lobbying regulators and government will reduce economic efficiency.

Competitive neutrality

Just as competition may be affected by the pricing of government inputs, it may also be influenced by the terms and conditions on which government agencies compete with the private sector. If government agencies are exempt from paying taxes or charges that private competitors have to pay, or if they are given other special treatment, then they may be able to operate at an advantage over their private sector competitors. (They may also suffer competitive disadvantages, such as more onerous accountability requirements).

A cornerstone of the Commonwealth Government's competition policy, competitive neutrality has been implemented by the Commonwealth and all States and Territories, as part of the Competition Principles Agreement (1996). Under this policy, the prices charged by government businesses are required to be adjusted to reflect the advantages and disadvantages of public ownership. Prices should at least cover costs (including a return on capital invested and all relevant taxes and charges).

Although this inquiry does not cover government business enterprises, competitive neutrality considerations are relevant because a number of business units operate within government regulatory and information agencies. The Bureau of Meteorology, for instance, operates a commercial business supplying meteorological products in competition with the private sector. The issue is to ensure competition is not disadvantaged by the Bureau of Meteorology supplying its basic products (on which the commercial products are built) to itself on conditions that are any different from those applying to private sector competitors. Applying competitive neutrality principles to the pricing of government's business units requires careful attribution of overhead and capital costs (see appendix H).

2.4 Cost recovery rationale for information agencies

Cost recovery of information products is influenced by two main characteristics. First, consumption of information products is usually discretionary, not mandatory. Thus, cost recovery may have a more immediate impact on the demand for, and supply of, information products than on the demand for some regulatory activities. Consequently, pricing is often used to manage demand. It may also give agencies some indication of consumer preferences. Second, once information has been collected and compiled, the costs of disseminating it can be very low and inappropriate cost recovery charges could impede the desirable use of information.

Given that pricing of information can have profound effects on its use, it can be important to establish why the Commonwealth Government is involved in supplying information products. One of the most fundamental reasons is that the government requires some information for its internal policy processes or to meet equity or social objectives. If these were the only reasons, then the arguments for cost recovery would be restricted to the case for charging the costs of dissemination to other users. Recouping the costs of collection and compilation of the information from these users could discourage valuable applications of the information. But there are also some important economic reasons for government involvement in the provision of information. These include:

- the public good characteristics of many information products (non-rivalrous and non-excludable), which mean the market is unlikely to provide these products adequately; and
- the positive spillover effects of some information products (benefits to third parties), such that, again, the market is unlikely to provide these products adequately.

In addition, economies of scale and scope may influence the products that information agencies supply and their prices.

Public good characteristics

Public good characteristics are present in many information products to some extent. Where information is non-rivalrous (that is, consumption by one person does not use up the resource, so that the resource is still available to others), and it would be difficult or undesirable to exclude others from using it, public provision may be necessary. For information products that have a high degree of public good characteristics, it will not be possible or desirable to attempt to recover costs. Basic weather services, for example, can be consumed by numerous people simultaneously, and it would be difficult to stop people passing on the information to others. The ABS's supply of basic statistics on the economy falls into a similar category. Once published in the media, key statistics on such things as gross domestic product, inflation and trade are widely cited and re-used.

In practice, there are very few 'pure' public goods in the information sector. It is possible in many situations to devise ways to exclude people and impose charges. Charging becomes possible if, for example, information is supplied only in hard copy form and restrictions are placed on the re-use of the information. Similarly, some agencies have developed conditional access systems for charging for information supplied over the Internet. But charging for such 'impure' public goods may be undesirable from an economic (not to mention social) perspective. Once information is collected, the cost of supplying it to an additional user tends to be low, even close to zero in the case of the Internet. Prices that are any higher than the marginal costs of dissemination (for example, the costs of printing an extra copy of a publication or downloading data from a website) may discourage socially desirable uses of this information.

A further important consideration is that it may be economically inefficient to implement a system for recovering costs where the costs of supplying the product to an additional consumer are low. The costs of the billing system itself would need to be recovered and these additional costs could distort consumption choices. However, the continual refinement of Internet based charging systems is steadily decreasing the costs of charging online consumers of information products.

Positive spillovers

The presence of positive spillovers may further strengthen the case for government provision of some information products. Two situations illustrate the influence of

positive spillovers on pricing. First, weather forecasting allows people to take precautions when warnings of floods and other hazardous climatic conditions are conveyed to the general public. This could have substantial impacts on, for instance, the deployment of emergency services. Second, basic statistical data about the economy help to create an informed and prepared community, and contribute to a well functioning economy and democracy. While charging may be possible, to do so may seriously undermine the benefits that otherwise may accrue where the positive spillovers are significant.

The creation of such positive spillovers needs to be contrasted with spillovers that may result from the subsequent use of information products. Data may be used, for example, by consultants for commercial purposes where the benefits are private and excludable, or in research that creates positive spillovers. The important distinction to make is that such positive spillovers arise from the *application* of the data, not directly from the data itself. Further, distinguishing between users on the basis of the likelihood of positive spillovers would be operationally difficult. The appropriate policy response in these circumstances may be to support the activities that generate the positive spillovers (that is, the research), through other measures (such as research grants), not to subsidise the provision of the data.

Economies of scale and scope

The high costs of collecting and compiling data mean that many information agencies have significant economies of scale and scope, not just in collection and compilation, but also in the subsequent analysis and dissemination. Information agencies such as the ABS, the Australian Geological Survey Organisation, the Australian Surveying and Land Information Group and the Bureau of Meteorology all must incur high data collection costs before producing any information products based on those data. Further, they may be more efficient at producing a variety of products from the information they collect than would a number of competing suppliers producing just a few products.

Where there are economies of scale, agencies may be tempted to adopt two-part or differential pricing policies to recover the overhead costs of collecting and compiling information. Under some circumstances, these approaches may lead to economically efficient outcomes (that is, where prices are set such that the demands of all who value the product more than its marginal cost are met). But they would need to be applied carefully so as not to compromise the achievement of other objectives. Such policies would not be appropriate for example, where products have significant spillover effects. Given that information agencies are established and operated to maximise public benefit, not revenue, a more appropriate focus

would be on maximising the dissemination of information and recouping overhead costs from general taxation revenue where appropriate.

The economics of gathering data mean information agencies will also have a substantial advantage over other (actual or potential) competitors in incrementally expanding their activities to meet the specific needs of particular consumers (economies of scope). There may also be some additional products that only they can provide for technical or confidentiality reasons. At some point, however, it should be possible for outside firms, drawing on the same basic data set, to supply competing products. Competitive neutrality considerations would then apply (see chapter 7 and appendix C).

Classifying information products

The above analysis suggests that taxpayer funding may be appropriate where:

- there are significant public good characteristics (that is, the products are non-rivalrous and either non-excludable or, where exclusion is possible, can be provided at such low cost that exclusion is economically undesirable); or
- there are significant positive spillovers.

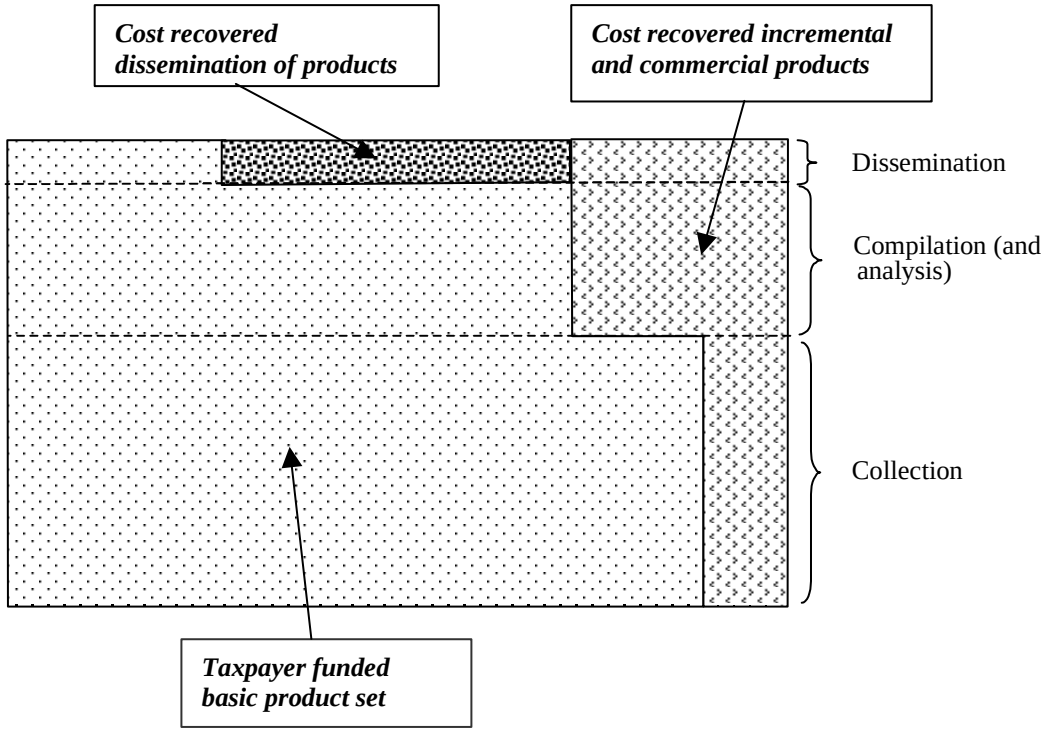
Some information products that do not meet these tests may nevertheless be funded from general taxation revenue, but only if the government explicitly decides that there are other significant policy reasons for doing so. Where these situations do not arise and information products benefit only particular consumers, there will usually be a case for charging for them.

While different agencies define their products differently, these broad distinctions allow information products to be classified into two broad groups: taxpayer funded 'basic products' and cost recovered 'additional products'. Basic information products typically involve the collection and compilation of data or other material (for databases or archives), and some (but not necessarily all) analysis and dissemination. Additional information products, in turn, can be classified into three groups:

- existing information products disseminated at marginal cost;
- incremental products (which may involve additional data collection or compilation) priced at incremental or avoidable cost; and
- commercial (contestable) products priced according to competitive neutrality principles.

This classification of information products is depicted in box 2.4.

Box 2.4 **Notional segmentation of the activities of information agencies**



This diagram illustrates the different activities and products that an information agency may undertake or produce. The areas of the different parts of the diagram are meant to indicate the notional size or importance of each product group. The primary distinction is between the basic product set (which is provided free) and additional products (which are cost recovered). Thus, that part of dissemination that is defined as being outside the basic product set, but is necessary for improving public access to data already collected, compiled and analysed, may be charged at marginal cost.

Incremental products may either build on the basic data already collected or involve additional collection, compilation, analysis and dissemination. These products may be priced at incremental (or avoidable) cost unless they are contestable, in which case competitive neutrality principles would mean commercial prices apply.

2.5 Cost recovery rationale for regulatory agencies

Many regulatory agencies in the Commonwealth public sector have cost recovery policies. They are involved in regulating products to decrease the risk of harm or damage that may arise to consumers, the whole community or the environment. These agencies typically undertake pre-market assessment of products and post-market enforcement and compliance. They may also supply some information products. Regulation exists partly as an alternative or an adjunct to the use of the

common law to address or reduce the damage that may arise from the production and consumption of products that present a high degree of risk (box 2.3). Examples include the Therapeutic Goods Administration, the National Industrial Chemicals Notification and Assessment Scheme, the National Registration Authority for Agricultural and Veterinary Chemicals, the Australian Prudential Regulation Authority and the Civil Aviation Safety Authority.

Many of these agencies address market failures arising from information asymmetries and spillovers. Information asymmetries occur where the supplier has more information about product characteristics than consumers do (box 2.1). If consumers do not have sufficient information, or if the information supplied is of such a highly technical nature that it is difficult to interpret, then consumers may have difficulty making informed choices. Boadway and Wildasin (1984) stated:

> Consumers might not know the implications of various products for their health and safety, nor will they have full information on the relative merits of various competing consumer items. … The provision of information has the attributes of a public good, especially the joint consumption property. Thus, information on product safety and health hazards is often publicly provided (for example, the Food and Drug Administration). (pp. 65–6)

One way of addressing information asymmetries is through government regulation aimed at providing information in a more accessible form (for example labelling). Regulatory agencies may go much further by making choices on consumers' behalf (for example, decisions about the safety and efficacy of pharmaceuticals or chemicals). The problem is to reflect accurately society's preparedness to trade off risk against access to new products that may have substantial benefits. Invariably, at any chosen level of risk, some consumers will be disadvantaged by not being able to gain access to high risk products. Terminally ill patients, for example, may be prepared to accept the possibility of dangerous side effects from the use of a non-approved drug if it gives them a longer life expectancy or a better quality of life.

Spillover effects may be an important issue in the design and application of some regulations. Negative spillovers could include pollution from the careless use of chemicals, a run on all financial institutions from the failure of one institution that followed poor practices, and the impacts of exploiting common property resources such as fisheries.

These considerations suggest that regulation affects various groups in society. Depending on the nature of the regulation, those affected may include: consumers of regulated products; regulated firms; and those for whom the risk of negative spillover effects is reduced. The objects clauses of regulation or legislation may reveal whom the regulation is intended to affect (box 2.5).

Benefits to consumers and producers

In many cases, consumers are the main beneficiaries of regulation. In some cases, consumers may deal directly with regulatory agencies. In other cases, they may be the direct consumers of the products of regulated firms or, where those products are intermediate inputs, the consumers may be further down the production chain.

Consumers may benefit in different ways. Where regulation acts to address information asymmetries, consumers benefit from being able to make more informed choices. Regulations can require regulated firms to label their products, for example, or require the regulator to provide educational material to help consumers make informed choices. Consumers may also benefit in a more passive sense from knowing that regulatory agencies assess and monitor the safety and efficacy of regulated products. In other cases, consumers may benefit from the regulator banning a product from the market (for example, a dangerous drug or chemical) or preventing an activity from proceeding (for example, a merger that would not have net public benefits).

Regulated firms may benefit too. Regulations are not usually introduced to benefit those who are regulated, but to modify their behaviour to create net social benefits. Some benefits of regulation that otherwise would accrue to consumers may, nevertheless, be captured by regulated firms. This may occur if firms can charge prices that more than recoup the cost recovery charges they have paid, or if they can increase demand by promoting regulatory approval as a selling feature of their product. This may also include situations where Australian regulatory certification provides marketing benefits for producers selling into overseas markets.

To the extent that regulated firms could capture these benefits by implementing a self-regulatory scheme and charging higher prices, they would. But the government's decision to introduce explicit regulation suggests that it judged that a self-regulatory approach would not give the appropriate degree of assurance to consumers. However, while government regulation may be more intrusive and costly than self-regulation, regulated firms may be able to capture in part the additional benefits that it creates for consumers.

Box 2.5 **The objects of selected pieces of legislation**

The *Therapeutic Goods Act 1989* does not specifically indicate who it intends to benefit, but it could be imputed from the object of the Act that it is primarily intended to benefit consumers. The object of the Act states that it is to:

> Provide for the establishment and maintenance of a national system of controls relating to the quality, safety, efficacy and timely availability of therapeutic goods that are … used in Australia … (s.4)

Addressing spillover effects would appear to be the prime purpose of the *Space Activities Act 1998,* under which fees can be set for rocket launches and other related purposes. The objects of the Act are:

a) to establish a system for the regulation of space activities carried on either from Australia or by Australian nationals outside Australia; and

b) to provide for the payment of adequate compensation for damage caused to persons or property as a result of space activities regulated by this Act; and

c) to implement certain of Australia's obligations under the United Nations' Space Treaties. (s.3)

In some cases, the objects of the regulation may address impacts on both consumers and the environment. The object of the *Gene Technology Act 2000* for example, is to:

> … protect the health and safety of people, and to protect the environment, by identifying risks posed by or as a result of gene technology, and by managing those risks through regulating certain dealings with [genetically modified organisms]. (s.3)

Similarly, the *Industrial Chemicals (Notification And Assessment) Act 1989* appears to target a variety of groups. Groups affected by the Act could include employees of firms manufacturing or using industrial chemicals, other users of chemicals and the general public. The environment could also be affected. The object of the Act is:

> … to provide for a national system of notification and assessment of industrial chemicals for the purposes of:
>
> (a) aiding in the protection of the Australian people and the environment by finding out the risks to occupational health and safety, to public health and to the environment that could be associated with the importation, manufacture or use of the chemicals; and
>
> (b) providing information, and making recommendations, about the chemicals to Commonwealth, State and Territory bodies with responsibilities for the regulation of industrial chemicals; and
>
> (c) giving effect to Australia's obligations under international agreements relating to the regulation of chemicals; and
>
> (d) collecting statistics in relation to the chemicals; and
>
> (e) being a system under which information about the properties and effects of the chemicals is obtained from importers and manufacturers of the chemicals. (s.3)

Avoiding negative spillovers

Several regulations specifically address the avoidance of negative spillover effects. An object of the *Gene Technology Act 2000*, for example, is to protect the environment (box 2.5). Where regulated firms contribute to negative spillovers, and regulation specifically addresses those spillover effects, there is a case for producers and consumers of regulated products to bear the costs of administering the regulations. In this way, prices paid would incorporate all of the costs of bringing those products to market. This would provide some price signals to both consumers (on the costs of highly regulated products relative to lightly regulated products) and producers (on the costs of and returns from investing in highly regulated industries relative to lightly regulated industries).

The Commission has commented previously on the implications of negative spillovers for cost recovery by regulatory agencies. It argued:

> Where it is not possible to allocate property rights and some other form of government action is being used to correct for spillovers, the question of who should pay will depend on the nature and size of the spillover and who is able to affect the size of the spillover at least cost. The prime objective is to achieve an efficient allocation of resources at least cost. … With respect to cost recovery, in general where those being regulated are the source of a negative externality, it may be efficient to charge them also for the cost of administering the regulation … as this is part of the costs of their activities imposed on society. (IC 1995, pp. 25–6)

Whether the charge is levied in the first instance on regulated firms or consumers of the product, the outcome is that the price of the regulated product incorporates the cost. (The practical issues of charging one group or the other are discussed below.)

Another approach, which may be suggested by the application of the beneficiary pays principle, would be for the general taxpayer to meet some of the costs of administering the regulations through the budget. The Australian Chamber of Commerce and Industry, for example, objected to industry being required to pay regulatory costs under such circumstances, arguing that the beneficiary was the wider community (sub. DR136, p. 4).

There are three problems with this approach. First, funding regulatory activities from the budget would disguise the costs to consumers and producers of the regulatory activities deemed necessary to limit the risk of the spillover occurring. This could inappropriately encourage the regulated industry to expand, to the disadvantage of other industries where spillover effects are not as important and where regulatory costs are not as high. In addition, where consumption of regulatory activities is discretionary, regulated firms would not face the same financial discipline.

Second, the benefits to the rest of the community result from costs foregone (that is, from not incurring a cost or not coming to some harm) and it may be argued on equity grounds that the community should not bear the expense of avoiding being harmed. Third, taxpayer funding creates other efficiency costs as a result of the impacts of taxes on the general community.

Incentive effects

Cost recovery may have important influences on the behaviour and efficiency of the government's regulatory agencies, and may also affect innovation and product development in the regulated industry. The impact on agencies may be positive (heightening firms' or consumers' interest in the efficiency of the regulator) or negative (creating incentives for regulatory creep and gold plating). These issues are discussed further in chapter 5.

Cost recovery may have an adverse effect on the regulated industry. It may, for example, inhibit innovation and product development where property rights are weak or charges are poorly designed. The impact of property rights can be illustrated by comparing two regulated industries: food regulated by the Australia New Zealand Food Authority, and pharmaceuticals registered by the Therapeutic Goods Administration. At first glance, it might be presumed that there are similar grounds for imposing cost recovery in both cases.

In the case of food, the Australia New Zealand Food Authority could theoretically charge applicants 100 per cent of the costs of assessing and processing a variation to a food standard. However, in the absence of intellectual property rights, a variation in a standard initiated by one firm would be available to all firms in the industry. While the safety of all consumers of that product (produced by any firm and not just the output of the applicant) would be protected, all other producers of that food could 'free ride' on the application of the first firm. Given that such an approach could discourage innovation in the development and marketing of new foods, funding from general taxation revenue (or an alternative levy based arrangement which charged all consumers) may be more appropriate.[2] In the case of patented pharmaceuticals, intellectual property rights ensure free rider problems are minimised and do not deter the introduction of cost recovery.

The way in which charges are set may also have incentive effects on regulated firms. Given that some firms and some products may impose greater risks than others, and thus require more regulation, a flat charging structure would benefit

[2] Currently, there are no charges for varying food standards, except where an 'exclusive capturable commercial benefit' is present.

some firms at the expense of others. A system of cost recovery charges that recognises the regulatory efforts involved in addressing different levels of risk may be more appropriate. However, even in such cases, care may need to be taken to ensure cost recovery is not otherwise contrary to policy objectives. If the Australian Prudential Regulation Authority, for example, were to charge for compulsorily auditing a financially troubled firm, then the result might be counterproductive (see appendix F).

Who pays?

Once it has been established that cost recovery may be appropriate, some practical issues arise. It may not be cost effective, for example, to design a system of charges that would be directly imposed on consumers. It may be more cost effective to charge the regulated firm with the expectation that they will pass on some of the costs to consumers. As the Commission has stated previously:

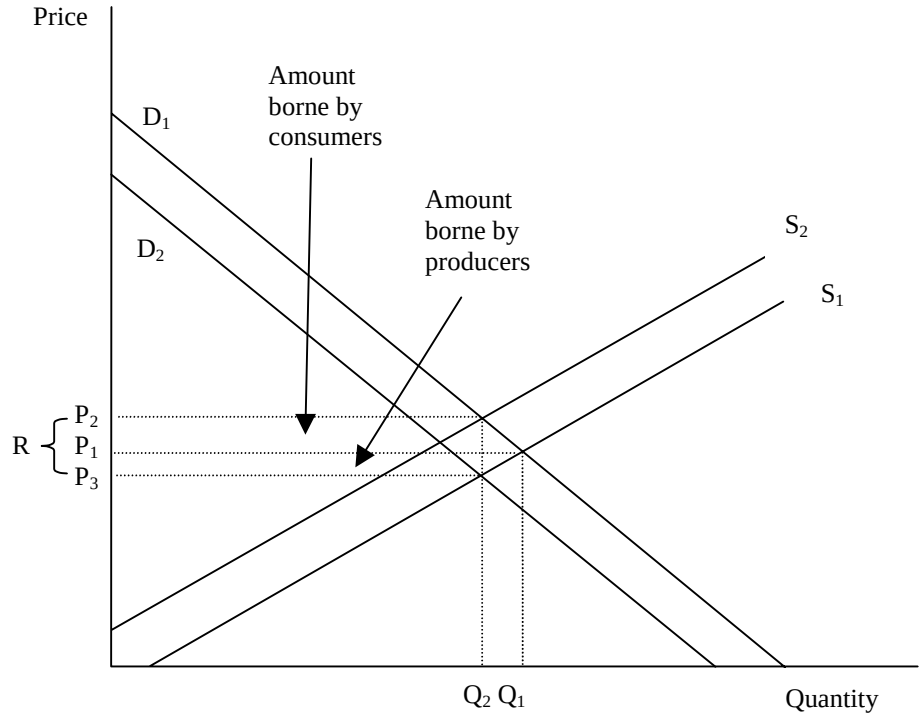
> … cost recovery from a diverse group of beneficiaries may still be possible. For example, charging the suppliers to such a group is often an efficient way to charge those who ultimately benefit. Depending on the extent to which businesses can pass on the costs, any increase in business costs will be borne by the industry in the form of lower profits and by consumers in the form of higher prices. (IC 1995, p. 26)

Charging regulated firms may also be more cost effective where the costs of regulatory activities differ substantially among firms (for example, the cost of assessments made on a 'fee-for-service' basis can vary according to the time and effort needed to undertake each assessment) and at different points over a product's life cycle. Translating such differences into consumer charges would result in a highly differentiated approach to setting charges and could require different charges for different products, or for similar products marketed by different companies.

The outcome will often be the same whichever group (firms or consumers) is targeted. Ultimately, both the producers and consumers of regulated products will each bear some of the costs (box 2.6). These considerations suggest that charging the regulated firms will often be the most efficient and cost effective approach. Regulated firms can be expected to pass on some of the regulatory costs, such that the various participants in the value added chain share the costs.

Box 2.6 **The burden of cost recovery charges**

In a simple model in which there are only producers (who are regulated) and consumers, it can be demonstrated that the imposition of cost recovery charges on either group will lead to the same outcome. The two groups will share the costs according to how responsive the supply and demand schedules are to changes in price. In this diagram, the additional regulatory cost is depicted as *R* on the vertical axis. This cost creates a wedge between the prices that consumers are prepared to pay and the prices that producers receive.



Requiring producers to pay the extra cost can be depicted by the vertical shift in the supply schedule from S_1 to S_2. At any quantity of industry output Q, producers would have to charge P plus R if they were to cover their costs. Consumers would then be likely to react by purchasing less of the now higher price good (this can be depicted by a move along demand schedule D_1). Supply and demand will only equilibrate when quantity has contracted from Q_1 to Q_2, where consumers are prepared to pay P_2. The price then received by producers is P_2 minus R, or P_3. Thus, prices paid by consumers are now higher than they were, prices received by producers are lower, and industry output is also lower. The regulatory costs are shared between consumers (who pay that component of R represented by the difference between P_2 and P_1), and producers (who pay that component of R represented by the difference between P_1 and P_3).

(Continued next page)

Box 2.6 (continued)

The same result could be derived by assuming that consumers pay the regulatory costs. This can be depicted by a downward shift in the demand schedule by the amount *R*. Given that consumers do not value the product any more than before the cost recovery charge was imposed on them, they will pay *R* less than they would have before. This can be depicted by the derived demand schedule D_2. The industry response would be to produce less of the regulated product, possibly by way of the most marginally efficient firm now being unprofitable and exiting the market. This can be depicted by a move along the supply curve S_1 to the point where the industry produces Q_2, receiving price P_3.

The degree to which costs can be passed on by producers or back by consumers depends on the relative elasticities of demand and supply. (Elasticities measure the responsiveness of a change in quantity demanded or supplied in response to a one per cent change in the price.) The more inelastic the demand curve, for example, the more consumers will bear the costs, other things being the same.

2.6 Concluding comments

The case for recovering the costs of particular regulatory and information activities depends on the presence of market failures and the degree to which the government requires those activities to be undertaken.

For information agencies, the case for recovering costs directly from consumers varies across activities. Information products can be grouped according to the degree to which they provide broad public benefits or narrower private benefits. Agencies typically have a basic set of products that have a relatively high degree of public good characteristics, that have significant positive spillover effects or that are required for other public policy purposes of the government. Charging for these products may be neither possible nor desirable.

There is also typically a range of additional products that have private benefits for particular consumers. Where additional resources need to be devoted to meeting specific private needs there may be a case for cost recovery.

The case for recovering the costs of administering regulation is complex. Because some regulation is intended to reduce the likelihood of negative spillovers, the beneficiary pays principle does not universally apply. A more general principle that may apply is that where regulation is designed to minimise impacts on either consumers or third parties (that is, from spillover effects), the price of each regulated product should incorporate the efficient costs of its regulation. This

approach has efficiency and equity advantages over the alternative of funding through general revenue.

However, some important caveats should apply to cost recovery by both information and regulatory agencies. Cost recovery should not apply where:

- it is not cost effective;
- it would be inconsistent with policy objectives; or
- it would unduly stifle competition and industry innovation (for example, through 'free rider' effects in the case of regulation).

The complex issues surrounding cost recovery for both information and regulatory activities suggest that the onus should be on the government and its agencies to demonstrate that there would be net benefits to the community from introducing cost recovery for particular products or activities.

It is also important to ensure the regulatory activities or information products themselves are appropriate. Imposing cost recovery on top of inappropriate government regulation or products will only compound their distortionary impact. It is also necessary to have processes in place that ensure agencies are as open and transparent as possible. Existing and proposed cost recovery arrangements could then be considered on their merits, in line with the guidelines and processes the Commission recommends in part 2.

3 Legal and fiscal framework

A legal and fiscal framework underpins the design and operation of cost recovery arrangements in the Commonwealth public sector. The Commonwealth Constitution places legal constraints on the nature of charges, while the division of powers between the Commonwealth and the States has influenced the design of these arrangements. The Commonwealth Government's budgetary framework creates the broad fiscal context within which cost recovery mechanisms operate. International obligations can also constrain agencies' abilities to recover costs. Examining the implementation of cost recovery in State jurisdictions and other countries can provide insights into different legal and fiscal arrangements.

3.1 Constitutional issues

The Commonwealth Constitution defines the structure of government and the respective powers of the Commonwealth and State governments. Two particular considerations affect cost recovery arrangements:

- the need to distinguish between 'taxation' and 'fee-for-service'; and
- the division of powers between the Commonwealth and the States.

Distinguishing between taxes and fees-for-service

There are important distinctions between taxes and fees. A purported fee-for-service may amount to a tax. If this is the case, then the legislation imposing the fee could be open to Constitutional challenge.

Taxation

A generally accepted definition of taxation is:

> A compulsory exaction of money by public authority for public purposes, enforceable by law, and … not a payment for services rendered. (*Matthews v Chicory Marketing Board [1938] 60 CLR 263*)

Taxes incorporate duties of customs and excise, but exclude royalties and fees-for-service. Section 51[ii] of the Constitution outlines the taxation powers of the Commonwealth:

> The parliament shall, subject to this Constitution, have power to make laws … with respect to: — taxation; but so as not to discriminate between States or part of States.

When imposing taxation, the Commonwealth must ensure that it complies with the following Constitutional requirements:

> Laws imposing taxation shall deal only with the imposition of taxation, and any provision therein dealing with any matter shall be of no effect. Laws imposing taxation, except laws imposing duties of customs or of excise, shall deal with one subject of taxation only; but laws imposing duties of customs shall deal with duties of customs only; and laws imposing duties of excise shall deal with duties of excise only. (s.55)

If a single Commonwealth Act attempted both to impose a tax and to deal with other matters, then the imposition of the tax would be valid, but the remainder of the Act would not. Therefore, to introduce a new tax, Parliament is required to pass at least two Acts — one authorising the imposition of the tax and one authorising 'other matters', including its collection and administration. This is reflected in the way many cost recovery charges are imposed.

Fees-for-service

Under certain circumstances, agencies may charge fees-for-service. The general principles are that fees must reflect the costs of services provided and that the service must be rendered to, or at the request of, the party paying the account (see appendix I). In some situations, agencies must have specific legislative authority to charge fees. In other situations, this authority may be implied. The distinction between these situations is sometimes unclear.

The Commission sought the advice of the Australian Government Solicitor on when legislative authority is required to impose fees-for-service. It advised that:

> The position in relation to charging for services is less clear cut … We take the view that the imposition of charges in respect of the performance of statutory duties (including the delivery of services as a matter of statutory duty) needs to be authorised expressly by legislation or by necessary implication from legislation … Thus, statutory authority would be required to impose a fee in respect of, say, an inspection which is required to be performed under statute. The position in relation to the performance of *discretionary* activities is more complicated and it is in relation to this that judicial authority appears to be divided. (See appendix I)

Even when an agency has express or implied authority to charge fees-for-services, the fee must not amount to taxation. Several agencies charging fees-for-service have

sought legal advice on the distinction between fees and taxes. The Space Licensing and Safety Office received advice that it was not imperative for fees to exactly equal costs, because 'if the fees were calculated in good faith' they would not amount to taxation. However, if revenue exceeds costs in one period, then fees should be adjusted in the next period to achieve balance (DISR, sub. 62, p. 16). The Australian Quarantine and Inspection Service received legal advice that over-recovery by 10 per cent or more could result in a charge being construed as a tax (ANAO 2000a, p. 69).

The National Library of Australia obtained legal advice from the Attorney-General's Department which supports the advice obtained by the Commission. Although the power to charge a fee-for-service is not explicit in the *National Library Act 1960,* the library was advised that:

> …in view of the discretionary elements of the provisions above, and the lack of any legal compulsion to obtain the services, we can charge a reasonable amount for the services if it is decided, having regard to the priorities and financial resources, that it is not feasible or convenient to do otherwise. (sub. DR125, p. 1)

The Australian Government Solicitor advised the Auditor-General that the most recent High Court case (relating to Airservices Australia) had adopted 'a more flexible approach to cost recovery than was previously thought acceptable' (see appendix I):[1]

> … at least in some circumstances, a charge that discriminates between users of a service, and recovers the costs of maintaining a network of services, not all of which may be used by particular users, may still be a fee-for-service, at least where the services are highly integrated. Other factors which may be relevant to the characterisation of a charge as a fee-for-services include the commercial context in which the charge is imposed, and whether it has a revenue raising purpose. (AGS in ANAO 2000c, p. 36)

Bessell (sub. DR120, p. 2) argued that fees that recover greater than historical cost may be subject to challenge. However, this view does not appear to be widely held and has not been tested in the courts.

Legal implications of the differences between taxes and fees

Where a Commonwealth agency has express legal authority to charge a fee-for-service, the same piece of legislation usually deals with other matters. A single

[1] The High Court decision in *Airservices Australia v Monarch Airlines* was handed down on 2 December 1999. Decisions were handed down at the same time in *Airservices Australia v Canadian Airlines International Ltd* and *Airservices Australia v Polaris Holding Company*, which raised the same issues and were heard concurrently.

piece of legislation will often establish the agency, describe its functions and grant the power to charge a fee-for-service. If the fee were to be challenged on Constitutional grounds and found to be a tax, then the fee would remain valid (as a tax), but all other parts of the legislation would become invalid (because an Act imposing a tax may deal with only the imposition of that tax, and all other provisions are of no effect).

Concern about the possible implications of purported fees being found to be taxes has led to several outcomes. Legislation drafters have attempted to ensure legislation granting agencies the power to charge service fees makes it clear that Parliament does not intend to impose a tax. Acts have been written in such a way that a fee found to be a tax would become invalid, but not the rest of the legislation. For example, the *Civil Aviation Act 1988* (s.67) allowed the Civil Aviation Authority — now Airservices Australia — to make determinations fixing charges provided:

> The amount or rate of a charge shall be reasonably related to the expenses incurred or to be incurred by the Authority in relation to the matters to which the charge relates and shall not be such as to amount to taxation.

Some agencies — for example the Australian Competition and Consumer Commission (see chapter 6) — have deliberately set charges at the level of the minimum direct cost of providing a service, to ensure there is no risk of fees being found to be taxes. This may lead to significant under-charging if major overhead costs should be charged or if direct costs are well above the minimum.

The Government has sometimes used tax Acts to impose cost recovery charges, although charges imposed as taxes are not always identified as such in the legislation or in policy documents (the National Registration Authority for Agricultural and Veterinary Chemicals and the Therapeutic Goods Administration, for example, use annual charges that are levied under tax Acts).

The advantages of using taxation instruments for charging include the more explicit authority they allow and their simplicity. The use of tax Acts may avoid possible Constitutional challenge and can be administratively simpler than relying on fee-for-service. However, the use of tax Acts to impose cost recovery can have disadvantages. The link between a tax and the costs of the service funded by that tax is indirect. A fee-for-service can be calculated on the basis of costs incurred, but taxes typically are levied on a proxy basis, such as turnover, revenue or volume. If the proxy chosen does not closely reflect the underlying cost structures, then the tax may introduce cross-subsidies among users of the service. It will also fail to have the allocative efficiency effects of more direct charging arrangements (see chapter 2).

It also may be more difficult to change the level of a tax over time (by changing legislation or regulations) than to alter administratively a fee-for-service. The former approach may provide the benefit of certainty but it restricts the flexibility of the cost recovery arrangements to respond to changes in costs.

In addition, a tax imposed for cost recovery reasons may come to be regarded purely as a source of revenue. Some inquiry participants, including Qantas, Ansett, the Board of Airline Representatives and the Australian Customs Service argued that this was the case with the passenger movement charge:

> … the passenger movement charge was introduced as a cost recovery measure, but in law it was a tax. With a 1998-99 budget decision to increase the passenger movement charge from $27 to $30 per passenger, a policy shift has taken place. The passenger movement charge is levied under Commonwealth taxing powers and is now partly applied as a general revenue-raising source. As a consequence the passenger movement charge is no longer solely linked to cost recovery of customs, immigration and quarantine. (ACS, trans., p. 447)

In the 2001-02 federal budget, the passenger movement charge was increased from $30 to $38 for travellers, effective from 1 July 2001. Qantas argued that that this was significant over-charging:

> … there is, by the evidence of the CEO of Customs, a significant over-collection which we believe either needs to be adjusted by a review of the charging, or conversely utilising some of that over-collection to meet other costs which are being imposed on the industry which [are] directly related to passengers. (trans., p. 1287)

It is essential that appropriate legal authority (either explicit legislative authority to charge fee-for-service or a separate tax Act) underpin cost recovery arrangements. Such authority not only ensures the validity of the charge, but also provides accountability and transparency. Where fee-for-service may be characterised as taxes, agencies should be cautious about relying on the recent High Court case to validate their fees. The decision appears to indicate a more flexible approach, but its application to individual agencies is not certain. Agencies should determine the most appropriate authority for their charges and structure any fee-for-service so they cannot be challenged as amounting to taxation.

RECOMMENDATION 3.1

All cost recovery arrangements should have clear legal authority. Agencies should identify the most appropriate authority for their charges and ensure that fees-for-service are not vulnerable to challenge as amounting to taxation.

Commonwealth/State arrangements

The division of powers in the Constitution affects the abilities of the Commonwealth and the States to act in certain areas. The limited ability of States to raise revenue independently, coupled with the inability of the Commonwealth to act in some areas, has influenced the design of some Commonwealth cost recovery arrangements.

Although States have significant revenue raising powers in theory, they are reluctant to act unilaterally to impose taxes such as income taxes. They fear that imposing a new tax would make them less attractive than States with lower tax rates.

The High Court's interpretation of ss.90 and 96 of the Constitution has defined the limits of the States' abilities to raise revenue. Under s.90, only the Commonwealth has the power to impose duties of customs and excise. The High Court ruled in 1997 that a tax applied anywhere in the production and distribution chain is a 'tax on production' and thus an excise. Consequently, the States, which had been imposing business franchise fees, lost a major source of revenue.

On the other hand the Commonwealth does not have the power to legislate directly in some areas. Section 109 of the Constitution makes it clear that Commonwealth legislation prevails where it conflicts with State legislation. However, in some areas, the Commonwealth has no power to legislate and must cooperate with the States to implement its policies. The Commonwealth and States can work around these Constitutional limits: (1) States can 'refer' (or transfer) their powers to the Commonwealth; (2) States can agree to pass identical legislation implementing a national scheme; or (3) one State can pass 'template' legislation that all other States then adopt by reference.

In practice, States have been reluctant to enter into national schemes of regulation without compensation from the Commonwealth for the loss of any existing sources of revenue. This compensation has been raised in some cases via an additional charge on those subject to the regulation. Commonwealth agencies then act as collection agencies for the States and redistribute the revenues raised. Under the terms of the Corporations Agreement between the Commonwealth and the States, a proportion of charges raised by the Australian Securities and Investments Commission is paid to the States to compensate them for revenues lost when they agreed to a national scheme of corporate regulation.[2] Prior to the national scheme,

2 Under the terms of the previous Corporations Law, Australian Securities and Investments Commission fees were imposed under State law (and as such were not constrained by s.55 of the Constitution). Parliament has passed a series of financial Acts that include the clarification of

States used corporations fees to raise significantly more than the costs of corporate regulation (see appendix F).

The Commonwealth's ability to cost recover in some areas is also affected by s.51(ii) of the Constitution, which provides that taxes cannot discriminate between States or parts of States. Section 51 has prevented the Australian Competition and Consumer Commission from charging industry levies on gas and electricity because it is not the gas and electricity transmission regulator in all States and thus the levies would not apply consistently across all jurisdictions (see chapter 6).

3.2 Legislative and fiscal arrangements

The Commonwealth Government's legislative framework, budgetary processes and reporting requirements affect cost recovery arrangements. The current legislative framework relating to the financial management and accountability of Commonwealth agencies, authorities and companies was introduced in 1997, when the *Commonwealth Authorities and Companies Act 1997*, (the CAC Act) and *Financial Management and Accountability Act 1997*, (the FMA Act) replaced the *Audit Act 1901*.

Consolidated Revenue Fund

The Consolidated Revenue Fund is the principal working fund of the Commonwealth. Section 81 of the Constitution requires all public monies raised by the Commonwealth to be credited to the fund. Section 83 of the Constitution states that monies cannot be drawn from the fund without Parliamentary approval (an appropriation). Therefore, virtually all cost recovery revenue must be paid into the Consolidated Revenue Fund and agencies can spend only money that has been appropriated to them by Parliament. Mechanisms such as special appropriations and net appropriations have been developed to allow agencies to use funds raised from cost recovery for their own purposes (box 3.1).

Australian Securities and Investments Commission fees as Commonwealth taxes. This was prompted by recent High Court decisions that identified problems with the Corporations Law (see appendix F).

Box 3.1 **Special appropriations and net appropriations**

Special (standing) appropriations (FMA Act, s.20)

Section 20 of the FMA Act sets aside components of the Consolidated Revenue Fund for specific purposes through a special appropriation. The amount appropriated will depend on the extent to which the claimants satisfy program eligibility criteria (specified in the Act of a legislation based program), alternatively the Minister for Finance and Administration may determine an amount in accordance with specified criteria.

These appropriations are not subject to Parliament's annual budget control because they do not lapse at the end of each financial year, differentiating them from annual appropriations.

Special appropriations are often used to 'hypothecate' specific tax revenues to particular uses. Examples include the *Aviation Fuel Revenues (Special Appropriation) Act 1988*, under which revenue collected from industry through aviation fuel customs and excise is appropriated to the Civil Aviation Safety Authority.

Net Appropriations (FMA Act, s.31)

Net appropriation agreements under s.31 of the FMA Act allow agencies to enter into agreements with the Minister for Finance and Administration to use funds raised from cost recovery for their own purposes.

Three categories of eligible departmental receipts that may be made available to the agency are marked as net appropriations. Category B receipts correspond to receipts from 'user charging' activities, including those from the provision of goods and services.

These agreements can be for any period of time and do not need to relate to any particular Appropriation Act. Net appropriation reflects the fact that the normal budget appropriation for the agency subject to the agreement will be net of the estimated cost recovery receipts.

Commonwealth Authorities and Companies Act

The CAC Act applies to bodies with a legal existence outside the Commonwealth Public Service. CAC bodies do not need to have 'corporation' or 'authority' in their title — the Australian Broadcasting Corporation, the Australian Broadcasting Authority, the CSIRO, the Special Broadcasting Service, the ABS, the National Library of Australia and the Australian Trade Commission are all subject to the Act.

These bodies may have some control of their operating funds and assets, independent of the Commonwealth. Some CAC bodies, (for example, government business enterprises operating in commercial markets) may control money in their own right and are able to receive revenues and spend receipts independently of the

Consolidated Revenue Fund. However, those CAC bodies that handle public monies on behalf of the Government, such as those that collect fees or levies, are required to credit these funds into the Consolidated Revenue Fund and are subject to the financial management arrangements that apply under the FMA Act.

Financial Management and Accountability Act

The FMA Act applies to Commonwealth bodies that financially are agents of the Commonwealth (that is, they manage public money and property). These bodies include departments of State, Parliamentary departments, statutory authorities and other Commonwealth bodies.

The FMA Act provides a framework for the management of public money and property. Elements that are particularly relevant to cost recovery include:

- the operation of the Consolidated Revenue Fund and a system of special accounts and the rules that apply to Parliamentary appropriations;
- special responsibilities of chief executives for the control and management of public money and property; and
- the preparation and audit of financial statements including annual agency reports.

Chief executive responsibilities

The FMA Act sets responsibilities in key areas for the chief executives of agencies (in some cases departmental secretaries) to manage resources efficiently, effectively and ethically. These areas of responsibility include the control and management of public money and property as well as the preparation of financial statements (DOFA, sub. 20 in JCPAA 2000, p. 2).

The Act gives chief executives autonomy and responsibility in the management of agencies. All agencies have a model set of Chief Executive Instructions to guide them in dealing with public money and property. However, the devolution of authority to chief executives was balanced against the need for a chain of accountability back to Parliament. The Parliamentary Library Brief to the FMA Act noted:

> Part of that balance is maintained by not granting to Chief Executives the degree of autonomy that might be expected to apply if, for example, the [Australian Public Service] were broken up into a multiplicity of self-governing/self-contained corporate entities. It is arguable that under the present Act, the powers of the Department of Finance remain firmly entrenched, although somewhat further removed from day to day operations. (Commonwealth of Australia 1997b, p. 7)

The Minister and Department of Finance and Administration retain a degree of control through (1) the ability to issue orders and guidelines on matters such as accounts and records, and (2) oversight of the general budgetary process:

> Finance very deliberately with the formulation of the FMA Act and the CAC Act stepped out of any sort of role in which it may appear to be a micro-manager of these agencies or any agency. However, it does have an interest in ensuring or observing if in fact efficient, effective and ethical behaviour does occur within these particular businesses. (DOFA, trans., p. 1358)

This shift towards greater agency accountability and responsibility has led to concern among some participants, especially in relation to cost recovery. The Tourism Taskforce stated:

> With the decentralisation to agencies, there is a great temptation to introduce new charges and [agencies] tend to do so on the basis of their own political perceptions and, as a result, there isn't a whole of government approach taken to many of these charges in terms of regulation impact statements etc. They don't certainly consider the broad impact on the whole of the economy of those measures. They take a very narrow focus within the agency concerned. (trans., p. 1085)

Financial statements

The FMA Act requires the maintenance of accounts and records as required by the Finance Minister's Orders for FMA agencies. Similarly, the CAC Act requires Commonwealth bodies and authorities to prepare annual reports. Both Acts require financial statements to be subject to an independent audit by the Auditor-General, while the remaining content is at the discretion of the reporting department/agency (BASI 1999, p. 89).

Under current financial reporting arrangements it is difficult to estimate the extent of cost recovery in the Commonwealth public sector (see chapter 4). Limited data are available in budget documentation such as the Budget Papers, the Portfolio Budget Statements and the *Commonwealth Government's Consolidated Financial Statements*. However, the data contained in these publications are typically not disaggregated sufficiently to allow cost recovery revenue to be identified separately, particularly at the agency level.

The Appropriation Acts each year specify that net appropriations received by agencies must be identified as such. Although these appropriations are usually identified as 'section 31 appropriations' in the agency's financial statements and Portfolio Budget Statements, the terms of the agreement are not identified. Similarly, there are no requirements as to how cost recovery revenue is recorded, which may inhibit transparency and accountability.

The Department of Finance and Administration provided the Commission with data on 'other taxes' and 'Commonwealth Government revenue from the sale of goods and services'. However, the Commission found these data also were too aggregated to enable analysis at the agency level. In addition, a number of items included both cost recovered and non-cost recovered revenue which the Commission was unable to identify separately. Similar problems arise with data provided in agencies' annual reports and Portfolio Budget Statements. It is difficult to establish the objectives, costing and revenue raising of many cost recovery arrangements.

FINDING

There is currently a lack of transparency and accountability in many cost recovery arrangements. It is difficult to identify from existing sources the overall level of cost recovery by Commonwealth regulatory and information agencies. Publicly available data are incomplete and inconsistent, and the Department of Finance and Administration is unable to identify cost recovery receipts separately from other revenue.

Moreover, at the individual agency level, it is difficult to establish the objectives, costing and revenue raising of many cost recovery arrangements.

Many inquiry participants, including both agencies and industry associations, endorsed this view. The Bureau of Meteorology for example, stated:

> … the Bureau would support increased oversight of cost recovery revenue (both section 31 and consolidated revenue) arrangements through more transparent reporting of cost recovery receipts for information agencies as part of the Budget process. Also, it may be appropriate for the Bureau's Advisory Board to monitor section 31 arrangements in the Bureau as part of its function of review of the allocation of resources within the Bureau. … The ensuing information will be included in the Bureau's Annual Report which is tabled in the Parliament. (sub. DR142, p. 2)

Likewise, the Australian Chamber of Commerce and Industry drew attention to deficiencies in reporting arrangements and suggested that agencies take greater responsibility in financial reporting (consistent with the FMA Act):

> In their reports to Parliament, the [Australian National Audit Office] and [Department of Finance and Administration] should give an audit and an aggregate report respectively on agencies' cost recovery arrangements. Heads of agencies should be responsible for reporting in their Annual Reports, the receipts from cost recovery and on what services, operating activities etc, the monies were used. Appropriate compliance by heads of agencies should be taken into account in the performance pay process. (sub. DR136, att. A, p. 15)

The Department of Finance and Administration suggested improvements to current reporting arrangements:

> Public reporting can be used to monitor the nexus between cost recovery receipts and expenditure of funds on a service. For example, the Portfolio Budget Statements could be used to project cost recovery revenue and expenditure at the output level, with *ex post* reporting through the annual report. (sub. 38, p. 5)

It also stated that it would be relatively simple to identify cost recovery revenue separately:

> The chart of accounts at the moment provides some level of information, but it may be useful to have additional lines in the chart in relation to cost recovery type revenue or section 31 type revenues, so it is easier to see where these are coming from and that would not cost too much at all. It would be a matter of increasing the number of lines in the chart and then having agencies putting information in there, so that wouldn't be a problem. (trans., p. 1370)

RECOMMENDATION 3.2

Revenue from the Commonwealth's cost recovery arrangements should be identified separately in budget documentation and in the Consolidated Financial Statements. It should also be identified separately in each agency's Annual Report and in Portfolio Budget Statements.

However, these reporting arrangements may not provide sufficiently detailed information to assess the efficiency of agencies imposing cost recovery. Other mechanisms for providing more detailed information on the objectives, costing and revenue raising of individual activities are outlined in chapter 8 as part of the discussion of ways in which to improve administrative arrangements.

Accounting issues

Traditionally, most Commonwealth reporting was done by program (area of activity) on a cash basis. White papers published in the 1980s — *Reforming The Australian Public Service* (1983) and *Budget Reform* (1984) — provided impetus for reforming the Commonwealth's reporting arrangements. The introduction of the FMA and CAC Acts resulted in two major changes to financial reporting arrangements: (1) a change in how the output is measured (from cash to accrual); and (2) a change in how the activity is described (from programs to outputs/outcomes).

Accrual accounting

Cash accounting involves recording revenues in the period when the cash is received and recording expenses when the cash is paid. In contrast, accrual

accounting recognises revenue and expenses as they accrue in a given period (usually the financial year) (Hoggett and Edwards 1987, p. 94).

Accrual reporting systems promote greater transparency and accountability in financial reporting, and provide a better basis for matching economic costs incurred during a reporting period against the economic benefit accrued in that same period. The accrual framework also facilitates the comparison of a transaction's full costs against benchmarks or standards.

Accrual accounting allows for expenses to be assessed more accurately and enables costs to be identified more accurately for cost recovery purposes. As a result, cost recovery charges have risen in some cases because costs that could not be readily identified under the cash system (such as capital costs and depreciation) are now recognised and taken into consideration.

Output based reporting

In April 1997 the Commonwealth shifted from program based reporting to output based reporting. This requires authorities and agencies to: specify and set prices for the outputs they will deliver; describe planned outcomes to which outputs contribute; and specify the performance information required to monitor, manage and account for the output delivery and the achievement of actual outcomes.

Output based reporting requires all outputs to be identified separately and costed. Agencies have implemented this approach to varying degrees. Some agencies have not separately identified some outputs relating to the 'public interest', such as the development of policy and the provision of advice to Ministers. These costs have been included in agency overheads and allocated across other outputs, many of which are subject to cost recovery. These outputs are not usually substantial, but the practice can lead to overcharging for these cost recovered activities (see chapter 7).

3.3 Institutional framework

A number of agencies have roles in managing Commonwealth public finance arrangements, including cost recovery. Parliament, the Minister for Finance and the Department of Finance and Administration have overall responsibility for budgetary processes. The Office of Regulation Review has an important advisory role in new regulatory arrangements and legislative reviews. Other bodies have roles in relation to specific aspects of public finance (some are identified in box 3.2).

Box 3.2 Some bodies involved in Commonwealth public finance

Australian National Audit Office (ANAO)

The ANAO is a specialist Commonwealth agency that provides audit services (performance audits, financial statement audits and better practice guides) to the Parliament, Commonwealth agencies and statutory bodies. *The Auditor-General Act 1997* regulates the powers and responsibilities of the Auditor-General and the ANAO. ANAO performance audits can include cost recovery arrangements. For example, the cost recovery systems of the Australian Quarantine and Inspection Service were the subject of an audit in 2000. Performance audits are performed on an *ad hoc* basis and do not form a systematic review mechanism for cost recovery arrangements.

The Auditor-General is responsible for undertaking annual financial statement audits of government departments, statutory authorities and government business enterprises. These focus on compliance with financial reporting requirements, rather than on the appropriateness or efficiency of cost recovery.

The ANAO produces better practices guides to improve public administration practices. It has not published any better practice guides in relation to cost recovery activities.

Joint Committee of Public Accounts and Audit

The Joint Committee of Public Accounts and Audit is a Parliamentary committee empowered to scrutinise the monies spent by Commonwealth agencies from funds appropriated to them. It examines all Auditor-General reports that are tabled in Parliament. In addition to the joint committee's statutory review process, the House of Representatives may refer reports to standing committees. The purpose in reviewing audit reports is to assess whether audited agencies have responded appropriately to the Auditor-General's findings.

Commonwealth Competitive Neutrality Complaints Office

The Commonwealth Competitive Neutrality Complaints Office investigates complaints about the application of competitive neutrality principles at the national level and advises the Treasurer. Competitive neutrality principles apply where a government business competes with the private sector. They do not apply to government agencies imposing cost recovery as monopoly providers, but may apply to government agencies operating in competitive markets.

Agency boards and advisory committees

Typically a body operating under the CAC Act is governed by a board that is responsible for management to the Minister. The CAC Act sets out standards of conduct for its directors, such as a standard for establishing an audit committee to assist in financial reporting, risk management and internal control. Most statutory bodies and agencies (including FMA Act bodies) provide for consultative committees, but their establishment and functions are not standardised.

The Expenditure Review Committee is the major decision making body on the expenditure side of the budget. The Prime Minister, the Treasurer and the Minister for Finance are all members of the committee. Given that the Expenditure Review Committee is a Cabinet Committee, its meetings are attended by officials from relevant departments. 'Spending' ministers speak to their proposal and are then questioned by committee members, who determine whether the proposal should be supported, rejected or amended.

Department of Finance and Administration

This Department oversees agencies' compliance with the FMA and CAC Acts, as well as monitoring the operation of the Acts (JCPAA 2000, p. 3). It also monitors the robustness of agencies' output pricing through pricing reviews and provides input into the budget process.

Pricing reviews

The introduction of outcomes/outputs based accrual budgeting requires agencies to price the outputs they produce to achieve the Government's desired outcomes. The Department introduced pricing reviews in 1999-2000 to hold agencies accountable for the quality, quantity and price of their outputs. Outputs are priced through market testing, various forms of benchmarking and the costing of outputs and inputs. The result of a pricing review is a report to the Expenditure Review Committee.

In July 2001 the guidelines for pricing reviews were updated, placing greater emphasis on the role of the agency in conducting the review (box 3.3). The objectives of the pricing reviews in 1999-2000 and 2000-01 included:

- consolidating the Government's reform agenda by assisting agencies to implement robust output costing systems;
- achieving greater transparency of the drivers of output prices for Ministers; and
- assessing the reasonableness of the prices of agencies' outputs.

Eighteen Commonwealth agencies undertook output pricing reviews in 2000-01. Various agencies, including Environment Australia (box 3.4), also completed pricing reviews in 1999-2000.

Box 3.3 **Department of Finance and Administration pricing review guidelines in 2001-02**

The objectives that guide the direction of pricing reviews in 2001-02 are:

- to evaluate the price of an agency's outputs;
- to enforce the financial framework reforms through improved financial, budgeting, costing and performance monitoring systems; and
- to allow a stronger focus on financial and resource management issues.

Responsibility for the output pricing review has shifted from the department (which remains involved as a specialist adviser) to the agency.

The four stages to the output pricing review process are:

- the scoping and planning of the review, which require an understanding of the agency environment;
- research and the collation of pricing data through market testing, benchmarking, finance diagnostics, process appraisals and stakeholder surveys;
- the evaluation of pricing data using mechanisms such as benchmark comparisons and review of stakeholder feedback; and
- report preparation, whereby a progress report is provided to the Senior Minister's Review in November, full reports are provided to both the portfolio Minister and the Minister for Finance, and a two page brief is provided to the Expenditure Review Committee (attached to the Portfolio Budget Statements).

Once the report has been submitted, the department and the relevant agency negotiate findings.

Source: DOFA (2001).

A pricing review includes the unit price of each output covered by the review. Where the proposed unit price is higher or lower than that already in the budget forward estimates, the difference must be justified. The report also indicates options for Government to reduce prices by requiring efficiencies; requiring different levels of quality; and if necessary, indicating a compromise on expected outcomes. Unlike the earlier reviews, the revised Department of Finance and Administration guidelines for the 2001-02 pricing reviews suggest a role for stakeholder consultation in assessing output quality. However, this does not guarantee stakeholder consultation. Agencies are not obliged to use this mechanism and stakeholders have no opportunity to contribute to areas outside output quality, such as price.

Because pricing reviews are presented to the Expenditure Review Committee they are given 'cabinet in confidence' protection and as such are not publicly available.

However, in its submission to the Commission, Environment Australia provided some information on its pricing review in 1999-2000 (box 3.4). It undertakes limited cost recovery so its review focused on outputs related to corporate services, policy analysis and advice.

Box 3.4 **Environment Australia's pricing review**

In 1999-2000 Environment Australia was subject to an output pricing review. The objectives were:

- to determine whether outputs are being delivered efficiently with regard to the price of those outputs compared with the prices of comparable outputs of other agencies or external providers; and
- to provide guidance for future output structure and reporting practices.

Stage one examined the overall cost effectiveness of corporate services and identified outputs with the potential for cost reduction. This resulted in a reduction of $5 million in Environment Australia's overall resource allocation for 2000-01.

Stage two of the review included remaining departmental output groups such as policy analysis and advice. These outputs are more difficult to price because they do not follow a predictable or replicable path or process and the criteria for success may change. The pricing of policy advice requires benchmarked standards for the types of policy advice provided and a comparative basis for the price of that advice.

Source: Environment Australia (sub. 76, att. D).

The Australian Fisheries Management Authority, along with other agencies, expressed concern over the pricing review process:

> [The authority's] limited knowledge of pricing reviews suggests that these may also operate in a … blunt manner. That is, they tend to be solely aimed at reducing the overall cost rather than a balanced assessment of the benefit/cost of providing specific services. (sub. DR160, p. 3)

However, expanding the role of pricing reviews in assessing cost recovery has received broad agency support and is discussed in chapter 8.

Budget processes

Budget processes subject governmental financial arrangements to Parliamentary scrutiny and can help ensure the transparency and accountability of cost recovery arrangements. Cost recovery agencies are subject, in principle, to the same budgetary processes that apply to all Commonwealth agencies, but this scrutiny is reduced through the use of ss.20 and 31 appropriations. The budget process (box 3.5) is a combination of top-down (Government strategies) and bottom-up

(agencies' strategies) elements. A complete budget cycle requires at least 22 months to complete, so a number of periods will overlap.

Box 3.5 **Budget process**

- Ministers bring forward policy initiatives.
- Ministerial initiatives are considered within the overall fiscal strategy of the Government.
- Senior Ministers' review considers the range of Ministers' initiatives.
- Ministers submit initiatives in the form of Portfolio Budget submissions to the Expenditure Review Committee.
- The Department of Finance and Administration Budget Group makes recommendations to the Expenditure Review Committee in the form of the *Green Brief* (an assessment of both financial and non-financial aspects of the Portfolio Budget submissions).
- The budget is delivered in Parliament.
- Senate legislative committees review the budget on a portfolio basis.

Source: DOFA (2000).

The Department of Finance and Administration is responsible for: coordinating the preparation of the budget estimates; facilitating the consideration of expenditure proposals by the Expenditure Review Committee; and ensuring the budget estimates are accurate and consistent with budget policy requirements. It is also responsible for explaining line items in the estimates process, including differentiating between 'aggregate non-tax' and 'other taxes, fees and fines' (line items that may include elements of cost recovery).

While the Department is ultimately accountable for budget estimates, portfolio departments and agencies have shared accountabilities to their Minister for constructing accurate and timely estimates to contribute to budget documentation.

Department guidelines

The Department of Finance and Administration is responsible for forming guidelines to assist agencies to implement Government policy on financial management. Various department publications have affected the implementation of cost recovery. Inquiry participants cited the *Guide to Commercialisation* (DoF 1996) and *Guidelines for Costing of Government Activities* (DoF 1991) as sources of information on the introduction of cost recovery (box 3.6).

Box 3.6 ***Guidelines for Costing of Government Activities* (1991)**

These guidelines outlined the scope for the costing of government activities and how agencies should apportion the costs of activities and programs while keeping in mind the broad objectives of:

- ensuring the level of service use is related to the full resource costs of providing the services;
- assessing the performance of individual units of production;
- meeting the requirements of any specific government policies (rate of return); and
- ensuring there is opportunity for fair and effective competition, if there is competition between the public and private sectors.

When user charging is involved, the guidelines stated that prices should reflect the financial charter and objectives of the organisation and whether competition existed between the public and private sectors. The suggested options included full cost pricing, marginal cost pricing and pricing of staffing, labour on-costs and overheads.

Full cost pricing

The concept of full cost recovery (including a return on capital) was identified as a primary benchmark, equating with the requirement that private sector organisations must satisfy in the long term if they are to remain viable. Full cost pricing would therefore be the policy objective of any public sector agency (or unit) with a self-sufficiency or commercial charter. Full cost recovery would mean that prices would be set to equate to average costs of production in the long term.

Marginal cost pricing

Short term marginal cost pricing was identified as a useful technique where marginal output decisions are needed and full cost pricing appears to be inappropriate. These situations may include:

- national security and/or other 'public interest' reasons;
- services characterised by seasonal troughs in demand over the year or off-peak periods in the consumption cycle; and
- government requirements to meet consumer service obligations to particular regions or recipients.

Staffing, labour on-costs and overheads

Most of the labour costs relevant to the production of a particular output can be readily assessed. However, the guidelines stated that agencies can account for those costs unable to be assessed by applying an overhead rate to the direct labour costs. These costs relate to: salaries; administrative/operational expenses; compensation and legal expenses; accommodation; superannuation; and corporate support.

Source: DoF (1991).

While these guidelines are no longer current, several participants referred to them as the basis for their cost recovery arrangements. However, these guidelines focus on costing issues and do not address fundamental questions about the introduction of cost recovery arrangements. Those agencies that did not use the department's guidelines relied on *ad hoc* reviews and consultancy advice. For example, the Bureau of Meteorology cited reviews by Freebairn and Zillman (2000a) and Slatyer (1997).

FINDING

The absence of current cost recovery guidelines has led agencies to rely on outdated publications such as the Guidelines for Costing of Government Activities *(DoF 1991),* ad hoc *reviews and consultants' advice.*

Office of Regulation Review

The Office of Regulation Review provides advice to Government, Commonwealth departments, regulatory agencies and statutory authorities on the efficacy of new regulatory proposals and reviews of existing legislation. This advice is provided through the Regulation Impact Statement (RIS) process which details the costs and benefits of regulation through seven steps (box 3.7).

Box 3.7 **Regulation Impact Statements — the process**

A RIS involves the following steps:

- outlining the issue or problem requiring action;
- outlining the desired objectives from the action;
- outlining all viable options (regulatory and non-regulatory) for achieving the objectives;
- assessing the impact (costs and benefits) of each option on consumers, business, government and the community;
- providing a consultation statement;
- recommending an option; and
- outlining a strategy for the implementation and review of the preferred option.

Source: ORR (1998, p. A2).

A RIS is required for any regulatory proposal affecting business, not just those considered by Cabinet. The portfolio department making the proposal prepares the RIS. Exemptions to the RIS process include regulations that:

- are of a minor or machinery nature and do not substantially alter existing arrangements;
- involve the procurement of specific products;
- are required in the interest of national security; and
- are primary or delegated legislation for implementing international agreements.

Although Office of Regulation Review guidelines state that the development of a RIS is mandatory, the absence of a satisfactory RIS has no automatic effect on a regulatory proposal. So long as a regulation is made lawfully (so that the agency has the power to administrate the regulation and it has been gazetted) the absence of a RIS does not make it invalid. The Government may choose to delay the implementation of a regulation or postpone policy approval until the RIS process has been completed, or it may choose to proceed without an adequate RIS. The only RIS enforcement mechanism is 'moral suasion', whereby the Office of Regulation Review annual report lists agencies that fail to develop a satisfactory RIS.

While overall compliance is improving, the Office of Regulation Review notes that in 1999-2000 a RIS had been prepared in only 91 per cent of cases at the time the regulation was tabled in Parliament. A RIS was prepared at the decision making stage of policy development in only 82 per cent of cases (PC 2000b, p. 3). Continued commitment to the RIS process is necessary to ensure the statements are prepared early in the policy development process.

Despite the RIS process providing a valuable review mechanism, its application to cost recovery is problematic. Many of the cost recovery activities covered by this inquiry meet the criteria that require them to be subject to a RIS: they are established using legislative and quasi-legislative processes; and they affect business.

However, the existing RIS guidelines do not explicitly address cost recovery, so most RISs focus on the regulation being introduced, with little or no attention to proposed cost recovery mechanisms. Many agencies see cost recovery as part of implementing government policy, rather than as a regulatory option, and choose not to go through the RIS process. In other cases, incremental changes to existing cost recovery arrangements have been exempted from the RIS process under the 'minor and machinery' provision — for example, the consumer price index based indexation of fee schedules and changes following the introduction of the goods and services tax.

Over the past four years only 13 cost recovery proposals were subjected to the RIS process, representing only about 1 per cent of all RISs. The RIS process was applied to only three cost recovery proposals comprehensively:

- the development of a more equitable charging system by the Civil Aviation Safety Authority;
- a new structure for recovering the costs of certain applications to the Australia New Zealand Food Authority; and
- the consideration of cost recovery options for the new Office of the Gene Technology Regulator.

Many RISs are pitched at a relatively high level of principle, because they address the economic costs and benefits of regulation. This may mean that a RIS would not address many important issues in cost recovery, such as the structure of charges and the effects on agency efficiency.

Many cost recovery arrangements are introduced as taxes, for which special RIS arrangements apply. Tax RISs follow a similar process to that of the standard RIS, but consultative requirements differ because consultation on proposed tax changes may be inappropriate, given the sensitivity of information and the possibility of taxpayers engaging in tax avoidance or minimisation (ORR 1998, p. B10). These concerns may be valid for general tax measures, but they are less significant for taxes imposed for cost recovery.

Other cost recovery arrangements would not be subject to a RIS. Regulatory arrangements that affect individuals, rather than firms, and administrative arrangements (such as those underpinning many information agencies' cost recovery) do not require a RIS. In addition, although the RIS process captures new proposals or one-off reviews of existing regulation, it does not require regular reviews of the existing stock of regulation.

FINDING

Regulation Impact Statements assess proposed regulation but have not dealt directly with many cost recovery proposals.

Many inquiry participants endorsed this finding including agencies and industry associations, Austrade for example, stated:

> The Regulation Impact Statement (RIS) process should be clarified to make it explicit that, where a regulation under review includes a cost recovery element, the RIS should address cost recovery by applying the guidelines proposed by this inquiry. (sub. DR149, p. 3)

3.4 International obligations

International obligations may constrain the ability of Commonwealth agencies to set cost recovery charges. These obligations may take various forms including: bilateral and multilateral agreements; international harmonisation of regulatory standards; and mutual recognition of other jurisdictions' regulatory decisions.

International agreements

Specific international agreements set the price (sometimes at zero) that Commonwealth agencies can charge for at least part of their services. This is particularly the case where Australia provides one element of an international service, such as intellectual property rights (which are granted on a territorial basis) or information products that have a geographic basis. International agreements may also govern the price for information supplied to international bodies such as the United Nations, the OECD and the World Trade Organisation.

Intellectual property rights

The ability of Intellectual Property Australia to determine and set prices is constrained by the Patent Cooperation Treaty. Fees for applications filed under the treaty are set by agreement with the World Intellectual Property Organisation. These fees contain two components: Intellectual Property Australia pays the first component to the International Bureau of the World Intellectual Property Organisation and retains the second. The International Bureau determines the fees for the first component (IP Australia, sub. 57, p. 11).

International information services

Australia belongs to a number of international bodies that provide standardised global information on subjects such as weather and mapping. These organisations have agreements about information sharing that affect Australia's ability to recover the costs of collecting and distributing this information (box 3.8).

The impact of these agreements may be mitigated by the following factors:

- restrictions on the re-export of the information by overseas organisations for commercial purposes; and
- the fact that the information is often limited to copies of information that is already freely available in Australia.

Box 3.8 **International information agreements**

World Meteorological Organisation (WMO). Members are required to provide to other members 'those basic data and products required to describe and forecast weather and climate and to support WMO programmes … on a free and unrestricted basis' (WMO Resolution 40-Cg XII). Members may be justified in placing conditions on their re-export for commercial purposes outside of the receiving country.

Australian Bureau of Statistics (ABS). Section 6(f) of the *Australian Bureau of Statistics Act 1975* requires the ABS to provide liaison between Australia and other countries and international organisations in relation to statistical matters. The ABS meets this obligation by supplying data and one copy of standard publications on a complimentary basis to international organisations such as the United Nations.

Australian Geological Survey Organisation (AGSO). This organisation provides seismic data free of charge (daily, weekly, monthly and annually) to World Data Centres around the globe and to the International Data Centre in Vienna 24 hours a day. AGSO also has an agreement with the Comprehensive Test Ban Treaty Organisation to maintain telecommunications links to international seismic stations to allow for the continuous transmission of data. AGSO is paid to provide this service.

AGSO has a memorandum of understanding with the US Geological Survey and is about to enter into a similar arrangement with the China Geological Survey. Although not legally binding, these memoranda provide for the sharing of data and the exchange of scientific and technical knowledge.

Australian Surveying and Land Information Group (AUSLIG). AUSLIG has no international arrangements for data sharing. It has arrangements with satellite operators at commercial rates.

Source: AUSLIG (sub. 44); Bureau of Meteorology (sub. 35); AGSO pers. Comm.; *Australian Bureau of Statistics Act 1975.*

World Trade Organisation

Other international agreements potentially restrict Australia's ability to impose cost recovery on imported products. Article VIII of the General Agreement on Trade and Tariffs restricts the ability of member countries to charge fees and duties in connection with importation or exportation. Charges must be limited to the approximate cost of services rendered and must not indirectly protect domestic products or tax imports or exports for fiscal purposes (WTO 1994).

World Trade Organisation agreements with particular relevance to cost recovery include the Application of Sanitary and Phyto-Sanitary Measures (the SPS Agreement) and Technical Barriers to Trade (the TBT Agreement). The TBT Agreement covers technical regulations and standards for packaging and labelling and procedures for assessing conformity with the standards. It also details how

technical barriers to trade may be used legitimately. The SPS Agreement requires members to base SPS measures on an international standard or a proper risk assessment. It applies to measures that protect human, animal or plant life from health risks arising from: pests; diseases; food additives, contaminants or toxins; or disease-causing organisms in foods, beverages or feedstuffs (DFAT, sub. 97, p. 2). Signatories of both the TBT and SPS agreements are entitled to impose appropriate measures and recover the associated costs — to the extent that they do not unnecessarily restrict trade. The SPS Agreement obliges signatories to, for example, not restrict trade more than necessary to maintain quarantine security.

Charging undertaken by regulatory agencies for import risk or equivalence assessments could raise World Trade Organisation issues under this agreement. The Department of Foreign Affairs and Trade flagged the *Australia New Zealand Food Authority Act 1991*, the *Agricultural and Veterinary Chemicals Code Act 1994*, the *Industrial Chemicals (Notification and Assessment) Act 1989* and the Gene Technology Bill 2000 (now an Act) as examples of domestic legislation that could raise World Trade Organisation concerns (DFAT, sub. 97, p. 2). The Australian Food and Grocery Council also noted concerns:

> Imposing levies on imported products to address the inequality of levying only domestically manufactured products may be viewed as a tariff barrier, or an unjustified technical barrier to trade (depending on how it was imposed). This may result in Australian products attracting similar [reciprocating] tariffs when exported to overseas markets, to their competitive disadvantage. Australia may be challenged as a signatory to World Trade Organisation Agreements. (sub. DR145, p. 11)

Harmonisation of standards

Australia is pursuing agreements to harmonise standards with other countries. For example, the Closer Economic Relations Free Trade Agreement between Australia and New Zealand applies to goods and services and, increasingly, to harmonising standards and legislation. An example of the latter is the establishment of the Australia New Zealand Food Authority and the associated development of joint food standards in 1995.

Harmonisation can lead to the adoption of different standards in Australia than would have occurred without an agreement. If the cost of administering these standards differs, then it may affect the level of cost recovery.

Mutual recognition

The mutual recognition of regulatory assessments and approvals can lead to price competition between regulators. If Australia were to recognise the assessments and approvals of overseas regulators, then firms wishing to sell on the Australian market would have an incentive to seek approval from the most efficient regulator. This would place pressure on the Australian regulator to maintain competitive prices. Mutual recognition can also reduce firms' costs by removing the need for multiple approvals to sell in more than one market.

The National Standards Commission, for example, is moving towards mutual recognition as a member of the International Organisation of Legal Metrology. Under this arrangement, international laboratories would accept each other's reports. The commission recognises that the arrangement would place it in price competition with overseas laboratories and expects it to reduce significantly the amount of testing conducted in Australia (sub. 31, p. 4).

Australia is also pursuing mutual recognition in other areas, including medical devices and chemicals. In the case of medical devices, Australia is a participant in the Global Harmonisation Taskforce (comprising Canada, Japan, the European Union and the United States). While the taskforce has not yet led to a significant increase in the recognition of overseas assessments or approvals, the Government recently decided to adopt the international classification of medical devices from the European Union but to retain the Therapeutic Goods Administration's role in approving products for supply in Australia (PC 2000a, p. 145). Further, mutual recognition of laws relating to chemicals is progressing through the Trans-Tasman Mutual Recognition Arrangement Chemicals Cooperation Program (ACSMA, sub. 60, p. 7).

3.5 Other models of cost recovery

While the Commonwealth is yet to implement official guidelines or legislation to assist agencies in implementing cost recovery, State governments and other countries have adopted different approaches to cost recovery.

International models

Although different issues are highlighted in different jurisdictions (as discussed in appendix G), a common theme is the distinction between taxes and user charging. The Constitutions of New Zealand, Canada and the United Kingdom are similar to that of Australia, in that they require that taxes be implemented on the basis of

specific legislation. Therefore, user charges that have the characteristics of a tax, but are not supported by legislation, may be invalid. The distinction between user charges and taxes in the United States is unclear and has prompted considerable litigation surrounding this issue (see appendix G).

The New Zealand approach to cost recovery is outlined in *Guidelines for Setting Charges in the Public Sector* (New Zealand Treasury 1998). The guidelines contain information on the accounting, costing and economic issues of cost recovery. Among other things, they encourage the use of cost recovery for revenue raising purposes. A stated objective is 'reducing reliance on funding from general taxation' (1998, p. 2).

The guidelines examine the economic principles that may make cost recovery inappropriate but provide limited advice on how to apply these principles. They provide, for example, a case for partial cost recovery, but state that 'the loss in public benefits from charging at full cost would have to be significant' (1998, p. 2). According to the guidelines, the potential beneficiaries of government activities, along with individuals, groups or firms that require regulation ('risk exacerbators'), should be subject to cost recovery.

The New Zealand Treasury has also identified characteristics that determine whether user charges amount to taxation. These include: whether the transaction is voluntary; the strength of the link between the revenue source and its use; the magnitude of the user charge; and whether indirect as well as direct costs are recovered (1998, p. 17).

The Canadian approach to cost recovery is outlined in its *Cost Recovery and Charging Policy* (Treasury Board of Canada Secretariat, 1997b). Produced following consultation with stakeholders, the policy provides guidelines to Canadian Government agencies on their charges. The guidelines adopt a 'beneficiary pays' approach and require government agencies to ensure consultation with affected parties before and during the cost recovery process. The guidelines provide for deviation from full cost recovery if the activity is affected by some public policy objective or contains a mix of public and private benefits (1997b).

The Canadian guidelines also contain some information on the economic issues surrounding cost recovery and limited information on accounting and costing matters. *User Charging in the Federal Government — A Background Document* (Treasury Board of Canada Secretariat 1997a) contains a detailed discussion of economic issues of user charges.

Cost recovery guidelines in the United Kingdom are outlined in *The Fees and Charges Guide* (UK Treasury 1992). These guidelines advise the UK Government

agencies on their charges. They contain detailed accounting and costing information but little information on economic issues. They presume a preference for full cost recovery, making no attempt to address when full cost recovery is inappropriate, other than stating that partial cost recovery is permissible with Ministerial agreement. Government agencies in the United Kingdom are unable to charge for services unless they have specific legislative authority to do so (1992, p. 2).

In the United States, *Circular No. A-25 Revised* (OMB 1993) provides guidelines to US Government agencies on setting charges. It contains limited information on the accounting, costing and economic issues surrounding cost recovery. It strongly encourages cost recovery and states that full cost recovery is appropriate from identified recipients of government activities, irrespective of whether all or some of the benefits are passed onto others, including the public in general. The Office of Management and Budget views cost recovery as an alternative to budget funding and believes this has been an important factor behind the increase in US user charges.

The Finnish approach to cost recovery is somewhat different in that it is based on a specific Act — the *User Charging for Government Services Act 1992*. It promotes the use of cost recovery and provides guidelines to Finnish Government agencies on their charges. The legislation lists many possible exemptions — including health care and other welfare services, the administration of justice, environmental protection services, education and general cultural activities — but does not explain these exemptions.

State models

New South Wales, Victoria, Queensland, South Australia, Tasmania and Western Australia have produced various guidelines on user charges (see appendix G). Some have a competitive neutrality emphasis and may exclude regulatory activities, while others have a broader scope. All the guidelines contain advice on costing, promoting full cost recovery as a general principle. Full cost recovery is frequently defined as including direct costs, indirect costs and imputed costs necessary for competitive neutrality compliance (for example, the cost of capital and certain taxes and charges from which public sector organisations are exempt). The Western Australian guidelines specifically consider alternatives to full cost recovery. They suggest short run and long run marginal cost pricing as possible bases for the charges.

The States' guidelines also give examples of when full cost recovery may be inappropriate. These are consistent with guidance given in the Competition Principles Agreement, clause 1(3), which sets out public interest factors to be

considered. Instances of inappropriate full cost recovery include conflicting policy objectives, legal restrictions and the presence of externalities. In Queensland, community service obligations or government service obligations can lead to partial cost recovery (subject to agreement between the agency, portfolio Department, portfolio Minister and the Treasurer).

Accountability mechanisms exist in most States but vary in their formality. In Victoria, Treasurer or Ministerial approval is required for changes in fees under certain circumstances. In Tasmania, there is a biennial external assessment of a government agency's charges by the Budget Committee, another appropriate committee, or Cabinet. The New South Wales guidelines do not specifically refer to an accountability mechanism, although they do state that agencies have the option of consulting with Treasury analysts for advice and assistance.

Most guidelines require government agencies to publish their charging policy. The policy is published as part of an agency's business plan in Victoria, in specific agency manuals in Tasmania, and in agencies' annual reports in Western Australia. The Victorian, Tasmanian and Western Australian guidelines require government agencies to review their charging policies internally each year. While in Queensland, agencies are required to report their costing and pricing every three months to the Queensland Treasury and portfolio Department.

4 Current cost recovery arrangements

A wide range of cost recovery arrangements exist within Commonwealth regulatory and information agencies. Agencies employ a variety of mechanisms to recover the costs of their activities or products and have varying rationales for these arrangements. Regulatory and information agencies often face different issues, and they are discussed under separate headings in this chapter where relevant.

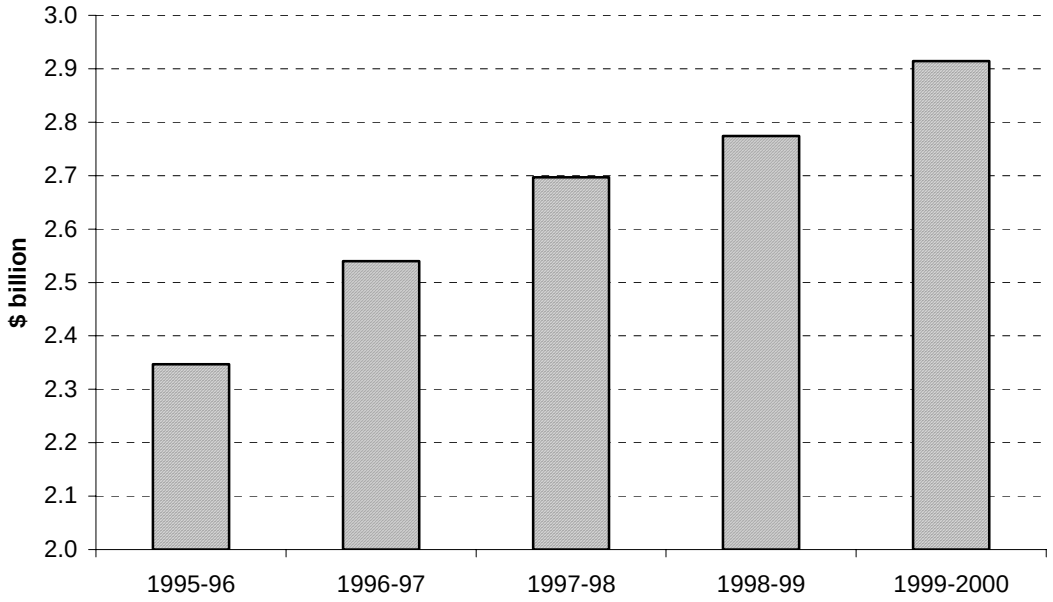
4.1 Introduction

Commonwealth regulatory and information agencies collect a significant amount of revenue through cost recovery. As noted in chapter 3, publicly available data on these arrangements at both the national level and individual agency level are incomplete. Thus, the Commission undertook a survey of agencies to estimate the magnitude and extent of cost recovery. Questionnaire responses by a selection of agencies are summarised in appendix B.

Departments and agencies that responded to the questionnaire collected a total of $3.2 billion in cost recovery revenue in 1999-2000.[1] The questionnaire asked agencies to indicate their cost recovery revenue from 1995-96 to 1999-2000. As indicated in figure 4.1, the revenue of agencies that reported for all five years increased annually and rose by 24.2 per cent in real terms over the period. If revenue collected by agencies that commenced cost recovery during this period were included, the increase would be even greater.

[1] This figure indicates the magnitude of cost recovery in Commonwealth regulatory and information agencies. However, it is based on agencies' own estimates of their cost recovery revenue. It includes revenue only of agencies that responded to the Commission's questionnaire, which are believed to include the main cost recovery agencies. Further, it includes transactions between Commonwealth agencies and between Commonwealth and State Government agencies, as well as between Commonwealth agencies and the private sector. It does not include some revenues that fall outside the scope of this inquiry (such as primary industry levies).

Figure 4.1 **Real cost recovery revenue of Commonwealth regulatory and information agencies, 1995-96 to 1999-2000[a,b]**



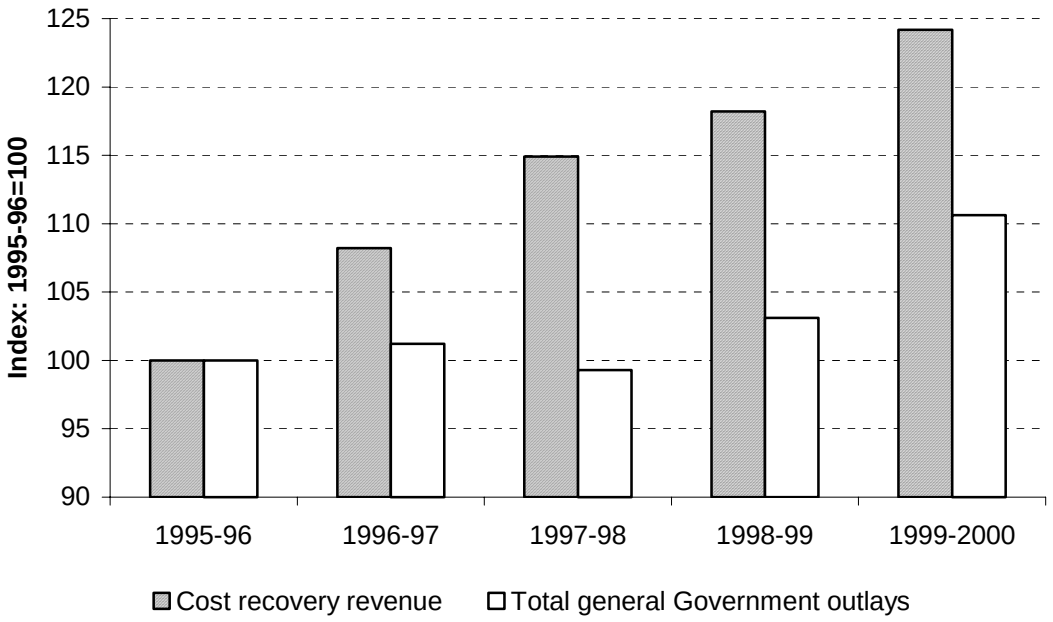
a Cost recovery revenues are based on agencies' own estimates. Revenues include only those of: (1) agencies that responded to the Commission's questionnaire; and (2) agencies that reported cost recovery revenues for all five years. Revenues include transactions both between agencies and between agencies and the private sector. They do not include some revenues that fall outside the scope of this inquiry. Cost recovery revenue for 1999-2000 is less than the $3.2 billion reported elsewhere in this report due to the exclusion of agencies that did not report cost recovery revenues for each of the five years. **b** Current dollars converted to constant 1999-2000 dollars using an implicit price deflator based on total final consumption expenditure.

Data sources: PC estimates based on questionnaire (part I) responses; ABS *National Accounts* on dX-Online database (accessed February 2001).

Over the same period, total Commonwealth Government outlays increased by 10.6 per cent in real terms.[2] The increases in Commonwealth cost recovery revenue and total government outlays are compared in figure 4.2.

2 *Final Budget Outcome 1999-2000*, table A1.

Figure 4.2 **Comparison of real increases in cost recovery revenue and total Government outlays, 1995-96 to 1999-2000** [a,b,c]



[a] Current dollars converted to constant 1999-2000 dollars using an implicit price deflator based on total final consumption expenditure. [b] Cost recovery revenues are based on agencies' own estimates. Revenues include only those of: (1) agencies that responded to the Commission's questionnaire; and (2) agencies that reported cost recovery revenues for all five years. Revenues include transactions both between agencies and between agencies and the private sector. They do not include some revenues that fall outside the scope of this inquiry. [c] There is a break in the 'total general government outlays' series between 1998-99 and 1999-2000 due to method and data source changes associated with the change from cash to accrual accounting.

Data sources: PC estimates based on questionnaire (part I) responses; *Final Budget Outcome 1999-2000*, table A1; ABS *National Accounts* on dX-Online database (accessed February 2001).

The reported cost recovery revenue by each portfolio is indicated in table 4.1. There has been a general trend among agencies to increase the level of cost recovery over time, although they introduced cost recovery at different times. Most of the existing arrangements were implemented in the past decade, although some agencies have a longer history of cost recovery. Many cost recovery arrangements emerged from internal reviews and independent reports, such as the Wallis (1997) inquiry into the Australian financial system and the Bosch (1984) inquiry into aviation cost recovery.

Table 4.1 **Cost recovery revenue by portfolio, 1999-2000**

Portfolio	*Cost recovery revenue* [a]	*Total expenses of portfolio* [b]	*Cost recovery/ total expenses* [c]
	$m	$m	%
Agriculture, Fisheries and Forestry — Australia	202	*1 448*	14.0
Attorney-General	479	1 354	35.4
Communications, Information Technology and the Arts	72	1 544	4.7
Defence	12	13 999	0.1
Education, Training and Youth Affairs	5	11 142	–
Employment, Workplace Relations and Small Business	32	1 690	1.9
Environment and Heritage	55	734	7.5
Family and Community Services	1	50 448	–
Finance and Administration	72	5 742	1.3
Foreign Affairs and Trade	172	2 379	7.2
Health and Aged Care	58	37 335	0.2
Immigration and Multicultural Affairs	226	714	31.7
Industry, Science and Resources	403	2 373	17.0
Prime Minister and Cabinet	24	1 105	2.2
Transport and Regional Services	730	2 777	26.3
Treasury	678	33 184	2.0
Veterans' Affairs	–	7 757	–
Total	**3 221**	**175 725**	**1.8**

[a] Figures include some transactions between agencies. [b] Figures are estimates of 1999-2000 'Total General Government Expenses by Agency' which include $18 640 million of inter-agency transactions but do not include $2310 million of small agency expenses. [c] These percentages may be lower than actual percentages due to the inclusion of expenses of agencies not surveyed by the Commission (and of those that did not respond) in the 'total expenses of portfolio figure'. – Rounded to zero.

Sources: PC estimates based on questionnaire (part I) responses; *Budget Strategy and Outlook 2000-01*, pp. 6.70–6.72.

4.2 Agency rationales for cost recovery

The Commission's questionnaire requested that departments and independent agencies explain the rationales for their cost recovery arrangements. The rationales given by selected agencies are summarised in table 4.2.

Table 4.2 **Rationales of selected agencies' cost recovery arrangements, 1999-2000**

Agency[a]	*Raise revenue*	*Expand services*	*Economic efficiency*	*Demand management*	*Agency efficiency*	*Equity/ distributional issues*	*International Agreements*	*Competitive Neutrality*	*Government policy or administrative decision*	*No cost recovery imposed*
ABARE								✓		
ABS	✓		✓	✓						
ACS	✓									
AEC								✓		
AFMA			✓							
AQIS									✓	
ASIC			✓			✓				
BoM[b]			✓				✓	✓		✓
CASA			✓						✓	
CSIRO					✓					
Environment Australia						✓				
IP Australia							✓			
NLA	✓			✓						
NRA									✓	
ScreenSound Australia	✓	✓	✓	✓		✓		✓		
TGA			✓						✓	

[a] ABARE – Australian Bureau of Agricultural and Resource Economics, ABS – Australian Bureau of Statistics, ACS – Australian Customs Service, AEC – Australian Electoral Commission, AFMA – Australian Fisheries Management Authority, AQIS – Australian Quarantine and Inspection Service, ASIC – Australian Securities and Investments Commission, BoM – Bureau of Meteorology, CASA – Civil Aviation Safety Authority, CSIRO – Commonwealth Scientific and Industrial Research Organisation, NLA — National Library of Australia, NRA – National Registration Authority for Agricultural and Veterinary Chemicals, TGA – Therapeutic Goods Administration. [b] These rationales relate to separate activities within BoM — only some of which are subject to cost recovery.

Source: PC estimates based on questionnaire (part II) responses and submissions.

Responses indicated a wide range of rationales. Often, there was more than one reason for an agency's current arrangements. Common rationales included:

- *to raise agency revenue*. Cost recovery arrangements were introduced to reduce funding from appropriations and lower the budget deficit. For example, the Australian Customs Service partly attributed the introduction of cost recovery for import processing activities to the Government's need to reduce the budget deficit (sub. 29, p. 2). The Department of Agriculture, Fisheries and Forestry — Australia noted that 'in the vast majority of situations, revenue raising will be an important objective of cost recovery arrangements' (sub. DR151, p. 4);
- *to expand services*. Cost recovery arrangements were introduced to supplement revenue from appropriations and to provide funds for additional services. For

example, ScreenSound Australia indicated that the expansion of its range of services was a guiding principle behind its cost recovery policy (sub. 30, p. 9);

- *to increase economic efficiency*. A number of agency responses may be grouped under the heading of economic efficiency, including 'user pays' and 'beneficiary pays'. For example, the Australian Fisheries Management Authority stated:

  > Current Government policy on cost recovery for fisheries management originated in the mid-1980s as part of the general philosophy that the beneficiaries of Government services should meet the cost of those services in accordance with the concept of user pays. (sub. 65, p. 1);

- *to manage demand*. Cost recovery arrangements were introduced to influence the demand for the activities of the agency. Generally, such arrangements attempt to encourage only genuine demands for agency activities. For example, the Department of Immigration and Multicultural Affairs explained that fees for non-Electronic Travel Authority visas act as a deterrent to frivolous applications (trans., p. 572);

- *to improve agency efficiency*. For example, The CSIRO listed one rationale as being 'to open certain activities to market-related forces to ensure their relevance to the needs of users and to improve their efficiency' (sub. 88, p. 4);

- *to address equity or distributional issues*. Through cost recovery arrangements agencies seek to improve equity in the distribution of costs. For example, Environment Australia noted that:

  > Where a government service provides an individual or group with a benefit over and above that which accrues to the general public, cost recovery can be used to improve equity in the distribution of the costs of providing the service. (sub. 76, p. 2);

- *to conform with international agreements*. For example, fees imposed by Intellectual Property Australia on applications filed under the Patent Cooperation Treaty are set by agreement with the World Intellectual Property Organisation (sub. 57, p. 11); and

- *to accord with competitive neutrality requirements*. Agencies providing services in competition with private providers must charge prices that are consistent with competitive neutrality principles. For example, the Australian Electoral Commission and the Australian Bureau of Agricultural and Resource Economics stated that they considered these principles when deciding which services should be cost recovered (sub. 73, p. 1; sub. 56, p. 15).

A number of agencies provided rationales for not imposing full cost recovery for at least some of their activities. These rationales included:

- *to provide a public good*. Most information agencies cited this reason for providing certain services free of charge. For example, the Bureau of Meteorology stated:

  > … the rationale for the provision of basic public information, forecast and warning services free to the community at large through the mass media rests on the fact that, because of their public good nature, the total national economic benefit from these services is the sum of their value to every individual decision maker; and the total economic benefit is therefore the greater the more widely they are made available and consumed. (sub. 35, p. 4);

- *to avoid conflict with policy objectives*. For example, in response to a proposal in 1993 to introduce a 'user pays' regime for its services, the Australian Transaction Reports and Analysis Centre (AUSTRAC) stated that it was:

  > … decidedly opposed to its clients having to pay a money cost for AUSTRAC services. That is because the [Financial Transaction Reports] Act is part of a program being promoted by Government and the Parliament to better focus law enforcement and revenue administrators on issues concerning financial misbehaviour and certain types of tax evasion … To charge those officers and agencies a money cost for the data and the services of AUSTRAC would be a retrograde step in the promotion of that goal. (submission to the Senate Standing Committee on Legal and Constitutional Affairs, in sub. 22, pp. 13–4); and

- *to allow for equity and access considerations*. For example, fees for applications to the Migration Review Tribunal are waived under certain conditions, including severe financial hardship (DIMA, sub. 53, appendix D).

The rationales for some cost recovery arrangements have changed over time — for example, rationales for the Passenger Movement Charge and the Therapeutic Goods Administration's cost recovery charges. In the second reading speech for the legislation replacing the Departure Tax with the Passenger Movement Charge, the charge was claimed 'to fully offset the costs of customs, immigration and quarantine processing at Australia's borders and the cost of issuing short-term visitor visas' (House of Representatives 1995, p. 1609). However, the Australian National Audit Office found that the Passenger Movement Charge was 'applied partly as a general revenue raising source, and is no longer solely linked to cost recovery of customs, immigration and quarantine service' (ANAO 2000d, p. 13).

When the Therapeutic Goods Administration commenced operations, the Minister responsible for health services at the time advocated only partial cost recovery, on the grounds that some activities were performed in the public interest. However, in a submission to the inquiry, the Therapeutic Goods Administration argued the subsequent increase to 100 per cent cost recovery was warranted on the grounds that industry gains a significant commercial benefit from product endorsement and 'that

all regulatory effort by the Therapeutic Goods Administration is undertaken solely because the industry exists' (sub. 89, p. 10).

Although there does not appear to be a consistent approach by similar agencies or within portfolios, some rationales are more predominant for information agencies, while others are more commonly applied to regulatory agencies.

Information agencies typically provided more clearly articulated rationales than did regulatory agencies, and the rationale of expanding services was more commonly cited among information agencies. For example, the ABS cited the following objectives in introducing its current arrangements:

> (a) to enable demand for ABS products and services to be used as a more reliable indicator of how ABS resources should be used; (b) to encourage users to address their real needs for ABS products; and (c) to relieve the general taxpayer of those elements of the cost of the statistical service which had a specific and identifiable value to specific users. (questionnaire response)

On the other hand, the questionnaire responses of many regulatory agencies did not provide clear rationales (beyond 'government policy' or an 'administrative decision') for their arrangements. For example, the Department of Industry, Science and Resources stated that an 'administrative decision' was the rationale for cost recovery of the Ionospheric Prediction Service (questionnaire response).

Some agencies referred to external reviews for the rationale of their cost recovery arrangements. For example, the Australian Maritime Safety Authority referred to a review of its levies (Taylor 1997). Other agencies have undertaken internal reviews of their cost recovery arrangements. However, these reviews typically focused on the implementation of cost recovery policies rather than their rationale.

Rationales could be expected to differ according to agency circumstances. However, the Commission considers that the wide range of observed rationales and the agencies' poor focus on economic efficiency also reflect the absence of any overarching government policy on cost recovery.

FINDING

There is no clear, current Government policy on cost recovery.

FINDING

The rationales for cost recovery of most information agencies are generally better developed and articulated than those of regulatory agencies.

The Commonwealth Government should adopt a formal cost recovery policy for agencies undertaking regulatory and information activities. This policy should implement the cost recovery Guidelines recommended by this inquiry.

4.3 Extent of current cost recovery arrangements

Commonwealth regulatory and information agencies impose a wide range of cost recovery arrangements and raise significant amounts of revenue. However, not all Commonwealth regulatory and information agencies engage in cost recovery. For example, the Industrial Relations Commission and the Australian Transaction Reports and Analysis Centre do not impose cost recovery on the users of their services. This section provides an overview of the extent of cost recovery in regulatory and information agencies, both in terms of the revenue raised and the activities subject to cost recovery.

Regulatory agencies

Cost recovery arrangements exist, to some extent, in almost all Commonwealth regulatory agencies. The cost recovery arrangements of health and safety regulatory agencies, the Australian Communications Authority and financial regulatory agencies are discussed in greater detail in appendices D, E and F respectively. The extent of cost recovery in selected regulatory agencies in 1999-2000 is summarised in table 4.3.

Table 4.3 indicates significant variation in the proportion of costs recovered by regulatory agencies. At the lower end of the range, the Australia New Zealand Food Authority and the Australian Radiation Protection and Nuclear Safety Agency recovered under 10 per cent of their costs in 1999-2000. At the other end of the scale, Airservices Australia, Intellectual Property Australia and the National Registration Authority for Agricultural and Veterinary Chemicals recovered over 100 per cent of their costs in the same year. Part of this variation is due to the different activities for which agencies recovered costs.

Some other agencies, such as the Australian Communications Authority, the Australian Prudential Regulation Authority and the Australian Securities and Investments Commission (see appendices E and F), are required to recover amounts greater than their costs, so as to fund programs or activities provided by other agencies (table 4.4).

Table 4.3 **Cost recovery in selected regulatory agencies, 1999-2000**

Agency [a]	*Cost recovery revenue* [b]	*Cost recovery / total expenses*	*Agency cost recovery target?*	*Cost of compliance monitoring recovered?*
	$m	%		
ACS	300.9	53.4	No	No
AEC	20.5	13.2	No	No
AFMA	8.5	35.1	No	Some[c]
AMSA	52.4	67.3	No	Yes
ANZFA	0.8[d]	6.1	No	No
AQIS	136.7	76.7	No	No
ARPANSA	1.2	7.5	No	No
ASA	585.4	108.6	Yes	Yes
CASA	59.8	71.4	No	Some[e]
IP Australia	72.8	108.2	Yes	na
NICNAS	3.7	100.0	Yes	Some[f]
NRA	17.6	108.6	Yes	Yes
NSC	1.4	34.1	No	No
TGA	41.4	84.5	Yes	Yes

[a] ACS – Australian Customs Service, AEC – Australian Electoral Commission, AFMA – Australian Fisheries Management Authority, AMSA – Australian Maritime Safety Authority, ANZFA – Australia New Zealand Food Authority, AQIS – Australian Quarantine and Inspection Service, ARPANSA – Australian Radiation Protection and Nuclear Safety Agency, ASA – Airservices Australia, CASA – Civil Aviation Safety Authority, NICNAS – National Industrial Chemicals Notification and Assessment Scheme, NRA – National Registration Authority for Agricultural and Veterinary Chemicals, NSC – National Standards Commission, TGA – Therapeutic Goods Administration. [b] Revenues may include transfers between Commonwealth agencies and Commonwealth and State public sectors. [c] AFMA recovers 50 per cent of compliance costs from industry. [d] ANZFA has not generated any cost recovery revenue from its regulatory services. This revenue is revenue from sale of publications. [e] CASA receives an appropriation, a proportion of which is allocated to its compliance monitoring and standards setting functions. [f] NICNAS receives an appropriation for 50 per cent of its compliance monitoring costs.

Source: PC estimates based on questionnaire (part I) responses and submissions.

The Australian Securities and Investments Commission's cost recovery arrangements are intended to recover its expenses, compensation payments to the States and Northern Territory for revenue foregone in corporations fees, and the notional costs of the administration of the national corporate regulation scheme (questionnaire response). The Australian Prudential Regulation Authority aims to recover its own expenses, levies transferred to the Australian Taxation Office to fund the administration of uncollected superannuation monies, and levies transferred to the Australian Securities and Investments Commission to fund its consumer protection function and the Superannuation Complaints Tribunal. Similarly, the Australian Communications Authority's cost recovery arrangements aim to recover not only that agency's expenses, but also part of the costs of the Australian Competition and Consumer Commission's telecommunications regulation, Australia's contribution to the International Telecommunications Union, government research grants and the administration of industry development plans.

Table 4.4 **Cost recovery by the ACA, APRA and ASIC, 1999-2000[a]**

Agency[a]	*Total cost recovery revenue (A)*	*Net cost recovery revenue*[b] *(B)*	*Total agency expenses (C)*	*A/C*	*B/C*
	$m	$m	$m	%	%
ACA	54.2	44.2	49.0	110.6	90.2
APRA	75.1	61.2	58.8	127.7	104.1
ASIC	361.0[c]	201.0	144.8	249.0	138.8

a ACA – Australian Communications Authority, APRA – Australian Prudential Regulation Authority, ASIC – Australian Securities and Investments Commission. **b** Total cost recovery revenue less transfers to other agencies and governments. **c** Does not include levies transferred from APRA. Includes a small amount of fines.

Source: PC estimates based on questionnaire (part I) responses and submissions.

When transfer payments made by the Australian Communications Authority and Australian Prudential Regulation Authority to other agencies are excluded from their cost recovery revenue (column B in table 4.4), their cost recovery revenue as a proportion of agency expenses comes closer to their 100 per cent targets (90 per cent and 104 per cent respectively). However, even after deducting transferred amounts, the Australian Securities and Investments Commission's cost recovery revenue is significantly greater than its expenses (139 per cent).

The figures shown in tables 4.3 and 4.4 provide a snapshot. However, cost recovery revenue has generally fluctuated from year to year and might have varied as a result of policy shifts, changes in agency functions or changes in demand. Agencies that set cost recovery charges to recover a specific proportion of costs need to estimate the costs of providing an activity or range of activities and the level of demand for these activities. Where agencies do not correctly estimate costs or predict the revenue that will be obtained from cost recovery, under-recovery or over-recovery will arise. In any given year, an agency may raise cost recovery revenue above (or below) a specified target. For example, the Australian Fisheries Management Authority stated:

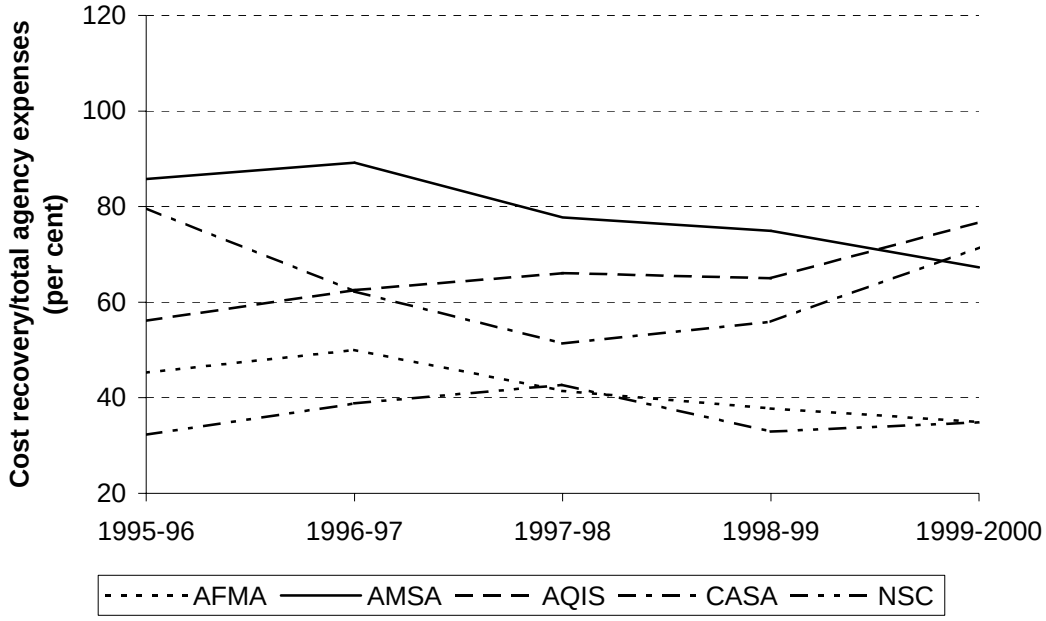
> … levies are calculated on the basis of budgeted recoverable costs for managing each fishery adjusted by any variances in recoverable costs for that fishery from the previous year. Consequently, levies for each fishery change every year and can increase or decrease significantly if there are significant changes in management costs. (sub. DR160, p. 2)

Agencies have dealt with over-recoveries in different ways. Some agencies retained any excess revenue and adjusted their cost recovery charges or adopted a 'wait and see' approach in case of future shortfalls (for example, the National Registration Authority for Agricultural and Veterinary Chemicals and the Therapeutic Goods Administration). Other agencies refunded any excess revenue to the industry or allocated an amount equal to the over-recovery to specific research or industry

development funds (for example, the Australian Quarantine and Inspection Service and the National Industrial Chemicals Notification and Assessment Scheme).

Although the cost recovery revenue of regulatory and information agencies increased at an aggregate level over the past five years (figure 4.1), that of individual agencies varied over the same period. The variation in the proportion of costs recovered by selected regulatory agencies over the five years to 1999-2000 is shown in figure 4.3.

Figure 4.3 **Proportion of costs recovered by selected regulatory agencies, 1995-96 to 1999-2000[a]**



a AFMA – Australian Fisheries Management Authority, AMSA – Australian Maritime Safety Authority, AQIS – Australian Quarantine and Inspection Service, CASA – Civil Aviation Safety Authority, NSC – National Standards Commission.

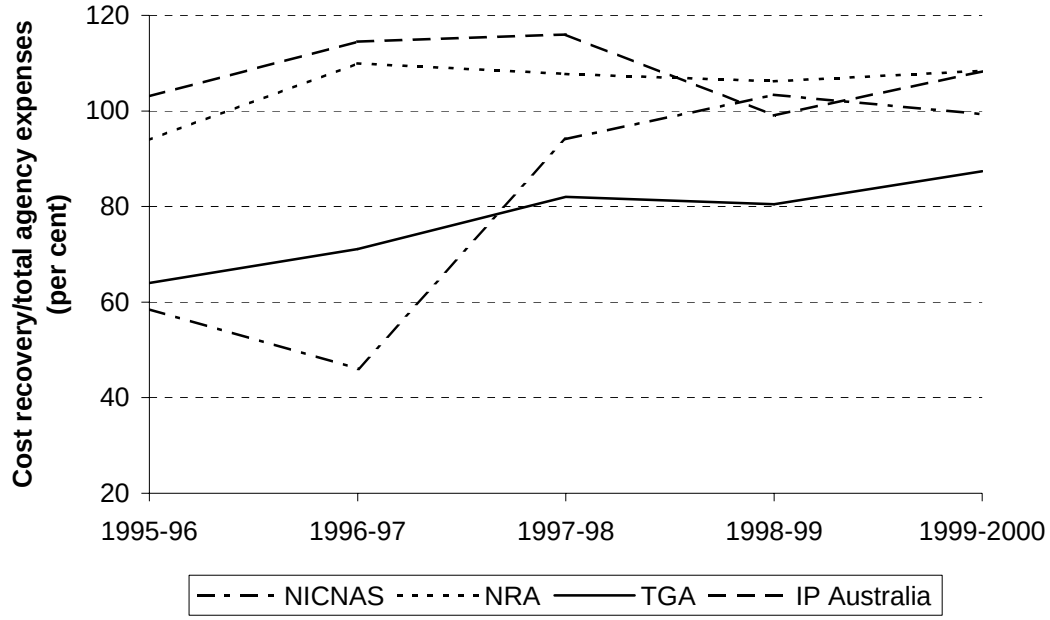
Data source: PC estimates based on questionnaire (part I) responses.

Some agencies are required to meet cost recovery targets to recover a specified proportion of their costs or the costs related to certain activities. Other agencies have discretion in choosing the activities that will be cost recovered. The Therapeutic Goods Administration and the National Registration Authority for Agricultural and Veterinary Chemicals have cost recovery targets of 100 per cent of total agency costs, whereas the Australian Quarantine and Inspection Service is required to recover 100 per cent of the costs of only its inspection and certification services. The Australia New Zealand Food Authority requires the payment of fees only where an 'exclusive capturable commercial benefit' can be identified or where applicants request that their applications be fast tracked (arrangements that had not

yet generated revenue as at 1999-2000). These arrangements are discussed in appendix D.

The cost recovery revenue of agencies with agency-wide cost recovery targets is indicated for a five year period in figure 4.4. The proportion of costs recovered by these agencies largely reflects the targets set. The two agencies with 100 per cent targets over the entire period (the National Registration Authority for Agricultural and Veterinary Chemicals and Intellectual Property Australia) fluctuated around the 100 per cent target. The proportion of costs recovered by the two agencies that had 100 per cent targets imposed during the period illustrates how the imposition of targets and subsequent increases in these targets has dictated the proportion of costs recovered by these agencies.

Figure 4.4 **Proportion of costs recovered by regulatory agencies required to meet cost recovery targets, 1995-96 to 1999-2000[a,b]**



a NICNAS – National Industrial Chemicals Notification and Assessment Scheme, NRA – National Registration Authority for Agricultural and Veterinary Chemicals, TGA – Therapeutic Goods Administration, IP Australia – Intellectual Property Australia **b** In 1995-96, NICNAS had a 50 per cent cost recovery target, which was increased to 100 per cent from 1996-97. In 1995-96, the Therapeutic Goods Administration had a 50 per cent cost recovery target, which was to be increased to 100 per cent over three years from 1996-97. However, the 1997-98 Budget introduced a 100 per cent target from 1998-99. The NRA and IP Australia had cost recovery targets of 100 per cent over the period shown.

Data source: PC estimates based on questionnaire (part I) responses and submissions.

Regulatory agencies undertake different types of activity, including regulatory activities, community service obligations, information services and activities for government such as policy development and prosecution. The activities for which

costs are recovered vary across agencies. Some regulatory agencies, including the Therapeutic Goods Administration, the National Registration Authority for Agricultural and Veterinary Chemicals, the Australian Securities and Investments Commission and the Australian Prudential Regulation Authority, recover the costs of compliance monitoring and other post-market activities. Others, such as the National Industrial Chemicals Notification and Assessment Scheme, the Australian Fisheries Management Authority and the Civil Aviation Safety Authority, receive an appropriation to fund a proportion of such activities.

Some agencies also recover the costs of policy functions such as the preparation of ministerial briefings, standards development and other government accountability activities. However, other agencies do not have these policy functions, so do not need to consider whether to apply cost recovery to them. For example, the National Industrial Chemicals Notification and Assessment Scheme does not undertake policy functions relating to industrial chemicals (which are the responsibility of the National Occupational Health and Safety Commission instead).

Typically, regulatory agencies recover charges from individual firms or industries. For example, firms seeking company or product registration will incur any fees associated with these services. Further, once these firms become part of a regulated industry, they may be required to pay levies imposed on the whole industry.

In a few instances, cost recovery charges of regulatory agencies are paid by individual consumers directly — for example, the Department of Immigration and Multicultural Affairs' visa application and citizenship fees, and the Civil Aviation and Safety Authority's fees for pilot licences. Consumers may also be indirectly affected by cost recovery charges through the purchase price of regulated products (see chapter 5).

Regulatory agencies also provide services to other Commonwealth agencies and departments. In some circumstances, other agencies and departments pay cost recovery charges as paid by non-government users. The Australian Electoral Commission, for example, has both government and non-government clients that pay cost recovery fees.

In other circumstances, funding transactions between agencies is more an issue of allocating budget funding than of cost recovery. For example, Centrelink enters into agreements with other Commonwealth agencies to deliver social welfare payments and services. Similarly, the Therapeutic Goods Administration and National Registration Authority for Agricultural and Veterinary Chemicals have a memorandum of understanding for the provision of assessment services and associated payments. These arrangements are not cost recovery in the sense discussed in this inquiry, but the funding of inter-agency transactions may have

consequences for cost recovery charges imposed on users outside the public sector (see chapter 7). Some of the cost recovery figures shown in tables 4.3 and 4.4 include such transfers.

Information agencies

Most information agencies that responded to the Commission's questionnaire have some cost recovery arrangements. These arrangements are discussed in appendix C. The extent of cost recovery across selected information agencies in 1999-2000 is summarised in table 4.5.

Table 4.5 **Cost recovery in selected information agencies, 1999-2000**

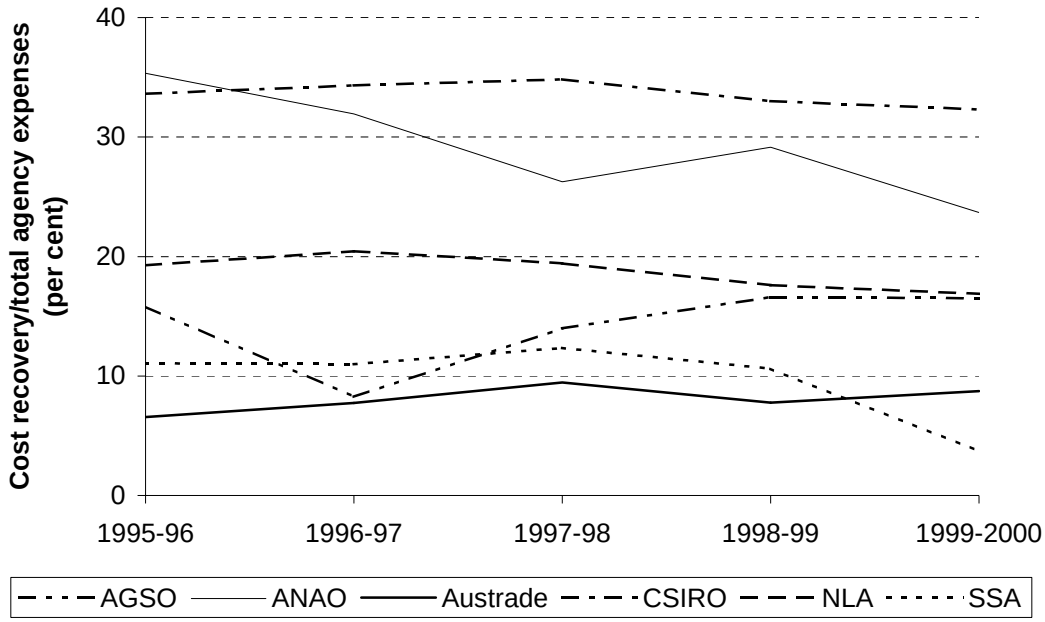
Agency [a]	*Cost recovery revenue* [b]	*Cost recovery/total expenses*	*Agency cost recovery target?*
	$m	%	
ABARE	11.2	51.1[c]	No
ABS	21.5	8.4	No
AGSO	12.1	16.5	Yes
ANAO	10.8	23.8	No
AUSLIG	4.7	14.2	No
Austrade	28.8	8.8	No
BoM	35.3	17.4	No
CSIRO	250.4	32.3	Yes
NLA	8.6	16.9	No
ScreenSound Australia	1.8	3.8[d]	No

[a] ABARE – Australian Bureau of Agricultural and Resource Economics, ABS – Australian Bureau of Statistics, AGSO – Australian Geological Survey Organisation, ANAO – Australian National Audit Office, AUSLIG – Australian Surveying and Land Information Group, BoM – Bureau of Meteorology, CSIRO – Commonwealth Scientific and Industrial Research Organisation, NLA - National Library of Australia. [b] Revenues also include transfers between Commonwealth agencies and Commonwealth and State public sectors. [c] ABARE receives a significant amount of revenue from the Department of Industry, Science and Resources which is included in the cost recovery revenue shown. [d] ScreenSound Australia noted that this figure would be much higher if the capital use charge were excluded from its appropriation (sub. DR144, p. 3).

Source: PC estimates based on questionnaire (part I) responses.

The proportion of costs recovered by information agencies varied between agencies and from year to year (figure 4.5). However, the proportion of costs recovered was generally lower for information agencies than for regulatory agencies. As with regulatory agencies, some information agencies have agency-wide cost recovery targets. The Australian Geological Survey Organisation and the CSIRO have cost recovery targets of 30 per cent of costs. These targets are substantially lower than the 100 per cent targets imposed on some regulatory agencies (figure 4.4).

Figure 4.5 **Proportion of total costs recovered by selected information agencies[a]**



a AGSO – Australian Geological Survey Organisation, ANAO – Australian National Audit Office, CSIRO – Commonwealth Scientific and Industrial Research Organisation, NLA – National Library of Australia, SSA – ScreenSound Australia.

Data source: PC estimates based on questionnaire (part I) responses.

Information agencies generally base the imposition of cost recovery on distinctions between a 'basic' or 'standard' set of taxpayer funded products and 'additional' products for which cost recovery may be imposed. The pricing policy of the ABS is:

- no charge for products and services considered to be community service obligations [CSOs];
- partial cost recovery for products and services, where there is an element of CSO contained in the product or service, although significant private benefit also exists;
- full cost recovery for products and services, where no CSO is perceived to exist; and
- a very few prices which include an allowance for 'risk' as well as cost recovery, where the product is seen as 'commercial'. (ABS, sub. 36, pp. 7–8)

Information agencies, like regulatory agencies, impose cost recovery fees on a range of users. The products of information agencies may be purchased by individual firms, consumers, tertiary institutions, State governments or other Commonwealth agencies. Although the focus of this inquiry is on cost recovery imposed on the private sector, the funding of transactions between government agencies is of

interest because it may have important consequences for cost recovery imposed on other users.

FINDING

Cost recovery arrangements exist, to some extent, in most Commonwealth regulatory and information agencies. However, there is little consistency in the application of these arrangements. Generally, there is no uniform approach as to which activities or products are subject to cost recovery and which are not.

4.4 Cost recovery mechanisms

The cost recovery mechanisms applied by regulatory and information agencies can be grouped into two categories — fees-for-services and taxes (often called levies). The distinctions between, (and the legal criteria for the application of), these mechanisms are discussed in chapter 3.

Regulatory agencies

Regulatory agencies generally use a mix of fees-for-service, and levies to recover costs. The different cost recovery mechanisms used by regulatory agencies are illustrated in table 4.6.

Fees-for-service

Regulatory agencies apply a wide range of fees-for-service including application, registration, assessment and licence fees (table 4.6). These fees-for-service may recover either a proportion of costs, full costs or, in some circumstances, above full costs. The Department of Immigration and Multicultural Affairs recovers part of the costs of providing its citizenship services through application fees. The National Industrial Chemicals Notification and Assessment Scheme imposes assessment and administrative fees to recover the full costs of its New Chemicals Assessment Program. Airservices Australia recovers more than the costs of its services by including a 'reasonable rate of profit'.

Many of the fees-for-service imposed by regulatory agencies are modular; that is, agency services are broken down into small components, each attracting a fee. Regulated firms then pay the sum of these fees to reflect the level of service provided. For example, the Therapeutic Goods Administration's evaluation fees:

> … are levied on a modular basis with separate fees being paid for each section of the required submission, based on the number of pages and the type of information

contained in each part of the submission. (Australian Self Medication Industry, sub. 23, p. 6)

Table 4.6 **Cost recovery mechanisms imposed by selected regulatory agencies, 1999-2000**

Agency[a]	*Type of fee-for-service imposed*	*Type of tax or levy imposed*
ACA	Administrative fees	Annual Carrier Licence charge, Spectrum Maintenance Component
AMSA	na	Marine Navigation Levy, Regulatory Functions Levy, Protection of the Sea Levy
ANZFA	Assessment fees, royalties	na
APRA	na	Financial Supervision Levy
AQIS	Fees-for-service, documentation fees	Registration charges, quantity charges (excise duties)
ARPANSA	Licence application fees	na
ASA	Commercial service charges	na
ASIC	Document lodgement fees, application fees, information search fees	na
CASA	Regulatory service fees	Fuel excise
NICNAS	Assessment fees, administration charges	Company registration charge
NRA	Application and renewal fees	Levy on disposals of registered products
TGA	Application, evaluation, assessment and inspection fees	Annual charge

a ACA – Australian Communications Authority, AMSA – Australian Maritime Safety Authority, ANZFA – Australia New Zealand Food Authority, APRA – Australian Prudential Regulation Authority, AQIS – Australian Quarantine and Inspection Service, ARPANSA – Australian Radiation Protection and Nuclear Safety Agency, ASA – Airservices Australia, ASIC – Australian Securities and Investments Commission, CASA – Civil Aviation Safety Authority, NICNAS – National Industrial Chemicals Notification and Assessment Scheme, NRA – National Registration Authority for Agricultural and Veterinary Chemicals, TGA – Therapeutic Goods Administration. na Not applicable.

Source: PC estimates based on questionnaire (part II) responses and submissions.

Fees-for-service imposed by regulatory agencies generally differ from fees imposed by information agencies. The customers of information agencies can choose whether to purchase a product, and how much to purchase. Regulated firms often have only a limited choice (to be regulated or not), although some firms may have some discretion in the amount of cost recovery charges they incur (for example, where charges are related to output or the number of products they wish to register).

Most regulatory agencies derive explicit legal authority to charge fees from an Act of Parliament. Often this authorisation is contained within the Act establishing the regulatory agency and is specific to fees charged by that particular agency. Regulations usually set out the levels and types of fee that can be charged. Some cost recovery fees are authorised by legislation dealing with a particular subject matter, which authorises all agencies to charge fees in relation to that matter. For

example, the *Freedom of Information Act 1982* authorises any agency receiving an application under the freedom of information legislation to charge a fee for this application.

Some agencies face legal restrictions on what activities they can cost recover and the extent of such cost recovery. For example, s.110 (1) of the *Industrial Chemicals (Notification and Assessment) Act 1989* enables the National Industrial Chemicals Notification and Assessment Scheme to charge fees for certain services provided under the Act. Other agencies have a general authorisation and thus a large degree of autonomy regarding the fee structures and levels they can impose. For example, s.8 of the *Meteorology Act 1955* enables the Director of the Bureau of Meteorology to impose 'charges for forecasts, information, advice, publications and other matter supplied in pursuance of the Act'.

Taxes and levies

Although agencies require a specific tax Act to impose a charge under taxation legislation, many agencies do not refer to this charge as a tax. For example, the Therapeutic Goods Administration's annual charge to maintain the registration or listing of a product is imposed as a tax under the *Therapeutic Goods (Charges) Act 1989*, but referred to more generally as a charge. Similarly, the National Industrial Chemicals Notification and Assessment Scheme refers to an annual charge imposed under taxation legislation as 'company registration'.

Unlike a fee-for-service, taxes (including levies) are often imposed where there is no direct relationship between the payment and the service provided. Taxes and levies therefore tend to be used to recover general agency costs such as the costs of policy and research activities or compliance monitoring functions. The National Registration Authority for Agricultural and Veterinary Chemicals, for example, funds its general policy functions and post-market activities from a levy on sales. In some cases, agencies impose a levy where it is possible to identify a group of beneficiaries but difficult to identify the individual users of a particular service or the extent of their usage. The Australian Maritime Safety Authority, for example, funds its marine navigation services from an industry levy rather than a series of direct fees because it is difficult to monitor the use of navigation aids.

In other circumstances, although agencies can identify the users of their services, they impose a levy for administrative simplicity. The Passenger Movement Charge (a flat fee), for example, was introduced to recover the costs of customs, immigration and quarantine, in preference to a system of fees. Other agencies impose a levy where imposing fees on users directly could discourage the use of a particular service. The Therapeutic Goods Administration funds its product recall

activities, for example, from an industry-wide levy rather than a fee on the company recalling the product, because a direct fee-for-service could deter companies from reporting potential threats to public health and safety.

Information agencies

Information agencies typically recover costs through a range of fees-for-service, including royalties.[3] Some agencies do not have explicit authorisation to impose fees but claim an implied authority to charge fees under a broad power contained in legislation. For example, s.7 of the *National Library Act 1960* gives the library the 'power to do all things necessary or convenient to be done for or in connection with the performance of its functions' (sub. DR125, p. 1). The cost recovery mechanisms imposed by selected information agencies are summarised in table 4.7.

Table 4.7 **Cost recovery mechanisms imposed by selected information agencies, 1999-2000**

Agency[a]	*Type of fee-for-service imposed*
ABARE	Service charges for economic research, publications and data services
ABS	Sale of products, licence fees, royalties
AGSO	Sale of geoscientific information (maps, datasets, other publications), fees-for-services and commissioned research
AUSLIG	Publication sales, data licence fees, royalties
BoM	Service charges for meteorological and commercial services
CSIRO	Fees for contract and cooperative research and development, technical and consulting services, grants, royalties and license fees, subscriptions, sale of publications and other products
NLA	Service charges, transaction fees, sale of products and services
ScreenSound Australia	Fee-for-service, licence fees, product sales, copying costs, fees for public program activities

a ABARE – Australian Bureau of Agricultural and Resource Economics, ABS – Australian Bureau of Statistics, AGSO – Australian Geological Survey Organisation, AUSLIG – Australian Surveying and Land Information Group, BoM – Bureau of Meteorology, CSIRO – Commonwealth Scientific and Industrial Research Organisation, NLA — National Library of Australia.

Source: PC estimates based on questionnaire (part II) responses.

Information agencies provide a variety of information products. The differing nature of these products can affect the nature of the cost recovery arrangements. Agencies that provide information in the form of data and publications can recover costs through purchase prices. Other agencies charge fees to access archival information. The ABS, for example, produces publications to which it can attach purchase prices, while ScreenSound Australia provides a range of services — such as screenings,

[3] The term 'royalty' can also refer to a type of tax. Information agencies impose royalties in relation to copyright and re-use of the information for commercial purposes.

presentations and exhibitions of audiovisual material — for which it partly recovers costs through access fees.

Some information agencies also impose licence and copyright fees. The Australian Surveying and Land Information Group, for example, imposes licence and copyright fees, as well as royalties. However, it receives a relatively small proportion of its revenue from royalties and noted that this form of payment attracts high administrative costs for many users (trans., p. 435). The ABS also imposes royalties in addition to selling products and charging licence fees, and in some situations charges both a fee and royalties for the same service (MariTrade, sub. DR111, p. 1).

4.5 Costs recovered

To implement cost recovery arrangements, agencies need to identify and measure the costs to be recovered and allocate these costs to particular activities. The processes for identifying and measuring costs are outlined in appendix H. Agencies may use a number of methods to allocate costs, including direct cost, Fully Distributed Cost, marginal cost and incremental or avoidable cost methods. Regulatory and information agencies typically use different approaches to allocating costs.

Regulatory agencies

Most regulatory agencies operate on a full cost recovery basis, either in relation to the agency as a whole or to individual activities. Agencies aiming to recover full costs tend to allocate costs using Fully Distributed Costing methods. Under these methods, direct costs are allocated to their respective activities and indirect costs are allocated across the range of cost recovered activities. Fully Distributed Costing methods include allocating indirect costs *pro rata* to direct costs (for example, assuming that an activity's share of indirect costs is the same as its share of labour). They also include Activity Based Costing, which attempts to allocate costs to each activity in a way that reflects use of resources. The Australia New Zealand Food Authority, the Australian Radiation Protection and Nuclear Safety Agency and the Australian Quarantine and Inspection Service allocate costs as a proportional share of direct costs. The National Industrial Chemicals Notification and Assessment Scheme, the National Registration Authority for Agricultural and Veterinary Chemicals and the Australian Maritime Safety Authority use Activity Based Costing to apportion costs (see appendix D).

Information agencies

As noted above, information agencies generally divide products into two categories: 'basic products' and 'additional products'. Although agencies may define these categories differently, the application of cost recovery to each category is generally consistent among agencies. Basic products are usually taxpayer funded, although there are some exceptions whereby some are cost recovered. Additional products are subject to varying degrees of cost recovery.

Some products are charged on the basis of incremental or avoidable costs (see appendix H).[4] The Bureau of Meteorology, for example, charges for providing specialised products to the aviation industry and the Australian Defence Forces. These are 'determined to recover the incremental costs of the provision of [these services], above the basic service' (questionnaire response).

Charges for commercial products are usually based on compliance with competitive neutrality requirements where there is actual or potential competition. Most agencies set fees for commercial services according to the market. The CSIRO's Costing and Pricing Policy states that 'the pricing of commercial activities must be based on the perceived value to the client and an estimate of their full costs' (sub. 88, p. 9). Similarly, the Australian Geological Survey Organisation stated that 'services competing with the private sector are charged at full cost (including all overheads), plus a proxy for rate of return' (questionnaire response).

4.6 Access and equity considerations

Agencies and/or Government may design cost recovery arrangements to improve or encourage access by particular user groups for a variety of reasons. These reasons include considerations of both horizontal and vertical equity (see chapter 2). Environment Australia referred to the notion of horizontal equity:

> Where a government service provides an individual or group with a benefit over and above that which accrues to the general public, cost recovery can be used to improve equity in the distribution of the costs of providing the service. (sub. 76, p. 2)

Perceptions of vertical equity — that those who have greater means should pay more than others — also pervade many cost recovery arrangements. For example, fees for applications to the Migration Review Tribunal are waived under certain conditions, including severe financial hardship (DIMA, sub. 53, appendix D).

[4] Incremental cost is the increase in cost attributable to the production of a particular type of product, which could include capital or overhead costs. Avoidable costs include all the costs that would be avoided if the agency no longer provided a particular product.

Other mechanisms used by agencies address perceived equity concerns, distribute the burden of cost recovery arrangements between users, or encourage access by particular user groups. These include:

- *minimum levy payment thresholds*. For example, only 'persons/companies importing or manufacturing industrial chemicals above $500 000 must register annually with the National Industrial Chemicals Notification and Assessment Scheme and pay a registration charge [levy]' (sub. 33, p. 2);
- *minimisation of upfront payments*. For example, the National Registration Authority for Agricultural and Veterinary Chemicals imposes only partial upfront cost recovery to avoid 'unduly disadvantag[ing] smaller companies or mitigat[ing] against local research and development efforts and the promotion of minor agricultural industries' (sub. 39, p. 7);
- *cross-subsidisation between cost recovery programs or locations*. Cross-subsidies are present in many cost recovery arrangements, particularly those with levies. Airservices Australia, for example, receives an appropriation from government to subsidise the costs of operating regional towers. However, the aviation industry noted that this arrangement in turn introduced a form of cross-subsidisation, because it is funded through fuel excise revenue from airlines;
- *differential pricing policies*. For example, agencies that charge access fees (such as ScreenSound Australia) may distinguish between users and charge prices according to characteristics such as age (child or pensioner discounts), income (discounts for low income earners) and employment status (student or unemployed discounts);
- *levy caps*. The National Registration Authority for Agricultural and Veterinary Chemicals, for example, limits the annual per product levy paid by registrants of agricultural and veterinary chemical products to $25 000 (sub. 39, p. 5); and
- *sliding scales for the calculation of fees*. Two of the three levies imposed by the Australian Maritime Safety Authority, for example, are calculated on a sliding scale following 'strong industry representations that the system of a quarterly flat charge … irrespective of usage was inequitable' (Taylor 1997, p. 10).

4.7 Institutional arrangements

Agencies undertaking cost recovery have varied institutional arrangements relating to consultation and review mechanisms, the application of agency-specific cost recovery policies and guidelines, and the publication and dissemination of fee structures and levels.

Regulatory agencies

Some regulatory agencies are independent statutory authorities, while others are situated within departments. Some agencies are accountable to a board, which is in turn accountable to a Minister. A number of boards include one or more representatives from industry, for example:

> The NRA Board comprises members having experience in regulatory affairs, consumer interests, [occupational health and safety], farming, government and the chemicals industry under an independent Chairperson. This allows a balancing of interests/expertise. (NRA, sub. 39, p. 6)

Some regulatory agencies facilitate consultation with industry through mechanisms such as industry consultative committees. The structure of these committees varies across agencies. For example, the Therapeutic Goods Administration has established several consultative committees including the Therapeutic Goods Administration — Industry Consultative Committee which comprises representatives from the administration and from peak therapeutic goods industry groups. The Committee:

> … facilitates consultation between TGA and the industry regarding input into the TGA budget and accounting against the TGA Corporate Plan; also provides direct feedback from industry to TGA on broad policy, resource allocation and performance issues. (sub. 89, p. 17)

The Therapeutic Goods Administration — Industry Consultative Committee's terms of reference include 'to examine and comment on the Therapeutic Goods Administration budget, including new initiatives and other budget measures, and on the proposed industry fees and charges' (ASMI, sub. 23, p. 8).

Alternatively, the Australian Quarantine and Inspection Service has a separate committee for each of its 14 agency programs, each comprising a wide range of industry representatives (see appendix D). A recent Australian National Audit Office report noted that:

> Each committee now has representation from AQIS, the major client groups and industry peak bodies and is the principal advisory forum for policy, strategic issues, costs of the program and fees and charges. (ANAO 2000a, p. 95)

In addition to these industry-specific consultative forums, the Australian Quarantine and Inspection Service has an overarching body known as the Quarantine and Exports Advisory Council to advise the Minister on quarantine and export policy and strategic issues. Council members interact with the consultative committees and a wide range of stakeholders (AFFA 1999, p. 39).

The Australian Fisheries Management Authority has a Management Advisory Committee for each fishery, each of which includes industry members. The authority stated:

> The MACs [Management Advisory Committees] are able to examine the budget for their fishery in detail and make recommendations for both increased and decreased expenditure. AFMA's total budget … is reviewed by AFMA's Executive, and the AFMA Finance and Audit Committee, before it is finally approved by the AFMA Board [which] has two of eight members drawn from the fishing industry. (sub. DR160, p. 3)

Regulatory agencies have varying processes for reviewing their cost recovery arrangements. Most agencies review their fee levels or levy rates at least annually. However, these reviews typically do not extend to the structure or imposition of the cost recovery. Most agencies do not have provisions for regular formal reviews of their arrangements and conduct reviews, if at all, on an *ad hoc* basis. Some agencies indicated that their cost recovery arrangements had been the subject of formal independent reviews. The Australian National Audit Office (2000a), for example, reviewed the Australian Quarantine and Inspection Service's cost recovery arrangements and the Australian Maritime Safety Authority's levies were the subject of the Taylor Review (1997).

Information agencies

Like regulatory agencies, information agencies have a mixture of institutional structures. Some are established as independent statutory authorities and others exist within government departments. Information agencies are typically governed by a director or chief executive officer who is responsible to a Minister. Some information agencies also have advisory committees. The Australian Statistical Advisory Council, for example, was established under the *Australian Bureau of Statistics Act 1975* as an advisory body on ABS statistical products, work programs and related matters. The Interim Council of ScreenSound Australia and the National Library of Australia's Library Council have similar roles.

Most information agencies have a mechanism for consulting with the users of their services. These mechanisms range from informal consultations and market research to formal committees. ScreenSound Australia, the Australian Surveying and Land Information Group, the Australian Geological Survey Organisation and Australian Bureau of Agricultural and Resource Economics all indicated in their questionnaire responses that they undertook market research and client surveys to gauge client satisfaction with products and charging policies. Alternatively, the National Library of Australia has a formal committee of elected and appointed industry representatives to advise on strategic and policy issues affecting the delivery of the

Kinetica service. Given that most information products are discretionary purchases, the consumption of these products may indicate demand and user satisfaction with the level of fees and value for money.

Most information agencies have undertaken, or are undertaking, reviews of their cost recovery policies. Some reviews have been internal (such as those of the ABS and the National Library of Australia), while others have been external (such as that of the Bureau of Meteorology). However, there does not appear to have been a consistent approach to reviewing cost recovery arrangements.

4.8 Summary

Almost all Commonwealth regulatory and information agencies have some type of cost recovery arrangement. These agencies collect a significant amount of revenue through a wide range of cost recovery arrangements. Agencies stated various rationales for these arrangements and there appears to be no consistent policy applied among similar agencies or within portfolios.

Most agencies recover the costs of some of their activities or products, but relatively few aim to recover all of their costs. Some agencies impose cost recovery to recover Government-specified proportions of the agency's total costs, while others have discretion to choose their level of cost recovery. There is no uniformity in which activities or products are subject to cost recovery, and the proportion of costs recovered varies significantly among agencies.

Regulatory and information agencies have applied many different fee mechanisms to recover costs. Information agencies typically use fees (including royalties) to recover costs, whereas regulatory agencies impose fees-for-service, taxes (or levies) or a combination. In determining the level of cost recovery charges, agencies also use different methods to allocate costs. Regulatory agencies typically allocate costs using fully distributed costing methods. Information agencies generally base their charges on marginal, incremental or avoidable costs.

Agencies may be influenced by access and equity considerations when determining their cost recovery arrangements. They use a variety of mechanisms to address perceived equity concerns, distribute the burden of cost recovery arrangements among users and encourage access by particular user groups.

Regulatory and information agencies have a variety of institutional arrangements focused on the agency's cost recovery arrangements. Differing institutional arrangements exist in relation to consultation and review processes, agency-specific

cost recovery policies and guidelines, and the publication and dissemination of fee structures and levels.

5 Effects of cost recovery

This chapter looks at the effects of cost recovery arrangements on agencies, industry, consumers and the wider community. Cost recovery can influence the way in which agencies pursue their objectives, and create both positive and negative incentives for agency efficiency and innovation. These effects on agencies are examined in sections 5.1, 5.2 and 5.3.

Many cost recovery charges, particularly regulatory charges, are paid by firms rather than individuals. Section 5.4 discusses the effects of these charges on firms, including market access, small business and innovation issues. Section 5.5 discusses cross-subsidies that may arise from some cost recovery charges, along with the effects they may have on firms and industry. Section 5.6 looks at the indirect effects of these charges on consumers (through increased prices or reduced product choice) and at the few cost recovery charges paid directly by individuals. Taken together, these effects can influence resource allocation and economic efficiency across the economy, and have important implications for the implementation and design of cost recovery charges.

5.1 Agency objectives

Cost recovery arrangements can have significant interactions with the overarching public policy objectives of agencies. By raising stakeholders' interests in the efficiency and effectiveness of the agency, cost recovery can focus attention on the way in which agency objectives are achieved. In some cases, the introduction of cost recovery has encouraged industry to demand key performance indicators from agencies. The Australian Chemical Specialties Manufacturers Association stated:

> We have already suggested that the introduction of key performance indicators and benchmarks would permit industry and agencies to monitor performance and efficiency improvements over time. In addition, we suggested that … suitable cost reduction targets [be] put in place. (sub. DR164, p. 4)

Some inquiry participants argued that the prospect of increased scrutiny has made agencies reluctant to introduce cost recovery, even where it is justified. Insight EFM stated:

> I have found that some agencies are more likely not to want to cost recover, or, at least, not to want to recover 100 per cent of costs, as they would then have to justify their cost structure and rates of charge. (sub. DR132, p. 8)

In other cases, the introduction of cost recovery can set up incentives that run counter to the agency's objectives and distort the agency's decision making. An over-emphasis on revenue raising may, for example, encourage agencies to charge fees for activities that should not be cost recovered or may distract agencies' focus from those activities for which they cannot charge. Such adverse incentives are likely to be accentuated where agencies are required to pursue agency cost recovery targets. The Nairn Report (Nairn *et al* 1996), identified this as a problem for the Australian Quarantine and Inspection Service, which at the time was required to meet an agency cost recovery target:

> Observations during the inspection phase of the Review lent weight to the view that quarantine staff were tending to concentrate effort on cost-recovered programs to the detriment of budget-funded activities … some quarantine activities appeared to be driven more by the ability to charge for services than by the need to meet the objectives of quarantine. (Nairn *in* Red Meat Advisory Council, sub. 47, p. 25)

The Australian Quarantine and Inspection Service's move to cost recovery on a program basis in 1997 partially addressed these concerns, but similar concerns remain in other agencies. (Other impacts of setting agency-wide cost recovery targets are discussed in section 5.4.)

By placing financial imperatives on regulatory agencies to raise revenue, agencies may also seek to impose regulatory mechanisms that can be cost recovered (such as licensing and approvals), rather than less stringent mechanisms that cannot be cost recovered (such as self-regulation), even though the higher level of regulation is not required.

A further concern is that cost recovery may distort agency incentives in a way that detracts from the achievement of the objectives of the Government or of individual agencies. For example, the Australian Geological Survey Organisation argued that cost recovery can distort key agency objectives:

> Undue focus on the pursuit of cost recovery … as an objective in its own right has the potential to subvert and distort longer-term strategic Government objectives in favour of short-term imperatives likely to attract funding from industry. (sub. 55, p. 14)

Similarly, the National Standards Commission said the imposition of 100 per cent cost recovery was contributing to a breakdown of the regulatory system:

> There is a significant price differential between trade-approved and non-approved weighing scales, due to a combination of design requirements and testing costs. Sales data suggest that traders are increasingly risking prosecution by using cheaper, non-

> approved scales. … Indirectly, it appears that the cost of pattern approval may be contributing to a breakdown of the regulatory system. (sub. 31, p. 3)

In addition, it stated that cost recovery had 'severely limited [its] ability … to carry out its public interest responsibilities (such as pattern compliance audits) as the cost of such work is not recoverable from industry' (sub. 31, p. 4).

Cost recovery can have a particular effect on information agencies' objectives. A key objective of all information agencies is to promote the dissemination and use of information, but inappropriate cost recovery charges could limit dissemination. For example, the Australian Geological Survey Organisation said that:

> High prices act as a disincentive to uptake and investment, and create a conflict with program objectives. (sub. 55, p. 15)

Although it may be costly to gather information, the cost of disseminating it to many users is very low. Charging more than the marginal cost of dissemination may discourage users who would have paid more than the marginal cost but less than the price charged.

For all of these reasons, in some cases, cost recovery may have beneficial effects. However, charges can create incentives for agencies to pursue those activities that raise the most revenue, rather than those most central to their key objectives.

FINDING

Not all cost recovery arrangements are consistent with agency policy objectives.

5.2 Incentives for agency efficiency

The term 'efficiency' has a number of meanings. Broadly, it refers to allocative efficiency — that is, ensuring resources are directed to their most productive uses across the economy (see chapter 2). But it also involves a concept of technical efficiency at the agency level — that is, achieving agency objectives at the lowest cost. Depending on its design and implementation, cost recovery can have desirable or undesirable effects on agency incentives to improve technical efficiency.

Desirable incentives for agency efficiency

The introduction of cost recovery can complement agency efficiency by instilling cost consciousness in both the agency and users. Cost recovery can encourage users to take a greater interest in the cost effectiveness of agency activities and to demand improved agency accountability. These positive incentives have been recognised by

both regulatory and information agencies. The National Registration Authority for Agricultural and Veterinary Chemicals, for example, stated:

> The expectation by industry that a fully cost-recovered regulatory agency will have a greater focus on efficiency and overall performance has resulted in the [authority] paying considerable attention to performance … (sub. 39, p. 5)

Similarly, Austrade stated:

> … as a service delivery agency, our view is that if we charge, then Australian businesses expect better service ... (trans., pp. 741–742)

Industry also recognised these benefits. The Australian Chamber of Commerce and Industry stated:

> The design, enforcement provisions, and method of funding of regulatory agencies influences the competitiveness of regulated industries. The introduction of user charges can create an incentive for industry to improve the cost effectiveness of the regulatory agency. (sub. 70, p. 14)

As Insight EFM stated:

> … cost recovery makes the regulator accountable for its cost structure and is much more likely to reveal inefficiencies and reduce, rather than increase, costs. (sub. DR132, p. 8)

And:

> … industry associations … can be extremely thorough in their grilling of bodies to identify costs and efficiencies and make managers accountable. I see that as a major benefit. (trans., p. 1243)

In summary, well designed cost recovery arrangements that are accountable, transparent and responsive can create strong incentives to improve agency efficiency.

Undesirable incentives for agency efficiency

Poorly designed cost recovery arrangements can create incentives that run counter to agency efficiency and encourage undesirable practices such as ‘regulatory creep’, ‘gold plating’ and ‘cost padding’ (box 5.1).

Box 5.1 **Undesirable incentive effects of cost recovery**

Cost recovery can create incentives for undesirable activities, including:

- **regulatory creep** — where additional regulation is imposed without adequate scrutiny. Regulation impact processes may be followed less stringently when cost recovery is possible, and the burden of additional regulation may be underestimated when it imposes no net cost to the Government;
- **gold plating** — where unnecessarily high standards or facilities are adopted. The ability to cost recover may allow agencies to impose their preferred levels of service, rather than the minimum necessary to satisfy clients or achieve government objectives; and
- **cost padding** — where costs are artificially inflated, motivated by the knowledge that all costs can be recovered.

Many inquiry participants argued that the ability to cost recover made it easier for agencies to justify inefficient practices, because agencies that made no net call on the budget did not face the same level of official scrutiny. The ability to raise revenue that is partly sheltered from budgetary and Parliamentary scrutiny reduces incentives to be cost effective — a case of 'out of sight, out of mind'. The Australian Pharmaceutical Manufacturers Association argued that 'it's probably easier to put [the cost] on industry because we're probably less difficult to fight with than the Department of Finance and Administration' (trans., p. 976).

The Complementary Healthcare Council of Australia stated that cost recovery effectively 'quarantined' the Therapeutic Goods Administration from pressures to be more efficient:

> As a 100 per cent cost recovery agency, the [Therapeutic Goods Administration] has been quarantined from the government requirements for an efficiency dividend. It has resisted introducing contestability as required by competition principles… [and] regulatory and business impact statements when making legislative change. (sub. 98, p. 2)

And in relation to other agencies, the Australian Chemical Specialties Manufacturers Association stated:

> … the current system provides few incentives to agencies to contain costs because they are not subject to the discipline of the Budget and Estimates Committee process. This lack of transparency also means that it is very hard for industry to accurately gauge whether agencies are operating efficiently. (sub. DR164, p. 3)

Regulatory creep

A number of inquiry participants raised concerns about regulatory creep. The Australian Paint Manufacturers Federation stated that cost recovery 'is seen by the bureaucrats as a way of extending the organisation's operations' (sub. 74, p. 4).

Particular concerns were expressed about the Therapeutic Goods Administration expanding its regulatory ambit without adequate regulatory impact assessments. Blackmores argued that it was 'pushing' complementary products into an inappropriate pharmaceutical model, with associated levels of cost recovery (trans., p. 1074). The Complementary Healthcare Council of Australia stated:

> [there are] some very good examples of regulatory creep over the last couple of years in relation to our industry and the way the regulation is interpreted and applied, causing significant cost to the industry and additional cost in terms of fees and charges ... (trans., p. 1168)

Whiteley Industries presented the example of inadequate scrutiny of the extension of regulation of disinfectants by the Therapeutic Goods Administration:

> ... there was never a Regulation Impact Statement done … despite industry's protests, … in the minutes of the disinfectant working group, there are clear references by the working party members from a number of associations, criticising the [Therapeutic Goods Administration] for not having done a Regulation Impact Statement. (trans., p. 1014)

While these regulatory changes may or may not have been justified, inquiry participants felt that cost recovery may reduce agency accountability — that is, while cost recovery can encourage users to take a greater interest in agency efficiency, it can also have a negative effect on accountability to Parliament through budget scrutiny processes.

Cost padding and gold plating

Cost padding refers to recovering of unnecessary costs instead of, for example, seeking efficiency savings. Gold plating refers to providing a higher level of service than is required to meet clients' needs or to satisfy Government objectives (box 5.1). The Commission received little direct evidence of cost padding or gold plating.

However, the potential for cost padding or gold plating was raised by several organisations dealing with the Therapeutic Goods Administration. A number of inquiry participants, including the Complementary Healthcare Council of Australia (sub. DR155, p. 3), the Australian Self-Medication Industry (sub. 105, p. 1), the Medical Industry Association of Australia (trans., pp. 1056–7) and the Australian

Pharmaceutical Manufacturers Association, (trans., p. 978), argued that a Government decision to increase the rent for the property the Therapeutic Goods Administration occupies, prior to it being sold, could amount to cost padding. The Complementary Healthcare Council of Australia complained of:

> … the government decision to substantially increase rent by 166 per cent on the [Therapeutic Goods Administration] premises on the basis that the building was to be sold off and thereby make it a more attractive investment property. (sub. DR155, p. 3)

Since the Therapeutic Goods Administration has a 100 per cent cost recovery target, the increased rent will be passed on to industry. Whether this amounts to cost padding will depend on how the level of rent was established and whether the current rent reflects a fair market value. (It should be noted that this issue relates to a Government decision rather than an agency initiative.)

Looking at other industries, Qantas argued that the level of cost recovery from the Passenger Movement Charge had not reflected significant improvements in efficiency:

> There have been significant changes in customs, immigration and quarantine processing since the [charge] was first introduced. Those changes have all gone towards greater efficiencies… [but] those efficiencies haven't been reflected in any reduction in the Passenger Movement Charge. (trans., p. 1290)

In relation to food regulation, the Australian Food and Grocery Council said:

> … excessive cost recovery may result simply from gold plating and padding effects … or from the failure to provide mutual recognition of assessment of products approved overseas. (sub. DR145, p. 17)

Whiteley Industries was concerned about potential for gold plating through the Therapeutic Goods Administration adopting unique product standards, funded by cost recovery:

> … at one-twentieth the size, our fees are 100 times the level of the American marketplace … they have to have special conferences over there [in the United States] to tell their own manufacturers … how to get through the [Therapeutic Goods Administration] requirements and the sort of additional testing that's required just for Australia. (trans., pp. 1004–5, 1011).

The Australian Chemical Specialties Manufacturers Association had similar concerns:

> Overall, the lack of international harmonisation of our regulatory system, for example in definitions and classifications makes provision of data and compliance more difficult and costly. There are a number of examples … where the refusal by Australian regulatory agencies to recognise the approval of products or chemicals overseas has led to high costs, substantial delays or products being prevented from reaching the market. (sub. DR164, p. 5)

Regulatory harmonisation and mutual recognition are essentially regulatory issues rather than cost recovery issues (and are therefore beyond the scope of this inquiry). However, cost recovery may discourage some agencies from pursuing efficiency gains through increased harmonisation and mutual recognition where these gains may involve reduced regulatory coverage and lower cost recovery revenue.

Some inquiry participants argued that incentives for regulatory creep, gold plating and cost padding can exist in the absence of cost recovery. For example, ScreenSound Australia said :

> … the possibility of 'gold plating' and 'cost padding' are not in fact related to cost recovery. Regardless of the power to impose charges it is possible for agencies to over service (and charge it to the taxpayer or the customer) and possible to 'cost pad'(and charge it to the taxpayer or the customer). (sub. DR144, p. 5)

Although it is difficult to pin down actual examples of cost recovery contributing to regulatory creep, cost padding or gold plating, it is clear that the potential for these negative effects exists. Cost recovery arrangements should aim to capture the positive efficiency incentives and address these negative features. Strategies for addressing these concerns are discussed in chapter 8.

5.3 Effects on agency innovation and technology

Cost recovery can interact with agencies' adoption or use of new technologies. In some cases, especially where cost recovery targets are imposed, cost recovery may create perverse incentives for agencies not to adopt newer, more efficient technologies.

This appears to be an issue for information agencies. Technological developments, such as the Internet, are reducing the cost of making information available, but their adoption may threaten existing agency revenue (and ultimately, the agency's size and structure). For example, current ABS policy (which is under review) is to charge the same price for a given publication, regardless of how it is provided (ABS, trans., p. 1118). This means that data provided over the Internet, where the marginal cost of dissemination is low, are charged at the same price as that of printed copies. This protects the ABS's 'hard copy' printing business and hampers the uptake of new technology.

This may be a particular concern if existing cost recovery arrangements over-recover the marginal or incremental cost of providing information, so as to subsidise other activities. Information agencies may be reluctant to shift to lower cost dissemination methods where overcharging would be more visible.

Other agencies, such as ScreenSound Australia, said that they did not regard cost recovery as a disincentive to the introduction of new technology, and that they were using it to lower the cost of charging and delivery systems (sub. DR144, p. 5). Financial regulators are rapidly adopting new technologies, such as the Australian Securities and Investments Commission's new electronic registration and data lodgment system. It also disseminates information electronically, with 94 per cent of company searches occurring online in 1999-2000 (ASIC 2000). The Australian Prudential Regulation Authority initiated a statistics project in February 2000 which should result in electronic lodgement and consultation of financial information being available by the middle of 2001 (APRA 2000).

In addition, some agencies are encouraging users to adopt new technologies that will reduce agency and user costs. For example, to encourage industry to use electronic certificates for export, the Australian Quarantine and Inspection Service undercharges for using electronic export documentation and overcharges for manually issued certificates. An Audit Office report into the Australian Quarantine and Inspection Service noted that industry agreed with the introduction of this practice (ANAO 2000a, p. 89).

New technologies can also affect the desirability or capacity of agencies to cost recover. At its simplest, new technology may involve adopting electronic payment systems that reduce the administrative costs of collecting and processing cost recovery charges. New technology may also promote both agency and industry efficiency, which may be reflected in lower charges. The Department of Agriculture, Fisheries and Forestry — Australia provided examples of new and emerging technologies that are affecting cost recovery within the department (box 5.2).

Box 5.2 **New technologies affecting cost recovery arrangements of the Department of Agriculture, Fisheries and Forestry — Australia**

Many areas of the department accept payment by credit card and electronic payments. In some cases — for example, Australian Bureau of Agriculture and Resource Economics' publications — invoice payments have been completely phased out. Such developments have reduced administrative costs, which flows through to users. Implementation of new technologies is expected to continue; for example, the Plant Breeders Rights Office plans to move towards electronic payments.

Both the bureau and the Plant Breeders Rights Office are interested in introducing e-commerce to their data provision services. They currently provide data to clients on a 'user pays' basis. The fees charged recover the cost of the time involved in providing the data. These services can be time consuming, particularly if the requests are complex or require extensive searches for information, and can involve significant costs for regular users. Developing technologies that would enable clients to access the databases through the Internet, selecting and purchasing the data they require, would result in significant savings for both clients and these areas of the department. The bureau believes it could save 10 per cent of its costs by introducing such technology.

The Australian Quarantine and Inspection Service has embraced new technology and e-commerce, making a number of databases of quarantine and commodity information available online. In addition, many of its inspection services are supported by online systems that provide efficient access for regular importers and exporters.

Source: AFFA (sub. 69, p. 11).

5.4 Effects on industry competition and innovation

The terms of reference for this inquiry require the Commission to examine, among other things, the impact of cost recovery on business, including small business, new technology, competition and incentive effects.

Some inquiry participants argued that cost recovery has affected the ability of new firms and new products to enter the Australian market, by creating additional costs to be met by industry. It was also argued that cost recovery has affected industry innovation. It is often difficult to distinguish the impact of cost recovery charges from the impact of regulations, from market conditions or, in the case of information agencies, from other factors such as technology, resource limitations and data confidentiality requirements. However, it appears that cost recovery charges may have had a separate, albeit small, effect on firms or products at the margin.

Barriers to entry for regulated firms

Inquiry participants gave little direct evidence of cost recovery charges *per se* forming a barrier to entry for firms (although the associated regulations may form a barrier to entry as part of their primary function). The risk of cost recovery charges becoming a barrier to entry for new firms is probably greater for regulatory charges than for charges associated with information services. Further, among regulatory charges, barriers to firms are probably more likely to occur in relation to charges for initial market entry (such as up-front assessment and business registration fees) than as a result of ongoing, post-market charges (such as annual levies or product re-registration fees).

Some inquiry participants suggested that regulatory entry costs (including registration and assessment charges) may have discouraged market entry by new firms in certain highly regulated industries. Few examples were available, because of the difficulty of identifying firms that have been discouraged from even existing. Cochlear warned of:

> … the discouragement to potential start up companies which could greatly benefit from having a lower cost access to the local Australian market to build their business prior to overseas expansion. (sub. 10, pp. 1–2).

The Complementary Healthcare Council of Australia claimed that regulatory fees — in conjunction with compliance costs and restrictions — may have pushed some local firms overseas and discouraged foreign firms from setting up in Australia:

> The [Council] is aware of some companies going off-shore to establish businesses that can mail order direct back into Australia as a direct result of the costs associated with regulation under the [Therapeutic Goods Administration]. We are also aware of US companies wanting to set up operations in Australia as the door into the Asian market but have not done so because of the cost and regulatory burden imposed by the Therapeutic Goods Administration system. (sub. DR155, p. 2)

In the telecommunications industry, the Australian Communications Authority stated that the Annual carrier licence charge may have discouraged some smaller firms from entering the industry in the past, but that the minimum charge was lowered in 1997 and alternative fees for smaller users were introduced (sub. 108, p. 6) (see appendix E).

Potential market entry disincentives for firms or joint research entities were anticipated for both the Office of the Gene Technology Regulator and the Space Licensing and Safety Office, because each regulated project will need individual regulatory approval. In the case of the Gene Technology Regulator, particular problems were anticipated from charging fees for initial approvals, because the

projects to be approved will be at the research and development stage and not necessarily profit generating (KPMG Consulting 2000). Avcare said:

> The Australian gene technology industry — which comprises substantial public sector research and development, as well as Australian and multi-national corporate investment — is in its infancy. Any move to impose full or substantial cost recovery in the near future will adversely impact on confidence and will be seen as contrary to the Government's own commitment to development of this industry, as outlined in the National Biotechnology Strategy. (sub. 28, p. iv)

Following a Senate inquiry, the Government decided that the Office of the Gene Technology Regulator will not charge fees for at least the first two years of regulation (see appendix D).

By contrast, the Space Licensing and Safety Office has set its charges by calculating its expected full operating costs over the relevant period (two years) and dividing this cost by the expected number of applicants. If revenue differs from costs in one period, then fees will be adjusted in the next period to achieve an overall balance (DISR, sub. 62, p. 16). Depending on how costs are calculated for cost recovery purposes, initial applicants may bear much of the set-up costs of the agency, which could deter entry.

In contrast, in the financial sector, the Association of Superannuation Funds of Australia said that the Australian Prudential Regulation Authority's industry levies for superannuation funds do not discourage market entry by new firms or products:

> … levies being paid by individual funds are not normally of such magnitude as to drive a decision whether to start up a new fund or amalgamate or discontinue an existing fund. (sub. 8, p. 6)

Barriers to entry for regulated products

Most examples provided by inquiry participants related to barriers to entry for individual products, not for whole firms. These were generally products being imported into Australia, rather than for new products developed in Australia. The examples were drawn from a few highly regulated industries such as therapeutic goods, complementary healthcare products and chemicals.

Barriers to entry for therapeutic goods

Inquiry participants mentioned several factors, in addition to regulatory charges, that can discourage entry to the Australian market for therapeutic goods. These included market size, expected 'market life' and regulatory compliance costs. The

Medical Industry Association of Australia said these factors make assessment and registration fees more difficult to recoup from product sales:

> Our industry surveys show that companies routinely determine not to bring certain new products to the Australian market, as a direct outcome of high [Therapeutic Goods Administration] entry costs, frequently slow approval times (though we concede the improvements that have been achieved) and small market size. (sub. DR122, p. 3)

Cochlear agreed, stating that:

> … the impact of 100 per cent cost recovery policy is to make market entry in Australia too expensive for many companies. Companies do not introduce new products to the Australian market where it is apparent that high up-front costs for evaluation and entry onto the Australian Register of Therapeutic Goods (ARTG) cannot be recovered in the often short market-life of the product. (sub. 10, pp. 1–2)

Further, the initial entry charges for this type of product were said to be higher (per sale) than in larger markets overseas (see appendix G). Cochlear said:

> Australian [regulatory] cost per sale, if you like, is three times that of Canada and about 20 times that of Europe, in terms of the application and registration charges. … we have basically decided in terms of product offering that we have two implant models that we will not market in Australia. … the market for those is so small that we can't justify the regulatory registration cost. (trans., p. 226)

In such cases, registration fees appear to be the 'last straw' in the cost equation for an already marginal product. They have had the effect of blocking some otherwise allowable and potentially beneficial therapeutic products from entering the market.

Barriers to entry for complementary healthcare products

For the complementary healthcare industry (which, like therapeutic goods, is regulated by the Therapeutic Goods Administration), inquiry participants said Australia's regulatory costs are high, particularly compared with those of New Zealand (where there are fewer regulatory requirements and no regulatory fees for the same products). The Complementary Healthcare Council of Australia said:

> … there's one importer in New Zealand who has well over 1000 products that he imports from America … at the moment he pays no regulatory costs at all. … While the Australian industry wouldn't like to see us go back to a system where there's no regulation, we believe there needs to be more appropriate regulation in terms of lower[ing] the barrier but also lower[ing] the costs. (trans., p. 1176)

Inquiry participants from the complementary healthcare industry explained that registration fees, although relatively small per product, can quickly add up to a large total for firms with large product ranges. This may lead some firms to reduce their

product range in Australia, compared with the range they might offer overseas. New Zealand firms for example, market less in Australia than in New Zealand:

> Medium sized New Zealand companies are only able to afford to market about 20 per cent of their product range due to [Therapeutic Goods Administration] direct cost and related costs. It costs approximately $450 to list a product with [Therapeutic Goods Administration], even if there are a hundred identical products already on the market. … No such costs apply in New Zealand. (National Nutritional Foods Association of New Zealand, sub. 11, p. 12)

This example illustrates the way in which product registration charges can reduce the number of products that a firm may choose to market in Australia, even where each of those charges are relatively small.

Barriers to entry for products in other industries

The National Standards Commission raised the cost of Australian pattern approval charges relative to those in comparable overseas markets:

> From the manufacturers' perspective, the benefit/cost of pattern approval in Australia is relatively poor, because the price for access to the Australian market is the same as the price for access to the whole of the European Community. (sub. 31, p. 4)

In the industrial chemicals industry, the National Industrial Chemicals Notification and Assessment Scheme recently prepared an evaluation of its Commercial Evaluation Category (CEC) permits for chemicals proceeding from the research and development stage to full commercialisation. The evaluation report found that some chemicals are not released in the Australian market for a number of reasons, including registration fees, customer demand and product suitability:

> Nine respondents (16 per cent) said the CEC permit fee was a reason for not introducing a new chemical via the CEC process. The main reason a chemical did not pass through commercial evaluation stage to further notification to [the scheme] and use, was customer acceptance (40 per cent) followed by performance of the chemical (33 per cent). Government fees and time for approval together accounted for 30 per cent. … about one third of CEC chemicals continue in the market. (sub. DR130, p. 3)

The National Registration Authority for Agricultural and Veterinary Chemicals shares similar concerns. It has lowered initial assessment fees and increased ongoing annual fees (based on product sales) so as to minimise discouragement of new registrations. It is intended that firms pay the approximate costs of regulation over the lifetime of a product, rather than before entering the market (sub. 39, p. 5).

Some inquiry participants said that, even with sliding scales and exemptions, the annual product registration charges of many regulators seemed significantly higher

than the cost of maintaining the annual register (for example, Blackmores, sub. 25). They said this discouraged firms from registering low-selling products. However, these annual registration charges often cover more than simple re-registration tasks and can include post-market monitoring, and even some pre-market assessment costs. This is the case for the National Registration Authority for Agricultural and Veterinary Chemicals. In other cases, these annual fees may be deliberately designed for demand management or other reasons to discourage obsolete products from remaining registered (see appendix D).

The effect of a reduced range of products as a result of barriers to entry is typically a reduced product choice for consumers (see section 5.7). Where the affected product is an intermediate one (for example, industrial chemicals used in the manufacture of windscreens or other components), the effect of barriers to entry can flow through into other industries that may use it as an input. In these cases, barriers to entry as a result of regulatory fees (or other factors) may have more widespread effects on industry.

FINDING

Cost recovery charges for some regulated products may have impeded market entry, particularly for products with small sales and/or a short market life. However, barriers to entry arising from cost recovery charges are difficult to distinguish from those arising from the regulations themselves or from general market factors.

Free rider issues for regulatory charges

Free rider disincentives (sometimes referred to as 'first mover' disadvantages) occur where the first entrant to a market bears the cost of entry, but cannot prevent others from gaining a free ride on their investment. This can provide a strong disincentive for firms that want to enter a new market but are unwilling to bear the initial cost on behalf of their potential competitors. Where the first firm gains a private benefit that outweighs its costs, it may proceed with market entry despite subsequent free riders.

Free rider disincentives are most likely to occur where the regulated product or service is generic — that is, where it does not have intellectual property protection from other firms copying it or benefiting from its improvement. Food products are the most notable example of the 'free rider' situation in this inquiry. Most food products cannot be patented in their own right (with the exception of some food additives). The Australia New Zealand Food Authority's response to this issue has been to develop an 'exclusive capturable commercial benefit' test for cost recovery charges (box 5.3).

Box 5.3 **'Exclusive capturable commercial benefit' test in the regulation of generic foods**

The Australia New Zealand Food Authority is responsible for developing Food Standards for commercial food products in Australia and New Zealand. Enforcement and inspection remain the responsibility of State, Territory and local governments. Currently, anyone may apply for a variation to a Food Standard (for example, to include a new ingredient).

Most food products (and the Food Standards themselves) are generic, and the authority has recognised 'free rider' problems as a hindrance to the introduction of direct charges for applications to vary a Food Standard:

> Unlike the activities of the Therapeutic Goods Administration or the National Registration Authority, in most cases, the processing of an application by [the authority] does not transfer a commercial benefit solely to the applicant. This is because the approval of an application is not limited to the applicant, nor generally to the individual product, but provides for generic amendments to the Food Standards Code. … this 'free-rider' effect would make it inequitable to charge an applicant the full cost of processing an application. (ANZFA, sub. 67, p. 3)

The authority noted that requiring all food producers to register individually would not be efficient, or compatible with the overall objectives of Food Standards regulation. An alternative would be to introduce an industry or consumer levy. However, the authority's operating costs are relatively modest, while the transaction costs of recovering a small amount from each of a very large number of food producers or consumers could be substantial. In addition, the main beneficiaries of food regulation — food consumers — are synonymous with the entire population.

A decision was therefore taken to fund Food Standards from general taxation revenue. In the small number of cases where an applicant for a Food Standard has an 'exclusive, capturable, commercial benefit', the authority has the option of charging an application fee.

In applying this test, inquiry participants said that some new additives for food production are patented and that the patent holder must license food manufacturers to use them. The incorporation of such additives into Food Standards would therefore appear to meet the 'exclusive capturable commercial benefit' test and attract a fee. The Australian Food and Grocery Council explained:

> In most cases you will not be able to free ride, for example, applications for food additives which are highly defined and often protected by patents and certainly by trade secrets in terms of their manufacture. But in other areas there may be a free rider which is clearly identifiable. (trans., p. 1304)

Among other agencies, free rider disincentives may have arisen in relation to the Therapeutic Goods Administration assessment charges for new therapeutic claims for generic products (for example, claims that aspirin thins the blood or that certain

vitamins have newly discovered health benefits). In relation to generic complementary healthcare products, the Complementary Healthcare Council of Australia said:

> The cost of evaluating a new [complementary health product] substance is high — upwards of $10 000. There is no capturable commercial benefit to a company from having a new substance evaluated and approved for use as an ingredient as there are no patent protections for [these products]. Once a new substance is approved, all players can use the substance. Accordingly, very few companies are able or prepared to trail blaze. (sub. 17, p. 9)

The lack of exclusive capturable intellectual property rights, in conjunction with regulatory charges, again seems to be a relevant factor. Blackmores explained:

> Given that we can't ever patent any of our products, there's a greater cost to us for going through the regulatory system than say, there is to the pharmaceutical industry, which can at least recoup some of those costs that they put into regulation and development. We don't have that protection (trans., p. 1074)

This may discourage generic producers from adding such claims to their products, depriving consumers of potentially useful product information.

These examples show that the existence of 'exclusive, capturable benefits' for regulated firms may affect the type of cost recovery charges that will be appropriate or, as in the case of the Australia New Zealand Food Authority, whether cost recovery should be applied at all.

FINDING

Where there are no exclusive capturable benefits, direct regulatory charges may inhibit the introduction of new products.

Industry competition issues for information agency charges

Some inquiry participants were concerned about the effect of fees for information services on access to data for research purposes. Some of these comments related to the level of fees (that they are too high), while others related to the structure of fees and to the fact that some fees appear to reflect more than incremental cost.

The Australian Geological Survey Organisation said it is concerned that its cost recovery arrangements —particularly its cost recovery target of 30 per cent — may make its data too expensive for some users:

> Benchmarking of AGSO products against its international competitors indicates that under present cost recovery policies the price of Commonwealth spatial and other related data is becoming uncompetitive and a disincentive to uptake. (sub. 55, pp. 16)

The Environmental Research and Information Consortium stated:

> … [our] annual data purchase (transaction) costs are higher than information production costs. This stifles business growth and our capacity for research and development and innovation. (sub. 7, p. 1)

The consortium identified benefits of no or low cost geological data resulting from research based on data from the Geological Survey of Victoria and the Northern Territory Geological Survey. These included viticulture, neem oil, sandalwood and mahogany projects. It claimed that

> … if (the) data had not been provided at no cost … this investment would probably never have eventuated. (trans., p. 1220)

A small but significant number of (private sector) inquiry participants outlined other problems they have experienced with the cost recovery policies of information agencies. These related to two important competition issues: competitive neutrality and monopoly supply.

Competitive neutrality issues

A small number of inquiry participants raised the issue of competitive neutrality in relation to services provided by information agencies. In some cases, participants felt that the information agencies were effectively their market competitors, as well as their main source of essential data. MariTrade said:

> They are competing with us … they are the provider of the information, they disseminate the information, they are a provider for government, but they are a monopoly supplier. … it's a pricing issue for competitive neutrality. (trans., p. 1029)

And the Environmental Research and Information Consortium said:

> Government agencies engaged in cost recovery compete unfairly in the delivery of resource information and knowledge because they have ready access to public data and [intellectual property] at no cost, and protect these data and [intellectual property] through minimising public access by imposing licence restrictions and high costs for public access. (sub. DR139, p. 1)

The consortium was also concerned that the CSIRO was attempting to sell a service similar to one that it had developed in overseas markets (trans., p. 1216).

For these reasons, some inquiry participants thought that information agencies should not venture into more commercial activities at all. Cumpston Sarjeant argued that:

> Competitive neutrality shouldn't arise because they shouldn't be competing with the private sector anyway. (trans., p. 946).

The Australian Competition and Consumer Commission has taken successful legal action against the Bureau of Meteorology for alleged misuse of its market power in supplying information to a competitor (ACCC 1997, see appendix C). These examples indicate that information agencies need to consider applying competitive neutrality principles to activities that potentially overlap the activities of their customers.

Monopoly provider issues

Many Government information agencies are monopoly providers of certain services, such as unique basic data collection services. While many are statutory monopolies, natural monopoly characteristics may also be present (for example, in some meteorological data collections). Some inquiry participants said that market power was an issue in negotiating the terms of supply of data. MariTrade said:

> … we do have a contract with the ABS which let's face it, we signed … because the commercial reality of it was that unless we accepted these conditions, as a monopoly supplier they would discontinue supplying to us. (trans., p. 1029)

These concerns indicate that information agencies need to be aware of the monopoly status of some of their services, and of the relevance of that monopoly to their cost recovery and pricing policies.

Small business effects

Some inquiry participants said that cost recovery arrangements have particular effects on small firms. Some highlighted the advantages for small firms, such as fee discounts or waivers. Others pointed out disadvantages, such as the reduced ability of small firms to spread regulatory or information product costs across a large inventory or turnover (that is, reduced economies of scale).

Effects of regulatory charges on small business

Several inquiry participants claimed that small firms are disadvantaged by regulatory charges because they cannot recoup the cost from large product ranges or high sales, as may larger firms. On the other hand, many regulatory agencies offer fee discounts and exemptions that often benefit small firms more than large ones.

The exact amount at which a charge becomes a barrier for entry for small firms, but not necessarily for larger firms, is unclear and may vary. The National Standards Commission thought pattern approval fees may form such a barrier:

> Typically, pattern approval of an instrument costs about $20 000 and takes 8 to 12 weeks to complete. Most customers are [small to medium size enterprises] or small import agents, for whom this represents a major expense and a barrier to entry into the Australian market. (sub. 31, p. 3)

In the therapeutic goods industry, the Medical Industry Association of Australia said that high regulatory charges on top of other market factors may be too much for some small firms to bear:

> There are going to be enormous pressures in the near term in our industry for consolidation and a lot of small players will disappear from the marketplace… [Therapeutic Goods Administration regulatory charges] are just another pressure for those small players that we need to address sooner rather than later. (trans., p. 1067)

In the financial industry, the Association of Superannuation Funds of Australia said that small firms appear to be paying more than their share of regulatory fees. It stated that:

> There is a very strong case for saying that small business through the annual return fees paid by proprietary companies is … subsidising the big end of town. (trans., p. 1042)

The Council of Small Business Organisations of Australia said that the proliferation of charges in some heavily regulated industries created a compliance burden for small firms. The imposition of several small fees was resented more than a single large impost, due to the book work required (trans. pp. 540–3).

Many regulatory agencies have tried to address such perceived equity concerns through sliding fee scales and exemptions based on product sales (NICNAS, sub. 33, p. 3). For example, the Australian Maritime Safety Authority has a sliding scale of fees for commercial vessels, and does not charge non-commercial or fishing vessels two of its three levies. Both the National Industrial Chemicals Notification and Assessment Scheme and the National Registration Authority for Agricultural and Veterinary Chemicals have minimum thresholds for annual levies (see appendix D).

In other instances, inquiry participants said that regulatory fee structures favour larger firms. Some maximum caps on levies (such as on chemical and pharmaceutical registration fees) mean that firms with sales above the maximum cap (per product) enjoy an effectively lower fee per unit of product. On the other hand, if the charge genuinely relates to regulatory costs, then a maximum cap simply may reflect the cost of the activity which the charge is intended to recover. The National Farmers' Federation supported such measures in cost recovery arrangements:

> [The federation] supports the incorporation of strategies such as levy caps and minimisation of upfront payments into the cost recovery principles. (sub DR162, p. 9)

Other inquiry participants argued that if the regulatory costs are the same (per product or per firm), then firms should pay the same. Avcare, for example, said that the regulation of low selling chemicals should not be 'subsidised' by a small number of high-volume chemicals (trans., p. 933). The Australian Food and Grocery Council said:

> We are also opposed to the imposition of higher charges on bigger companies. We just cannot see that this is justifiable on any equitable basis if the costs incurred by the regulatory agency are the same. (trans., p. 1117)

This range of examples indicates the diversity of approaches to 'small business' issues among agencies that have cost recovery charges. In most cases, fee thresholds, discounts and caps are calculated on sales or turnover per product, not per firm. Regulatory costs per firm, therefore, tend to reflect the number of regulated products and sales per product, rather than the size of the firm.

Effects of information agency charges for small business

The Commission was not presented with many concerns about the cost recovery practices of information agencies that were particular to small business users. Some small private research firms said they dislike the ABS's pricing arrangement with universities, with whom they compete for business. Cumpston Sarjeant said:

> We strongly believe that universities should be treated on the same basis as businesses. …. We often find we're competing with the universities and I think … they get the data cheap … the data should be very cheap to everybody. (trans., p. 941)

In response, the ABS said that its pricing policy for universities reflects the cost savings of dealing with one group instead of many separate users, and that the arrangement is a form of bulk purchase rather than a special discount (trans., p. 1116).

Other inquiry participants said that small firms may be particularly affected by the high price of geological data. The Geological Survey of Victoria said:

> These high prices act as a disincentive to access and use of the information. Furthermore, they disadvantage smaller companies that are likely to try to use products not suited to [the] task to minimise the cost to their exploration program instead of purchasing [Australian Geological Survey Organisation] data. (sub. 99, p. 2)

The Australian Geoscience Council made a similar point:

> With the current pricing arrangements, only the larger exploration companies can afford to use [the Australian Geological Survey Organisation's] important regional geophysical data sets. (sub. DR116, p. 1)

In the case of ScreenSound Australia, 'capacity to pay' is considered on a discretionary basis for some cost recovery charges, along with 'clear private benefit of economic value to the customer' and other criteria (sub. DR144, p. 6). However, this pricing policy is intended to allow for free or discounted access by academics, community groups and other non-profit users, rather than to promote small commercial business users over larger ones.

The Commission considers that the most appropriate charging strategy for information agencies is to price additional information products at the marginal cost of disseminating existing information or the incremental cost of undertaking any additional work (see chapter 2). Under this approach, there would be little scope for differential treatment of clients based on firm size. Where the Government wishes to subsidise particular users, it may be more appropriate to do so through direct subsidies rather than through cost recovery arrangements (see chapter 7).

Regional effects

The Commission received little information on cost recovery arrangements that may affect firms or consumers in regional areas differently to those in other locations.

Avcare suggested that any disincentives to undertake gene technology research (from proposed charges by the Office of the Gene Technology Regulator) may detract from agricultural development that could benefit regional areas:

> A setback for the agricultural gene technology industry will impact directly on the rural sector and the regional communities that support, and benefit from, competitive profitable rural industries … (sub. 28, p. iv)

In telecommunications, it is possible that the Australian Communications Authority charges might have had a different impact on regional spectrum users than on metropolitan users (see appendix E). The Commission received no information on this effect from spectrum users. The authority said that it did:

> … not believe there are significant access and equity or regional competitiveness issues associated with the radiocommunications cost recovery regime. (sub. 108, p. 9)

Cumpston Sarjeant noted that the high cost of requesting disaggregated ABS data (for which users are charged per cell) and regional data from some other Government agencies may limit research for regional planning and development purposes, because such research generally requires a high degree of data disaggregation. It stated that:

> … the data [are] masked by the confidentiality restrictions. … Secondly, the costs at the moment would be pretty high. This problem applies to a lot of regional [research]

> issues: disease, poverty, land degradation. They're all issues where the public may have something to contribute … but are barred from getting the data. (trans., p. 942)

Similarly, restricted access to geological and other spatial data may limit certain forms of regional development, such as mining or innovative agriculture (which can require sophisticated geophysical data analysis to determine feasibility). The Australian Geoscience Council noted that the Australian Geological Survey Organisation data 'are widely used in the mineral and petroleum exploration industries' and that high prices for data may limit the expansion of these important regional industries (sub. DR116, p. 1).

These examples indicate that where data are priced according to the level of disaggregation or detail required, users of regional data may face higher costs than those faced by users of national data, and some forms of regional research may be discouraged.

Industry innovation effects

The consequences of failing to develop and adopt new technologies can be substantial. The Chemicals and Plastics Action Agenda gave an example in the case of paint:

> The Australian refinish industry uses approximately 15 million litres of paint per year, of which more than 50 per cent is low solids acrylic lacquer that has a solvent content of 70–80 per cent. While low solvent alternatives have been made available in the USA and Europe, the technology has not been introduced in Australia. It is estimated that at least 2 million litres more solvent is emitted per year than would be the case if low solvent alternatives were available in Australia. (sub. 15, p. 6)

The evidence presented to the Commission on the effects of cost recovery on technology overlapped significantly with the effects discussed above — that is, some charges for information and regulatory services may impede research and development or the introduction of new technology in Australia. In the case of charges for information services, the key concern is that high data costs potentially discourage research and development across a number of industries and across society more generally (see above and appendix C).

Examples given by inquiry participants mostly involved regulatory cost impediments to importing new technologies into Australia. The National Standards Commission, for example, pointed to approval fees that discourage the adoption of new measurement technology in local industry:

> When the cost of pattern approval represents an unacceptable barrier to entry of the Australian market, it deprives the users of trade measurement equipment of access to the latest technology, and restricts market competition. (sub. 31, p. 3)

As discussed in section 5.4, regulatory entry costs tend to work in conjunction with other factors (such as Australia's small market size and the typically short market life of high technology products) to form barriers to new products. In relation to therapeutic goods, the Medical Industry Association of Australia said:

> The nature of our industry is inclusive of high technology products that frequently have a very short shelf life. … our industry needs a responsive regulatory system if our products are to reach consumers before their technology life is superceded. … [Therapeutic Goods Administration] registration can cost up to $96 000 at the moment … if it's a high-risk item to get up that's hard to recover. (trans., pp 1056, 1065)

In the chemicals industry, inquiry participants, such as the Plastics and Chemicals Industries Association, said some newly developed specialist chemicals were not being imported into Australia because of regulatory costs and, presumably, the small Australian market for such substances (trans., pp. 4–5).

Avcare said high development costs meant they need to take a global approach to developing and launching new products. The speed and cost of market entry worldwide —not just in Australia— was the relevant factor:

> Products such as our soybeans have been ready for the commercial market for some time, been grown out of America. But until we have clearances in the major markets we won't actually release that product. … Having the full set of clearances in all markets is a key decision point for the person developing the technology. (trans., p. 937)

In relation to gene technology research, Avcare said that even though charges for approval by the Office of the Gene Technology Regulator have been deferred (see above), the possibility of fees in the future could encourage private sector gene technology research to relocate overseas:

> In the private sector, the capital resources and research and development skills behind gene technology are particularly mobile internationally and can easily be withdrawn from Australia if local costs are considered too high. (sub. 28, p. iv)

In theory, not all regulatory charges can be expected to have the same impact on innovation. Fees associated with pre-market assessment and initial product registration are more likely to discourage innovation than are post-market annual registration fees or industry levies, which are often based on sales levels.

Several regulatory agencies have addressed this issue in their fee structures. The National Registration Authority for Agricultural and Veterinary Chemicals, for example, issues free 'minor use' permits for substances for research purposes or to develop new products. The National Industrial Chemicals Notification and

Assessment Scheme has similar 'early access permits' for new 'low hazard' chemicals for local research and product development, but normal assessment procedures and costs apply to chemicals with higher hazard ratings (see appendix D).

Cases such as these reinforce the relevance of the cost of market entry, as well as the speed of approvals, market size and the speed of adoption by downstream users, to industrial innovation in Australia. However, where the Governments wishes to support industry research and innovation, it should pursue these goals through direct policy instruments such as transparent grants and subsidies, rather than through discounted cost recovery charges.

5.5 Cross-subsidy issues

Cross-subsidies occur when one group of users pay for more than the costs of the services they receive, and the surplus is used to offset the cost of services provided to other users. Cross-subsidies are not the same as differential pricing or partial cost recovery (see chapter 7). They may occur as an unintended result of the chosen charging mechanism or deliberately, to pursue equity or social policy objectives.

Examples of cross-subsidies in cost recovery charges

The Commission received evidence of cross-subsidies (or perceived cross-subsidies) between firms using the same or similar Government services from a range of industries.

The Civil Aviation Safety Authority's air safety services are funded by a combination of levies on fuel consumption, fees-for-service and taxpayer funding. Inquiry participants from the airline industry questioned the link between the consumption of fuel and the consumption of safety services. Ansett said it has 'enormous concerns' about the fuel levy's appropriateness, efficiency and transparency as a cost recovery mechanism (trans., pp. 693–694). Qantas said that the large domestic airlines meet a disproportionate share of the costs of industry regulatory and safety services, to the benefit of small operators and private users of small regional airports (sub. 63. p. 4).

One funding option may be to replace the fuel levy with a ticket tax to be paid by commercial and private aeroplane passengers. However, this may face a similar problem to that of the fuel levy, in that some users' costs (for example, those of private passengers on smaller aircraft) may not reflect their use of regulatory and safety services. The Civil Aviation Safety Authority said that 'additional study

needs to be put into the issue of cross-subsidisation' in the airline industry (trans., p. 1125).

Some inquiry participants claimed that cross-subsidies arise from the National Registration Authority for Agricultural and Veterinary Chemicals and the Therapeutic Goods Administration charges, as a result of sliding fee scales and concessional registration charges for small selling products (aimed partly at encouraging innovation — see section 5.5). Avcare argued that under the National Registration Authority for Agricultural and Veterinary Chemicals' fee structure, a small group of high volume products have effectively subsidised the bulk of low sales products over many years:

> A few users of the regulatory system who have products with high sales subsidise all the others. …. once the assessment costs have been paid, those higher selling products continue to subsidise those that don't pay their way. …. [The] model needs to be amended to remove the cross-subsidisation inequity. (trans., p. 927)

Similarly, Blackmores argued that the Therapeutic Goods Administration fee concessions for small turnover products are a form of cross-subsidy:

> We see a lot of inequity in the fees and charges that we as a company pay. … the larger companies are definitely subsidising the smaller companies. (trans., p. 1070)

A recent Australian National Audit Office report on charges by the Australian Quarantine and Inspection Service found evidence of cross-subsidies between some services, including the cargo risk management, entry management and animal quarantine station programs. However, the extent of these cross-subsidies 'was not readily quantifiable because of the general absence of data on actual costs incurred to provide particular types of services' (ANAO 2000a, p. 23).

The Department of Agriculture, Fisheries and Forestry — Australia (responsible for quarantine services) said that any cross-subsidies between services are not significant and may be expensive to eliminate completely (AFFA, trans. p. 663). The Australian Quarantine and Inspection Service said a cross-subsidy model was adopted within its meat inspection program at the request of meat processing industry firms, all of which use the same discrete set of services (AFFA, trans., p. 668). This particular cross-subsidy appears to be between activities within the same service, but not necessarily between firms.

The Australian Chamber of Commerce and Industry said regional firms should pay more than metropolitan firms for the same inspection service to reflect differences in travel costs:

> [For] inspectors visiting regional/rural establishments, … the travel costs are not being fully borne by the establishment where the inspection is taking place but transferred, at least in part, to urban-based establishments. (sub. 70, p. 7)

Among other cost recovery charges, financial regulatory agencies' fees may involve a degree of cross-subsidisation between firms or industries. As noted in section 5.4, the Association of Superannuation Funds of Australia said that small firms may be 'subsidising the big end of town' through annual regulatory charges (trans., p. 1042; see appendix F).

Effects of cross-subsidies in cost recovery charges

Cross-subsidies between different processes or different users may permanently disadvantage one group relative to another. Those who pay the subsidy may restrict their use of the product, reducing desirable consumption that would have taken place if products were appropriately priced. Conversely, those who receive a subsidy may be encouraged to use too much of the product. There may also be 'flow-on' effects where the cross-subsidised services are inputs to other activities.

In addition, the costs of cross-subsidies often remain hidden. Favoured groups can receive benefits without those incurring the costs knowing that they are doing so. In many areas of Government activity, cross-subsidies to assist regional or other special groups have been progressively wound back and replaced with direct subsidies. These subsidies are a more transparent form of assistance and thus are preferable to hidden cross-subsidies.

These examples of cross-subsidy illustrate the challenges faced by agencies seeking to structure their charges so as to minimise their impact on particular groups of users, while also keeping charges equitable for all users (see chapter 8).

5.6 Effects on consumers

Cost recovery of Government services can affect consumers indirectly (where firms pass on the cost of the charges they have paid), or by discouraging market entry and consequently choice. Individuals may also pay Government charges directly, including passport, visa and pilot licence fees.

Indirect effects on consumers

The extent to which consumers ultimately pay for the cost of regulation or information inputs depends on how much of the charges imposed on firms can be passed on (see chapters 2 and 7). In most cases, cost recovery charges are passed on to consumers regardless of where the charge is placed in the supply chain. In aviation, for example:

> Inevitably, in this business our margins are so thin that we have little option but to pass these extra costs on, because they are considerable; they are on a per passenger pass through basis and whether you put an extra discreet charge on the ticket or whether you absorb it in fares, it's going to be passed on in some way. … Any extra charge will get pushed through into the ticket price in the end. (Qantas, trans., pp. 1104–6)

In the complementary healthcare industry, the Complementary Healthcare Council of Australia said that Australian consumers 'may pay higher prices or have a smaller range of choice for some regulated products' as a result of cost recovery charges (sub. DR117, p. 8). Others in the industry agreed. For example, Blackmores stated that:

> … consumers of complementary healthcare products already pay heavily for government regulation, which is partially passed on through the prices we are obliged to charge for our products. (sub. DR114, p. 2)

As discussed in section 5.4, some inquiry participants argued that regulatory fees imposed per product (such as for pharmaceuticals and chemicals) discourage firms from expanding or diversifying their product ranges (see appendix D). For most types of regulated product, lack of registration or listing will mean the product cannot be sold in Australia. For example, the Australian Chemical Specialties Manufacturers Association said that in the chemicals industry:

> … consumers are being denied the option of choosing a more effective or cheaper product because the inefficiency and lack of competition inherent in the current system are making new products prohibitively expensive. (sub. DR164, p. 6)

For therapeutic products, the absence of the Therapeutic Goods Administration registration makes it far more difficult and expensive — but not totally impossible — for patients to gain access to the product:

> They are not missing out totally because a physician or a surgeon can go to the [Therapeutic Goods Administration] and say, 'I have a specific clinical need. This device will fulfil that. I want to implant it,' and then they are taking that responsibility because it hasn't been evaluated by the [Therapeutic Goods Administration]. So it puts a lot more onus on the surgeon. (Cochlear, trans., pp. 208–9).

However, other inquiry participants indicated that the prohibition on promoting non-registered products has limited the uptake of this special access scheme. Awin argued that:

> The special access scheme is available if a surgeon hears during one of his travels overseas of something, and he can go to the [Therapeutic Goods Administration]. They will give him permission to use that product on that patient which gives you the right to supply it. … it's very limited and the rules actually forbid promotion, so we have no access to orphan-type products (trans., pp. 1065–6)

In summary, any cost recovery arrangements will, at the margin, affect the prices and range of products available to consumers, in that products with low profitability or demand are less likely to be put on the market. However, it is unclear whether this has occurred to a significant extent for Australian consumers.

Direct cost recovery from individuals

Few Commonwealth Government cost recovery charges are directly paid by individuals. Examples include charges for visa applications, pilot and seafarer licences and some information services (such as copying charges, see appendix C).

In 1999-2000, the Department of Immigration and Multicultural Affairs raised $225.1 million (and covered 40 per cent of its total costs) through various charges on individuals, including visa application fees, translating and interpreting service charges, citizenship fees and publications sales. Visa application charges apply for most non-humanitarian visa categories and recover some compliance, monitoring and processing costs (DIMA, trans., p. 573). The department was concerned about the administration costs of some of these charges, due to the large volume of small value transactions, high security costs and the preference of many clients to pay by cheque or cash in a variety of currencies (sub. 53, p. 7).

English Australia claimed that there is potential for over-recovery in the department's student visa charges and that efficiency gains in the provision of services (for example, from online applications) have not been reflected in lower fees (sub. 6, pp. 7–8). The Tourism Task Force was similarly concerned about the potential for over-recovery from a new fee of $20 for electronic travel authorities. The fee was introduced to recover an annual technology cost of $200 000, but is expected to recover much more (trans., p. 1095).

Both English Australia and the Tourism Task Force emphasised the highly competitive nature of international education and tourism. English Australia claimed Australian student visa application charges are high relative to those of other comparable countries (sub. 6, p. 3).

The department stated that Australian visas are not always directly comparable to those from other countries. Australian student visas, for example, include work rights (which they do not in most comparable countries) and carry high enforcement costs. The department added that research by the former Bureau of Immigration, Multicultural and Population Research indicated that the relative cost of visas is not a strong influence on people's migration preferences, but acknowledged that it is necessary for tourism and other temporary visa charges to be 'internationally competitive' (trans., pp. 571–8).

In the aviation and shipping industries, individual aviation and marine personnel pay fees for competency certification to the Civil Aviation Safety Authority (which charges from $20 to $100 and, for flight tests and engineers' exams, $75 per hour) and Australian Maritime Safety Authority (which charges from $15 to $370). The Commission did not receive any information from participants about these charges.

Airlines collect the Passenger Movement Charge from air passengers, to contribute to aviation regulatory and safety costs. Inquiry participants from the airline industry suggested that most passengers are not aware that they are paying the charge, because it is not collected directly (Qantas, trans., p. 1105).

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Australian consumers pay some cost recovery charges directly and may be affected indirectly through higher prices or less choice of products.

5.7 Conclusion

Cost recovery can create both positive and negative incentives for information and regulatory agencies, in terms of agencies' key policy objectives, their efficiency (or cost effectiveness) and their ability to innovate and adopt new technology. These incentives have important implications both for the appropriateness of introducing cost recovery and for the design of cost recovery arrangements (see chapters 7 and 8).

It is difficult to separate the effects on industry of cost recovery from the effects of: the regulations (many of which are designed to keep certain products out of the market); data access conditions (such as privacy and technological constraints); and general market conditions (such as market size and expected market life). Evidence presented to the Commission indicated that regulatory and information cost recovery charges (in conjunction with these other factors) might have discouraged the market entry of some firms and products, particularly where potential sales were judged to be too small to cover the additional cost of the regulatory or information charges.

Most charges associated with Government activities, particularly those associated with regulatory activities, are paid by firms rather than individuals. To the extent that these charges are then passed on to other firms and to consumers, cost recovery charges may also affect consumers indirectly by increasing prices or by reducing the range of products available. The implications of these considerations for the implementation and design of cost recovery are examined in chapters 7 and 8.

6 Cost recovery under the *Trade Practices Act 1974*

This inquiry incorporates a review of charges under the *Trade Practices Act 1974* (the TPA). This review stems from the Government's commitment under the Competition Principles Agreement to review legislation that restricts competition. The review of charges under the TPA has been specifically requested under the terms of reference and is closely linked to the rest of the inquiry.

6.1 Introduction

This chapter assesses the objective of charges under the TPA and the extent to which the charging arrangements impose benefits or costs on consumers and firms, while particularly noting their effect on competition. Under the Competition Principles Agreement (box 6.1), legislation should not restrict competition unless it can be demonstrated that the benefits of the restriction to the community as a whole outweigh the costs, and that the objectives of the legislation can be achieved only by restricting competition. Relevant options for TPA charges are identified in light of these conditions.

6.2 Charges under the Trade Practices Act

A number of charges are imposed under the TPA, varying in their nature and effects. Charges are made for arbitration functions, authorisation applications, notifications, various other applications (such as those relating to conference agreements made by international shippers), copying of registers and discretionary products such as publications. This section first describes the TPA and the role of the Australian Competition and Consumer Commission (ACCC), and then examines the charges under the TPA.

Box 6.1 **Legislation review requirements**

Under the Competition Principles Agreement, all Australian governments agreed to review and, where appropriate, reform existing legislation that restricts competition.

The Commonwealth Government released its review timetable in June 1996, nominating 98 separate reviews and foreshadowing the review of charges under the TPA. In announcing the Legislation Review Schedule, the Government also outlined requirements for reviews. In particular, the Government stipulated that each review is to be approached according to clause 5(1) of the Competition Principles Agreement, which states that:

> The guiding principle is that legislation (including Acts, enactments and Ordinances or regulations) should not restrict competition unless it can be demonstrated that:
>
> a) the benefits of the restriction to the community as a whole outweigh the costs; and
>
> b) the objectives of the legislation can only be achieved by restricting competition.

The Agreement also outlines how reviews should be conducted (clause 5[9]). Specifically, a review should:

- clarify the objectives of the legislation;
- identify the nature of the restriction on competition;
- analyse the effect of the restriction on competition and on the economy generally;
- assess and balance the costs and benefits of the restriction; and
- consider alternative means of achieving the same result, including non-legislative approaches.

The inquiry terms of reference for the review of charges under the TPA are drawn from these broad requirements (terms of reference 2, 5 and 6).

Trade Practices Act

The objective of the TPA, as set out in the Act (part I) is to 'enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection'. In broad terms, the TPA covers anti-competitive and unfair market practices, consumer protection, company mergers and acquisitions, product safety/liability and third party access to facilities of national significance (ACCC 2000a).

The coverage of the TPA has grown significantly since its introduction in 1974. It includes provisions, for example, relating to consumer protection (part V), along with industry-specific parts such as international liner cargo shipping (part X) and telecommunications (parts XIB and XIC). Part XIB relates to anti-competitive

conduct in the telecommunications industry, while part XIC relates to telecommunications network access. The telecommunications-specific parts were added in 1997 and coexist with parts that relate to more general economy-wide access to nationally significant facilities (part IIIA) and anti-competitive practices (part IV). A major amendment was also made in 1999 when part VB — relating to price exploitation under the new tax system — was enacted.[1]

The ACCC is an independent statutory authority which administers the TPA, the associated State and Territory application legislation and the *Prices Surveillance Act 1983*.[2] It has additional responsibilities under other legislation. For example, the ACCC has responsibility for competition matters under the *Telecommunications Act 1997* and regulates third party access to natural gas pipelines under the *Gas Pipelines Access (Commonwealth) Act 1998*.

Trade Practices Act charges

Charges under the TPA are specified in the Act and under the *Trade Practices Regulations 1974*. The TPA will often allow for a charge for a particular activity, with the details, such as the level of the charge, specified in the regulations. Because the charges are specified in the TPA and the TPA regulations, the ACCC does not have any discretion to vary the amount, change the charging structure or waive the charge. The ACCC can only set charges where it is charging for discretionary products (see below).

Charges for non-discretionary products can be changed only by amendment to the TPA and the TPA regulations. Parliament must pass amendments to the TPA, and changes to TPA regulations must be notified in the *Commonwealth Government Gazette* and laid before each House of Parliament.

Activities for which charges are imposed under the TPA (table 6.1) can be categorised into five broad groups:

- arbitration functions, such as the notification of access disputes and access arbitrations;
- various applications and notifications, including applications for authorisations;

[1] Part X was the subject of a Commission inquiry (PC 1999b). The Commission was conducting two inquiries relevant to the TPA when this report went to print: one inquiry into part IIIA, and one into parts XIB and XIC.

[2] State and Territory application legislation extends the reach of part IV of the TPA — which relates to anti-competitive practices — to virtually all firms, including unincorporated firms and Government trading enterprises.

- various applications under part X (concerning international liner cargo shipping), comprising copying of registers and registration of conference agreements;
- the provision of a discretionary good or service (product), such as conducting workshops, holding seminars, training and providing information; or
- copying of registers.

Some terms relevant to the charges under the TPA are defined in box 6.2.

Box 6.2 **Some terminology relevant to TPA charges**

Access arbitration. The ACCC has powers to arbitrate disputes between access seekers and access providers over access to declared services. For the ACCC to engage in arbitration, an access seeker and/or access provider must notify the ACCC of an access dispute.

Authorisations. These give immunity from court action by the ACCC, or any other party, for particular restrictive trade practices that breach the TPA. Authorisations are only granted if the ACCC considers that the public benefits of the conduct outweigh the detriment from reduced competition.

Conference agreement. This is an unincorporated association between two or more shipping companies coordinating services on a specific trade route.

Declared services. Access providers are obliged to supply these services to access seekers.

Exclusive dealing. Generally, this occurs where one individual or organisation that trades with another restricts what the other party deal in or with whom they deal.

Notifications. These give immunity from court action by the ACCC, or any other party, for a potential breach of the exclusive dealing provisions of the TPA.

Third line forcing. This form of exclusive dealing occurs where a supplier supplies, or offers to supply, a product on the condition that the purchaser acquires a second product from another supplier. Suppliers also engage in third line forcing if they refuse to supply a product because the supplier has not acquired, or not agreed to acquire, a second product from another supplier.

Third party access. This is access by an access seeker to a declared service provided by an access provider. It allows the seeker to provide products using the access provider's infrastructure.

Undertakings. These voluntary offers regarding the terms and conditions of access are made by an access provider to the ACCC. The ACCC can accept or reject an undertaking. Under part IIIA of the TPA, undertakings may precede declaration. Under part XIC, undertakings must follow declaration.

Sources: Miller (2001); TPA.

Table 6.1 **TPA charges, 2001**

Charge description	*TPA part*	*Charge ($)*
Arbitration functions	**Parts IIIA and XIC**	
Notification of third party access dispute		2 750
Pre-hearing (excluding variation of an existing third party access determination)		10 850
Pre-hearing relating to a variation of an existing third party access determination		2 170
Arbitration hearing charge (for each day or part of a day)		4 340
Applications or notices	**Part XII**[a]	
Application for an authorisation of anti-competitive conduct (excluding acquisition of shares or assets)		7 500
Additional application for an authorisation relating to an earlier application for an authorisation of anti-competitive conduct (excluding acquisition of shares or assets)		1 500
Application for an authorisation of the acquisition of shares or assets		15 000
Notifications of exclusive dealing (excluding third line forcing)		2 500
Notifications of third line forcing		100 or 1 000[b]
Additional notification of exclusive dealing relating to an earlier notification (excluding third line forcing)		500
Additional notification of third line forcing relating to an earlier notification[c]		200
Application for registration of a contract that provides for access to a declared service		5 425
Application for registration of agreements for access to a declared telecommunication service		5 425
Application for an exemption order from anti-competitive conduct in the telecommunications industry		7 500
International liner cargo shipping	**Part X**	
Application for a copy of an entry in a register or a part of a conference agreement file		30 (in part), 60 (whole)
Application for registration of a conference agreement		360 (provisional) 210 (final)
Application for registration of an ocean carrier's agent		100
Discretionary products	**Part XII**	
Workshops, seminars and training; provision of speakers, information and publications; development of industry codes of conduct		Determined by ACCC
Copies of registers	**Various**	
Copying of a register		1 per page, plus 10 flat charge for certified copies

a These functions are performed under various parts of the TPA (authorisation applications and notifications are performed under part VII; application for registration of an access contract is performed under part IIIA; application for an access agreement is performed under part XIC; and applications for exemption orders are performed under part XIC). However, the ability to charge for the functions is contained in part XII. **b** Charges of $100 apply to notices given by individuals or proprietary companies. Charges of $1000 apply to other applicants.**c** Excludes additional notices given by individuals and proprietary companies.

Source: ACCC (sub. 66, attach. 1, pp. 1–5.)

A number of cost recovery arrangements that are used to fund specific ACCC functions are not charged under the TPA, but are an important component of ACCC funding. These arrangements are not subject to the legislative review of charges under the TPA, but would still need to be subject to the Guidelines recommended by this inquiry. For example, the ACCC receives a portion of the revenue collected from a telecommunications levy authorised under the *Telecommunications (Carrier Licence Charges) Act 1997*. The Australian Communications Authority collects this levy from telecommunications carriers. (The authority's cost recovery arrangements are discussed in appendix E.) This funding covers the cost of performing the ACCC's telecommunications regulation functions, such as regulation of anti-competitive conduct and access to networks. The ACCC received around $2.8 million from the telecommunications levy in 1999-2000, in addition to the revenue from charges under the TPA for the ACCC's provision of telecommunications regulation services. The latter revenue includes charges under part XIC, such as for the notification of access disputes (ACCC, sub. 66, p. 3).

In addition, the 2000-01 Budget increased the rate of excise and customs duty on aviation turbine fuel to recover the ACCC's costs of regulating airports under the *Airports Act 1996*, the *Prices Surveillance Act 1996* and the TPA. These regulation activities include administering airport access arrangements, assessing compliance with airport price caps, monitoring the prices of aeronautical related services at airports and monitoring the quality of service. The ACCC is forecast to receive around $1 million per year from the rate increases (Treasury 2001a).

The 2000-01 Budget also announced a levy on Australia Post to recover the ACCC's costs of regulating competition for postal services. The ACCC is forecast to receive around $1 million per year from this levy (Treasury 2001a). (The legislation to implement this levy is before Parliament.) While this chapter is primarily concerned with the charges collected by the ACCC under the TPA, the emergence of these other cost recovery arrangements has substantially changed the financing context within which the ACCC operates.

Revenue from Trade Practices Act charges

Around $4.3 million of the ACCC's costs was recovered by it, and by other agencies on its behalf, in 1999-2000 (questionnaire response). This included around $1.2 million in revenue from charges under the TPA (table 6.2). TPA revenue was around two per cent of the ACCC's total operating revenue of $58.4 million in that year (ACCC 2000b). Around half of this revenue was earned from charging for discretionary products such as conducting workshops and seminars, training and providing information. The ACCC retained this revenue by way of a net

appropriation agreement made under s.31 of the *Financial Management and Accountability Act 1997* (the FMA Act). (Chapter 3 discusses net appropriation agreements in more detail.) The Department of Transport and Regional Services collected a further $17 160 from international liner cargo shipping under part X of the TPA. The ACCC also retains revenue from making certified copies of documents under a s.31 agreement. All other revenue is paid into the Consolidated Revenue Fund without being earmarked for the ACCC.

Table 6.2 **Revenue from TPA charges, 1999-2000**

Activity with TPA charge	*Revenue*	*Recipient*
	$	
Arbitration functions	165 750	CRF[a]
Provision of discretionary products[b]	682 018	ACCC
Applications or notices	370 850	CRF
International liner cargo shipping	17 160[c]	CRF
Copies of registers	8 259	CRF/ACCC[d]
Total	**1 244 037**	

[a] Consolidated Revenue Fund. [b] Revenue raised from these charges is retained by the ACCC in accordance with an agreement under s.31 of the FMA Act. [c] This revenue was received by the Department of Transport and Regional Services rather than the ACCC. [d] Revenue raised from making certified copies of documents is retained by the ACCC under a s.31 agreement. Revenue raised from making copies of other documents is paid to the Consolidated Revenue Fund.

Sources: ACCC (sub. 66, attach. 1, pp. 1–5); DTRS, (pers. comm., 27 June 2001).

The ACCC described the basis on which its portion of TPA charge either revenue is retained under s.31 of the FMA Act and used for its own purposes, or forms part of the Consolidated Revenue Fund:

> Usually what is in the legislation, in the regulations, goes to consolidated revenue, except for the amounts that we have some discretion about; for instance, the publication-type work and some of the training and seminars and so forth, and that also is the same funding that we recover under the section 31 account of the Financial Management Act. (trans., p. 814)

The revenue retained by the ACCC under s.31 is not used to fund specific ACCC activities, but rather is used as a source of general funding. The other cost recovery revenue collected by the ACCC is not hypothecated or appropriated to the ACCC.

Legal constraints on Trade Practices Act charges

TPA charges are technically fees-for-service. If these charges were challenged and found by the Courts to be taxes, then under the Constitution all other TPA provisions could have no effect. Therefore, the ACCC sets the charges in a manner that minimises the possibility of them being interpreted as taxes. (A separate tax Act

is needed to impose charges that are legally taxes. Chapter 3 provides a discussion of taxes and fees-for-service.)

Therefore, the ACCC recovers only the lowest expected cost of providing arbitrations, various applications and notifications, and copies of documents:

> The fees and charges set out in the TPA and regulations are based on the lowest expected cost of performing the service. To that extent they do not reflect actual costs. None of these fees have been increased since their insertion into the legislation. (ACCC, sub. 66, p. 4)

Charges for the provision of discretionary products under s.171A (such as charges for conducting workshops and seminars) are based on the costs of providing the products (see below) and are not otherwise constrained. The Department of Transport and Regional Services broadly recovers the overall cost of various functions under part X of the TPA.

6.3 Nature of Trade Practices Act charges

Charges under the TPA vary in their effects on users and on the degree of competition. Charges can be appropriate where there are private benefits and they can have a role in ensuring that product users take account of the costs of product provision in their decisions. However, charges may also affect access to ACCC products, and ultimately, the degree of competition. This section examines TPA charges in more detail for each of the five charge categories. The basis of charges and beneficiaries as perceived by the ACCC are summarised for each function in table 6.3. The effects of technology are examined where appropriate.

Table 6.3 **Basis of TPA charges and the ACCC's perceived beneficiaries**

Function	*Costs recovered*	*Beneficiaries of the function*
Arbitration functions	Lowest expected cost of the function[a]	Parties subject to the arbitration activity, but also the public generally
Applications or notifications	Lowest expected cost of the function	Parties lodging the application or notice, but also the public generally
Applications under part X	Broadly, the overall cost of the function	Predominantly parties lodging the application, but also the public generally
Discretionary products	Costs of providing products	Parties requesting the products
Copies of registers	Lowest expected cost of the function[b]	Parties requesting the copies

[a] Arbitration function charges include the arbitration hearing charge that is charged per day. This charge is based on the lowest expected hearing cost per day. [b] The charge for copies of registers is generally charged per page. This charge is based on the lowest expected cost per page. Registers containing information relating to prior years are now available electronically. The charge for these is treated as discretionary, reflecting the cost of providing the product.

Sources: ACCC (sub. 66, p. 3); DTRS, (pers. comm., 27 June 2001).

Charges for arbitration functions

The TPA gives the ACCC the power to arbitrate disputes over third party access to services that have been declared. A dispute could arise between owners or controllers of declared nationally significant infrastructure assets (for example, an electricity grid) and individuals or organisations who seek access to that infrastructure. Either party can notify the ACCC of an access dispute. Once the dispute has been notified, the ACCC arbitrates between the two parties and makes a determination regarding access. The Commission's inquiries into the National Access Regime (PC 2001a) and telecommunications-specific competition regulation (PC 2001b) discuss access issues in greater detail.

The ACCC may charge for its arbitration functions for access disputes under both the general access provisions of part IIIA and the telecommunications specific access provisions of part XIC (table 6.1). These parts and the associated regulations provide for charges for:

- notifying access disputes (s.44S and regulation 6C, s.152CM and regulation 28T);
- pre-hearings for access dispute arbitrations if the dispute is in respect to an existing determination from an access arbitration (s.44ZN and regulation 6F, s.152DM and regulation 28W);
- pre-hearings for any other access dispute (s.44ZN and regulation 6F, s.152DM and regulation 28W); and
- hearings for third party access arbitrations (s.44ZN and regulation 6F, S.152DM and regulation 28W).

Dispute notification and pre-hearing charges must be paid by the party making the notification. Hearing charges are apportioned at the ACCC's discretion between the parties at the hearing on that day. The structure and level of arbitration charges are the same under both part IIIA and part XIC. This is because the arbitration processes under both parts are similar.

Revenue raised from arbitration functions was $165 750 in 1999-2000 (table 6.2) and can be presumed to have recovered only part of the total cost of performing these functions. This revenue was received from those arbitrations performed under part XIC because no arbitrations were performed under part IIIA in 1999-2000.

Charges for notifying access disputes and pre-hearing charges are intended to recover the lowest expected cost of preliminary work undertaken by the ACCC for an arbitration hearing. They recover, for example, part of the costs of ACCC staff working on the dispute. Pre-hearing charges for access disputes concerning an

existing determination are lower than those for other disputes because the costs of the preliminary background work are lower. The hearing charge is intended to recover at least part of the per day costs of conducting the arbitration hearing (for example travel and room hire costs).

The ACCC charging for arbitration functions is in line with practices by State, Territory and Commonwealth courts, which commonly charge to file matters for judicial and dispute resolution functions for civil matters. Revenue from civil court charges amounted to around 27 per cent of total expenditure in 1999-2000 for each civil court in each State/Territory and the Commonwealth (SCRCSSP 2001).

Charges for applications and notifications

Part XII (s. 172) of the TPA gives the Governor-General the power to make regulations prescribing the charges payable to the ACCC for making particular applications or giving notifications. The TPA regulations provide for charges for:

- authorisation applications and notifications;
- applications for registration of contracts that provide for access to a declared service;
- applications for registration of agreements for access to a declared telecommunication service; and
- applications for an exemption order from anti-competitive conduct in the telecommunications industry.

The ACCC reported revenue of $370 850 from applications and notifications in 1999-2000 (table 6.2).

Authorisations and notifications

The TPA is a regulatory instrument for promoting competition as a means to an end, to improve the welfare of Australians. However, it does recognise that in some instances 'public benefit' may result from practices that actually lessen competition (Miller 2001). Under part VII of the TPA, exemptions from some of the restrictive trade practices provisions can be granted through authorisations and notifications of exclusive dealing (box 6.4).[3]

[3] Restrictive trade practices for which authorisations can be granted include: anti-competitive agreements, including price fixing; covenants affecting competition; primary and secondary boycotts; anti-competitive exclusive dealing; exclusive dealing involving third line forcing; resale price maintenance; and the acquisition of shares or assets that are likely to lead to a substantial lessening of competition. Authorisations cannot be granted for the misuse of market power.

Box 6.3 **Authorisations and notifications**

Authorisations

An authorisation gives immunity from court action by the ACCC, or any other party, for particular restrictive trade practices that breach the TPA. Authorisations are granted only if the ACCC considers that the public benefits of the conduct outweigh the detriment from reduced competition. For example, an authorisation could be granted for acquisitions or mergers that would result in a substantial lessening of competition, or for firms acting as a cartel, if the ACCC considered that there was a net public benefit from doing so. Public benefits can arise from:

- lower prices for consumers from efficiency gains through economies of scale and scope; or
- improved service to customers; or
- improved international competitiveness and growth in export markets; or
- the expansion of employment or prevention of unemployment in efficient industries.

After consideration of the application, the ACCC prepares a draft determination (except for mergers). Before making its final determination, the ACCC must give the opportunity for any interested party who is dissatisfied with the draft to request a conference. Authorisations can be of limited duration and made subject to conditions. Only parties to the conduct can make authorisation applications.

Notifications

A notification gives immunity from court action by the ACCC, or any other party, for a potential breach of the exclusive dealing provisions of the TPA. Notifications for exclusive dealing differ from authorisations because the immunity operates from the date of lodgement (or from 14 days after lodgement for third line forcing), and remain unless revoked by the ACCC. Parties do not have to wait for a decision by the ACCC. Only parties to the conduct can make notifications.

Source: Miller (2001).

TPA regulation 28, along with schedules 1A and 1B, specify the charges payable for authorisation applications and notifications. Charges vary depending on whether they are for an authorisation application or notification, and on the type of authorisation or notification (table 6.1).

The ACCC will not begin to process an authorisation application or notification until the charge has been paid in full. Additional related authorisation applications regarding anti-competitive conduct (excluding mergers and acquisitions) and notifications of exclusive dealing attract a concessional charge (table 6.1). The application must be lodged within 14 days of the original application and the

conduct must occur in the same (or a closely related) market to that involved in the original application or notification.

Information technology is having some impact on authorisation applications and notifications. Currently, the authorisation application and notification forms are available over the Internet. The ACCC would like to allow applications and notifications also to be made over the Internet, along with payment of the charges (sub. 66, p. 9).

Charges for other applications

The TPA allows for contracts and agreements to be made that provide for access to a declared service, including a declared telecommunications service. It also provides for exemptions from anti-competitive conduct in the telecommunications industry (box 6.4). The charges under the TPA and the TPA regulations for these activities are shown in table 6.1.

- Part XII (s.172) and regulation 6G allow for a charge to be payable for applications made to register a contract that provides for access to a declared service made under part IIIA (s.44ZW).
- Part XII (s.172) and regulation 28X allow for a charge to be payable for applications made to register an agreement for access to a declared telecommunications service made under part XIC (s.152ED).
- Part XII (s.172) and regulation 28(2B) allow for a charge to be payable for an order exempting specified activities from the scope of telecommunications industry anti-competitive conduct provisions made under part XIB (s.151AT).

All charges are payable at the time of the application. The charges for access contracts under part IIIA and access agreements under part XIC are the same ($5425). An exemption order is similar in nature to an authorisation. The charges for an exemption order application are the same as for a non-merger authorisation application ($7500).

Box 6.4 **Access contracts, agreements and exemption orders**

Part IIIA access contracts

Part IIIA (s.44ZW) provides for applications to register a contract that provides for access to a declared service. The parties to the agreement are an access seeker and the access provider. Each party to the contract must apply to have it registered. In deciding whether to register the contract, the ACCC must consider the public interest, including the public interest in having competition in markets, and the interests of all individuals and organisations who have rights to use the infrastructure. A registered contract can be enforced as if it were a determination made by the ACCC, in substitution for the remedies available under contract law.

Part XIC access agreements

In a similar manner, part XIC (s.152ED) provides for applications to register agreements for access to a declared telecommunications service. The ACCC takes into account the same factors when deciding to register the agreement as it does when registering a contract under the general access provisions. A registered agreement can be enforced as if it were a determination made by the ACCC, as is the case for an access contract under the general access provisions.

Part XIB exemption orders

Under part XIB (s.151AT), an individual or organisation may apply for an order exempting specified activities from the scope of telecommunications industry anti-competitive conduct provisions. The order may be made if the ACCC considers that the conduct is not anti-competitive or is likely to result in public benefits that outweigh the detriment from reduced competition. Exemption orders can be of limited duration and can be made subject to conditions.

Source: Miller (2001).

Charges for applications under part X (international liner cargo shipping)

Under part X of the TPA, international shipping lines are able to make and apply for provisional and final registration of conference agreements (box 6.5). Shipping lines may also apply for the registration of an agent, change of agent or change of agent's details. The Department of Transport and Regional Services performs the registrar function.

Box 6.5 **Conference agreements**

Under part X of the TPA, international shipping lines are able to make conference agreements, which are unincorporated associations between two or more shipping lines coordinating services on a specific trade route. Conference agreements may allow shipping lines to achieve economies of scale and scope, reducing costs to importers and exporters, and improving the frequency and reliability of service. Part X exempts conferences from anti-competitive provisions (part IV) of the TPA on the basis that they improve services to Australian exporters and do not misuse any market power.

The exemptions are also conditional on the parties to the agreements undertaking certain obligations towards shippers, such as negotiating shipping arrangements and providing information to shippers when reasonably requested to do so. The Minister may withdraw exemptions on a variety of grounds.

Sources: PC (1999b); DTRS, (pers. comm., 27 June 2001).

Part X specifies that a number of registers, along with conference agreement files, must be kept by a registrar or the ACCC. These include a register of conference agreements, a register of non-conference ocean carriers with substantial market power and a register of ocean carrier agents. Conference agreement files contain a number of documents related to the agreement.

Registration of a conference agreement gives the parties partial and conditional exemptions from s.45 of the TPA relating to contracts that restrict dealings or affect competition and s.47 of the TPA relating to exclusive dealing.

Part X specifies that regulations can prescribe charges for applications for provisional and final registration of conference agreements, along with applications for copies (in whole or part) of registers and conference agreement files. Part X also specifies the maximum amounts that can be charged. Regulation 31 and schedule 2 specify the current levels of charges (summarised in tables 6.1 and 6.4). These charges are set at a level that broadly recoups the overall costs of the Registrar of Liner Shipping (table 6.3). In no case are the charges set at the maximum allowable under the TPA.

Table 6.4 **International liner cargo shipping charges, 2001**

	Current level	*Maximum allowable under the TPA*
	$	$
Application for provisional registration of a conference agreement	360	1200
Application for final registration of a conference agreement	210	700
Application for registration of ocean carrier's agent	100	160
Application for a copy of a part of an entry in a register or a part of a conference agreement file	30	200
Application for a copy of the whole of an entry in a register or the whole of a conference agreement file	60	200

Sources: TPA; DTRS, (pers. comm., 27 June 2001).

Charges for discretionary products

Under part XII (s.171A) of the TPA and the TPA regulations (regulation 28A), the ACCC is able to charge for discretionary products (table 6.1). Under the TPA, a discretionary product is one that:

- the ACCC has the power to perform but is not required to perform under any law; and
- the ACCC is requested to perform by an individual or organisation (TPA, part XII).

The TPA regulations specify that the ACCC may charge for:

- conducting workshops and seminars, training, and supplying material published by the ACCC in the course of carrying out its functions and powers;
- providing a speaker or information for a workshop or seminar not arranged by the ACCC, and providing information to be used in publications not published by the ACCC; and
- developing industry codes of conduct that encourage compliance with the TPA (regulation 28).

For these activities the ACCC is not bound by the TPA to provide the product if requested and the level of the charge is not prescribed in the Act. These activities can be distinguished from regulatory activities where the ACCC must provide the product if requested and the level of the charge is prescribed in the TPA.

Revenue from discretionary charges amounted to $682 018 in 1999-2000. This accounted for just over half of all revenue from TPA charges (table 6.2). These

charges differ from most other charges discussed in this chapter because the ACCC is able to base them on the cost of producing the products on a case by case basis, rather than on the lowest expected cost of producing the product. The ACCC also engages in a degree of price discrimination when charging for some discretionary products. For example, it will often provide some documents free to students for which it would have otherwise charged.

The ACCC has imposed charges for discretionary products in a number of ways. For example, publication prices have often been set at $5, $10 or $15 depending on the type and size of the publication. Typically, prices for guides to legislation and ACCC procedures, along with pricing inquiry reports and pricing monitoring reports, are set at one of these price levels. The ACCC also charges $75 for an annual subscription to the *ACCC Journal*, $100 for compliance training packages, and $50 for conduct compliance training packages. For sales of 10 or more copies, there is a 25 per cent discount (ACCC, sub. 66, att. 2, p. 2). Prices paid by other government agencies and external organisations are often negotiated. A number of publications are offered free of charge.

Free publications are also offered on the Internet. The ACCC stated that:

> Free publications are those which the ACCC consider are of benefit to the public generally, for example, consumers or large groups of people such as small business. Some free publications are also offered where the ACCC has received specific funding from Government for information programs in a particular area such as 'country of origin'. (sub. 66, p. 9)

Business and consumer information sheets and leaflets, along with product safety guides and goods and services tax reports and guidelines, are often free and available on the Internet. The ACCC's *Online Services Action Plan* committed it to examining the feasibility of placing on the Internet all free publications, media releases, significant speeches, information for firms and consumers, conference papers and goods and services tax guides (ACCC 2000d). Publications can be ordered over the Internet. The ACCC is examining the possibility of also allowing purchasers to pay for publications online.

The ACCC has charged for speaker's expenses for appearances at conferences — charges that were originally determined by benchmark comparisons. However, it is unclear how frequently, if at all, the ACCC reviewed these benchmarks. Training manuals for various activities have been sold for $390. This material was prepared for public release, and the development costs have been amortised over the expected number of sales.

In 2000, the ACCC engaged KPMG to undertake a pricing review of a number of its products and to propose a pricing model. Products included in this review

included discretionary products and copying of documents (including copies of registers that have been placed on CD-ROM). KPMG considered that charging for discretionary products has typically been undertaken with little guidance available to staff:

> We were unable to locate any documentation that would give support to the principles that underpinned the adoption of the discretionary charges. As a consequence, there is no guidance available to Commission staff with which to make assessments about the appropriate pricing for new or divergent products/services, for example, CD-ROM copies from public registers. (ACCC, sub. 66, att. 2, p. 2)

KPMG proposed a pricing model to examine the pricing arrangements of some existing discretionary products and whether they could be enhanced. For example, the model could be used in assessing the extent to which development costs should be recovered; determining direct costs for materials on a per unit basis; assessing the time required by staff on a per unit basis; and estimating the transaction volume. KPMG found that the ACCC is 'recovering all of the costs associated with the preparation for, and distribution of, products for sale' (ACCC, sub. 66, att. 2, p. 1). The ACCC now uses the model to price its discretionary products.

Charges for copies of other registers

Various sections of the TPA require the ACCC to create or hold public registers other than those required under part X. Individuals or organisations may be entitled to obtain copies of those registers. Copies can be made of the register of part IIIA access undertakings and codes, the register of part IIIA access agreements and the register of declared services under part XIC. The charges for copying these documents are set out in TPA regulation 28 at $1 per page, with an additional flat $10 charge for making a certified copy (table 6.1) These charges are based on the lowest expected cost per page of the function (table 6.3). These charges do not apply to making copies of registers and conference agreements under part X.

Registers can be viewed in hard copy at ACCC offices for free. However, the ACCC's public registers are held in the Canberra office, with the exception of the s.23 public register held under the Prices Surveillance Act in the Melbourne office. Duplicates of the registers may be held in other ACCC offices.

Information technology is affecting the way in which the registers are provided and thus the costs and charges of doing so. The ACCC has placed 10 statutory and voluntary registers on the Internet, where they can be accessed free of charge. These registers contain current information and also information relating to recent years. Registers containing information relating to prior years can now be made available by the ACCC on CD-ROM or by e-mail. The ACCC has treated the charge for these

CD-ROMs as a discretionary charge that reflects the cost of providing the service, and uses the KPMG model to calculate it.

6.4 Effects of Trade Practices Act charges on competition and economic efficiency

TPA charges have the potential to affect competition and economic efficiency by discouraging the use of the various regulatory services discussed previously. They may also limit access to information from registers and to discretionary products such as workshops. However, charges can play a role in limiting frivolous or vexatious applications and dispute notifications, and help ensure consumers take account of some of the costs involved in providing information products.

In relation to TPA charges generally, the ACCC stated:

> Since the other fees and charges imposed by the ACCC are set at the minimum expected cost of performing the service they are not very large and in many instances do not cover the ACCC's costs of performing the function. It is therefore unlikely that these fees and charges would have an adverse impact on the parties paying the charge or on economic activity generally. (sub. 66, p. 4)

The ACCC also stated that:

> There is no quantitative evidence that the introduction of charges since 1993 has had an impact on the demand for services and products of the ACCC. (sub. 66, p. 4)

Regulatory activities

Cost recovery may be justifiable for regulatory activities such as arbitration functions, applications and notices and conference agreements where there is a significant private benefit. However, it is important that the size of the charge does not unduly restrict access to functions performed under the TPA and thus affect competition or the achievement of public benefits.

Arbitration functions

ACCC arbitrations over access to the services of essential facilities, such as a gas pipeline or a telecommunications network, can have benefits to both access seekers and consumers.

There are three charges for arbitration functions — a notification charge, a pre-hearing charge and a hearing charge. The party that notifies the dispute pays both the notification and pre-hearing charges. This means the party that can

potentially benefit the most by gaining access to the infrastructure asset on better terms than the facility operator has offered, will pay the costs of bringing the arbitration. However, who actually benefits from the arbitration will depend on the outcome of the arbitration. Who actually pays the hearing charge depends on how the charge is apportioned at the arbitration.

There can also be private benefits to both parties if a dispute is resolved more quickly and easily via arbitration than via action through the courts. (Court action would be the only alternative if the TPA provisions did not exist.) A dispute resolution mechanism that functions more efficiently and effectively than taking action in the courts could also have benefits to consumers. It would facilitate access to infrastructure, thus promoting more competition in related markets. Increased competition could, in turn, reduce prices faced by the end consumers of a particular service such as telecommunications services. However, there could be a downside if increased access to infrastructure led to the access service provider deferring infrastructure investment (PC 2001a).

Applications and notifications

There are also likely to be public and private benefits from applications or notifications made under the TPA. Merger authorisations, for example, which by their nature endorse a lessening of competition, are granted only if net public benefits are likely to result. That is, the public benefits must outweigh the costs of decreased competition in the market. These public benefits could arise from factors such as lower prices for consumers or improved service to customers (Miller 2001). However, the ACCC also pointed to a potential private benefit:

> Although there is an element of public benefit in the ACCC assessing authorisation applications to ensure the public detriment does not outweigh the public benefit, there is also a significant private benefit in that authorisation protects the applicant from prosecution for authorised conduct. (sub. 66, p. 3)

There will also be a private benefit to firms where a merger authorisation is allowed, as their profits could increase from the ability to exploit economies of scale and scope.

Applications for non-merger authorisations can also be made and, if successful, will give a firm immunity for some activities that otherwise would have contravened the TPA. For example, a non-merger authorisation could apply to practices such as price fixing, which otherwise would breach the anti-competitive conduct provisions of the TPA.

If charges for applications and notifications are set above costs, then they could unduly discourage firms from engaging in regulatory activities under the TPA that have beneficial impacts. It is important that such benefits are not limited by firms being deterred from making an application.

As for arbitration functions, the private benefits of applications and notifications are likely to be large relative to both current charges and the public benefits. For example, for most firms, the charges for arbitrating a dispute could be expected to be small relative to the potential private benefits from gaining that access. In most cases it is unlikely that the current levels of charges have a significant effect on demand for such applications or act as a barrier to access and thus reduce competition. Similarly, for a merger to contravene s.50 of the TPA, a high level of concentration in the market and barriers to entry would be expected to result. That is, the firms involved would be large relative to the size of the market with substantial financial resources. Given the sizeable private benefits that could potentially arise from an authorisation or notification, it is unlikely that current charges act as a deterrent in most cases.

In addition, the transactions costs for the firms involved in making an application or notice are likely to be far in excess of the charges by the ACCC. Applying for a merger authorisation can involve substantial legal and administration costs for the firms involved in convincing not only the ACCC of the public benefits of their proposal, but also the shareholders of the two companies involved of the private benefits of proceeding.

While charges for authorisation applications and notifications do not appear to act as a deterrent to making such applications, there should be a greater degree of transparency of the costs that the charges are intended to recover. The Australian Chamber of Commerce and Industry stated:

> For authorisation under the TPA, a fee of $15 000 applies whether the time taken by the ACCC is one or twelve months. To industry's knowledge there is no basis for the figure of $15 000. There should be a more transparent and justifiable basis for the setting of any fee or charge. (sub. 70, p. 15)

Information on charges under the TPA is readily available from the ACCC. But, apart from knowing that the charge is linked to the lowest expected cost, there is little information on the actual costs charges are intended to recover.

Other applications

There are also private benefits for access seekers of registering access agreements and access contracts relating to declared services. However, both parties could

benefit because they would have the opportunity to agree on the terms and conditions of access that are laid down in the contract or agreement. The contract or agreement would be enforced as a determination, provided that it was in the public interest. This could reduce recourse to legal action under contract law that may take place if the TPA provisions did not exist. There could also be benefits to consumers, because access agreements and contracts facilitate access to infrastructure, and greater access could improve competition and quality of service.

Applications under part X

In a similar manner, applications made under part X (such as conference agreements) provide benefits to exporters and consumers and private benefits to the parties involved. The Commission previously outlined some benefits of conference agreements:

> Conferences can provide a mechanism for efficient delivery of scheduled, direct shipping services on a particular trade route. Lower costs of provision of such services require the various economies of scale and scope, which characterise liner shipping, to be captured. (1999b, p. 34)

The private benefits arising from conference agreements may be substantial, particularly compared with the size of the charges for applying to register conference agreements. There is potential to reduce the costs of operating regular shipping services by pooling risks and improving the utilisation of shipping capacity. Exporters could benefit through improved frequency and reliability of service, and through shippers passing on lower costs. The size of the charges are also small compared with the size of the shipping firms that would typically enter into a conference agreement.

Effects on small and medium firms

While the impact of TPA charges on many firms may be negligible, there is a risk that TPA charges could adversely affect small and medium firms. In relation to arbitration functions for small third parties, the ACCC stated that:

> There is a risk that small third parties may be discouraged from notifying a dispute because of the increase in their operating costs from paying flat fees for notification and arbitration of a dispute. The ACCC is not aware that these disincentive effects are significant. (sub. 66, p. 4)

In relation to merger authorisations, firms that are small relative to the size of the market typically do not have the market power to 'substantially lessen competition' under the TPA by merging and, as such, would not need to go through the merger authorisation process. However, small to medium sized enterprises may be involved

in authorisations relating to restrictive trade practices under the TPA, such as price fixing.

The ACCC referred to charging flat charges for authorisation applications, regardless of the size of the firm:

> Whether that has competitive effects in terms of, in the proportionate sense, making it easier for a larger firm, say, to approach us for authorisation than it is for a smaller firm, I think that's a potential issue. (trans., p. 821)

For a small firm, the charge for a non-merger authorisation application could be a deterrent. But, again, a small firm is unlikely to be involved by itself in such processes. If charges are spread across a number of small parties to the authorisation, such as through a professional body or a collective, then the costs per party would not be significant. For example, the ACCC recently made a draft determination on an application by Premium Milk Supply in respect of the collective negotiation of farm-gate milk prices and milk quality with Pauls Limited. Membership of Premium will be offered to 580 Queensland milk producers currently selling through six cooperatives. If all these milk producers take up membership of Premium, then the authorisation application charge will be $12.93 each. The ACCC has made a draft determination proposing to grant conditional authorisation for up to four years (ACCC 2001).

Discretionary products and copies of registers

While the ACCC is primarily a regulatory agency, it undertakes some information activities. The ACCC provides publications, seminars and training on a discretionary basis. It also provides copies of a number of public registers. Some publications — for example, those that explain rights and responsibilities under the TPA — are educative and may have broad public benefits. By improving public knowledge of roles and responsibilities under the TPA (for example, knowledge of anti-competitive practice provisions), these products may facilitate compliance and competition. The Guidelines recommended by this inquiry suggest that these publications would be funded from general taxation revenue (see part 2). Currently, the ACCC does not charge for publications where it considers that there are public benefits.

Other activities, such as workshops and training, do not appear to have such broad benefits and a case may be made for cost recovery. However, it is desirable that those who wish to access the information are not unduly discouraged from doing so. Currently, the ACCC charges the cost of providing products where it has undertaken some work in tailoring products to meet the needs of the client. This

seems appropriate in the case of, for example, tailoring seminars, training and more specialised publications.

There are both private and public benefits of allowing copies of registers to be made, mainly through the greater accountability and transparency of TPA processes, including ACCC decision making. There are private benefits for an access seeker, or a competitor, from being able to copy the register of part IIIA registered access agreements. Private benefits could also be derived by competitors, or potential competitors, from being able to access information about conference agreements. There may also be broader benefits from consumers or firms being able to obtain information on authorisations and notifications that could potentially affect them. The information could also be beneficial to policy makers.

Charging to recover the incremental cost of discretionary activities such as running a workshop will ensure consumers take account of the cost of running the workshop in their consumption decisions. Pricing gives users important price signals and allows agencies to ration finite resources, by explicitly recognising the additional costs of providing the product.

Given that many of the discretionary activities could be seen as basic information provision functions of the ACCC, charging may discourage people from fully and properly complying with the TPA. Therefore, care should be taken to ensure charges are not set at a level that unduly restricts access to information. Limiting the public's knowledge of the TPA could reduce competition. In the case of registers, it would be undesirable for the charges to limit access to the information contained in them. But charges are also important in ensuring consumers take some account of the costs of retrieving and making copies of registers.

However, there could be incentives for the ACCC to over-supply discretionary products where it is able to retain cost recovery revenue under a s.31 agreement and has some discretion in setting the level of the charge. For example, the ACCC could have an incentive to promote the consumption of seminars and publications to earn revenue, and to price these inefficiently, if it is able to recover indirect and joint costs. (See appendix H for a discussion of costing issues.) However, these incentive effects appear to be negligible because some discretionary products can face market disciplines.

Current charging practices do not appear to limit access to information unduly. The prices for most publications are set at a low level and the publications are provided free where the ACCC considers there is a public benefit. The ACCC also provides a number of publications free over the Internet and engages in some price discrimination. Where higher charges are charged for a product, the ACCC would

typically have undertaken work in tailoring the product to the needs of a particular client.

Demand management

Charges can play an important role in signalling to users the cost of resources involved. For example, charges may discourage arbitration functions, applications and notices that are frivolous or vexatious. Charges will also create an incentive for parties to reach settlement without resorting to arbitration. In addition, charges could play an important role in limiting applications and notifications that are clearly not in the public interest and would have little chance of being successful. The ACCC stated that:

> There are anecdotal observations that the quality of authorisations and notifications improved after the introduction of a fee. (sub. 66, p. 4)

There could also be incentives for firms to 'free ride'; using the ACCC as a source of low cost legal advice. A firm could, for example, put in an authorisation application to see whether a proposed merger would be successful. This incentive could arise where the cost to the firm of preparing the authorisation application is below that of the market price of the legal advice received from the ACCC. In this case, there are some grounds for charging an appropriate charge to reduce the incentive for firms to free ride on the ACCC and to encourage them to make good quality applications. The ACCC was aware of this issue and stated that:

> … our basic approach is that we get something which — either through inadvertence or perhaps through someone trying to free ride on our resources — if we get something that's just not complete and not adequate, our normal approach is to basically give it back to the parties and say, 'look, you really should do some more work on this'. (trans., p. 822)

6.5 Options for Trade Practices Act charges

There are a number of options for TPA charges. Charges could be removed or linked more closely to the cost of performing the function. Charges could also be imposed on functions that are not currently subject to cost recovery. These options differ in their effects on demand management, the incentives faced by the ACCC and users of TPA products, and the extent to which they could be considered to amount to taxation.

Remove all charges

One option would be to abolish all TPA charges. Revenue from TPA charges amounted to around two per cent of ACCC revenue in 1999-2000. That revenue could be replaced by general taxation funding with a relatively small effect on the Commonwealth budget. Further, the ACCC would no longer incur the transaction costs of administering and collecting the charges.

However, the Commission considers that charges can play a role in demand management. Even where the charges are based on the lowest expected cost of the function — that is, charges for access arbitrations, various applications and copying registers not held under part X — they ensure consumers take into account some of the cost of those functions. Charges for discretionary products such as publications and workshops, which usually are based on the cost of providing the product, would also contribute to demand management, as do charges under part X. In addition, charges reduce incentives to free ride on the ACCC (by using it as a source of low cost legal advice).

Impose charges on functions not currently subject to charges

No charge is currently made for a number of functions performed under the TPA. It would be inappropriate to impose charges for some of these. Many of the functions performed under the TPA are compliance and protection activities and it would, for example, be inappropriate for a firm alleged to have engaged in restrictive trade practices under part IV to pay the ACCC to take legal action against it before its guilt or innocence has been found. It would also be inappropriate to charge for a number of consumer protection activities under part V.

The ACCC has powers to regulate gas and electricity transmission from sections contained in part IIIA of the TPA. The power to regulate gas arises from s.44ZZM and the power to regulate electricity arises from s.44ZZA, along with the gas code and the national electricity code. However, the ACCC stated that:

> It is not clear whether these sections of the TPA would allow the ACCC to charge fees for performing functions conferred upon it. (sub. 66, p. 6)

The ACCC has considered using an industry levy to recover the costs of regulation of the gas and electricity industries (for example, an excise that could be based on transported volumes of gas and electricity through the network). However, the ACCC stated that the levy would be Constitutionally invalid because:

> … the ACCC is not the electricity and gas transmission regulator in all States, and therefore an industry levy, which would be a form of excise, would apply in some States and not others. Section 51(ii) of the Constitution gives the Commonwealth the

> power to make laws with respect to taxation, provided that they do not discriminate between States or parts of States. (sub. 66, p. 5)

However, other charges could conceivably be imposed. There are currently no charges for some functions under the TPA for public inquiries into the declaration of eligible telecommunications services under part XIC. The ACCC can hold these inquiries either on its own initiative or following a request. The service may be declared if the ACCC is satisfied that the declaration will promote the long term interests of end users. There could be a private benefit for the access seeker from gaining access. Further, there could be large benefits to consumers flowing from increased competition.

There are no charges in relation to the assessment of undertakings under parts IIIA or XIC. An access undertaking is a written undertaking by an access provider that sets out terms and conditions on which the provider will agree to offer access to all access seekers. The ACCC can decide whether to approve an undertaking. These functions confer a private benefit of infrastructure access to access seekers, along with certainty for both the access seeker and the access provider. They also have broader benefits through increased competition in related markets by virtue of access to the service of this essential infrastructure. For these reasons, it is important that charges do not discourage access providers from making an undertaking and thus be contrary to the policy objective of increasing competition.

Access undertakings are not the only method of gaining or increasing access to infrastructure. For example, the service can be recommended to be declared by the National Competition Council, subject to a number of criteria that would make the service generally available to access seekers. There are no charges for declarations. Access can also be gained through an effective industry specific regime that can be a State based access regime or a Commonwealth regime outside part IIIA (PC 2001a). The effects of imposing charges for undertakings, or any other access method, cannot be considered in isolation from other approaches to access. The ACCC stated that:

> What particularly worries us in relation to charging for these various activities would be to have a charge for one particular way of achieving access but not having a charge on something else, or setting the charges independently because, in some cases, depending on whose perspective you're looking at from out in the private sector — in some cases these different things can be very much alternatives. (trans., p. 823)

And:

> … it's really that there are several different but interrelated activities under the part IIIA access regime. If we were to have charges on those you'd really need to do it across the board. (trans., p. 823)

Linking charges more closely to the cost of the function

Some charges could be linked more closely to the cost of performing the function and determined on a case by case basis. Charges for regulatory functions are generally based on the lowest expected cost of the product. Some are currently based on the lowest expected per unit cost of the product and hence vary in proportion to the resources devoted to the products. This is the case for a merger authorisation. The arbitration hearing charge is charged per day, while the charge for copies of registers is charged per page.

The costs of some functions will not vary from case to case, while costs for others will. The ACCC stated that:

> Most of the administrative costs involved in processing applications or conducting arbitrations and conferences are the same regardless of the content of the application. Some of the processes are set down in the TPA, particularly the public register process and some decision making processes. However, the assessment of applications may result in different degrees of research, consultation and analysis. The complexity of the market, the number of market players and in the case of adjudication matters the issues associated with balancing the public benefit/anti-competitive effect will impact on the costs of the case. (sub. 66, p. 6)

Charges for assessing applications have typically been based on the lowest expected cost of the function to ensure they are not considered to be taxation. The ACCC has estimated that the median cost for the majority of non-merger authorisations is around $60 000 to $75 000, with costs ranging from $10 000 to over $100 000. It also estimated that less than 10 per cent of non-merger authorisations would cost in the vicinity of $10 000 and that two or three authorisations each year would cost between $80 000 to $100 000 (ACCC, pers. comm., 7 March 2001). These costs compare with the non-merger authorisation charge of $7500.

The ACCC stated that the costs for merger authorisations are generally less than for non-merger authorisations because they have a shorter prescribed timeframe of 30–45 days and do not require a pre-decision conference or a draft determination. The ACCC estimated the median cost to be around $55 000 (ACCC, pers. comm., 7 March 2001). However, the merger authorisation charge of $15 000 is double the non-merger authorisation charge. This raises some doubts about the basis for determining authorisation charges and suggests that there could be a case for improving the accountability and transparency of all TPA charges.

Linking charges more closely to the cost of performing the function, and determining them on a case by case basis, would increase revenue collected under the TPA if the demand for such functions were inelastic. A proportional approach would ensure that each user of the function or product takes the full cost of the

product into account when making their consumption decisions. It would also ensure the costs of more complex and costly applications are recovered from applicants. If charges reflected the cost of performing the particular function, then there should be no difficulties with the charges being interpreted as taxation.

The ACCC stated that there are some difficulties associated with more direct charging arrangements:

> Up-front assessment of the amount of effort and associated costs to adjudicate an application could be difficult as often it is not until some analysis is performed that the real extent of the matter becomes apparent. (sub. 66, p. 7)

However, the Commission can see no particular reason why the ACCC could not do an initial assessment of the expected cost of performing the function. This is fairly common practice elsewhere in the economy. Alternatively, the ACCC could use a proxy for the complexity of an application. It could, for example, base the charge on the amount of material supplied as part of an authorisation application. A similar approach is currently undertaken by the Therapeutic Goods Administration which bases the charge for evaluating an application to list a prescription medicine on the number of pages of data contained in the application. There could, however, be an incentive for the ACCC to over-quote in the event that it might take longer to do the application than thought. In this situation, accountability and transparency mechanisms would become important.

As an alternative to charging at the time of the application, the cost could be calculated at the end of the case. The ACCC identified some difficulties with this approach:

> … there is an issue of timing of a fee after the event: should it be before or after the ACCC decision? As well, systems would have to be introduced to collect the fee if the applicant failed to pay it after a decision was made. (sub. 66, p. 7)

Possible difficulties in getting firms to pay after an unfavourable decision would be avoided if the decision is not announced until the charge is paid. The need for the ACCC to resort to legal action to recover the outstanding charge would also be avoided.

Another possible drawback of basing charges on costs could arise because there are no competitive disciplines on the ACCC as a monopoly provider of regulatory functions under the TPA. Allowing the ACCC to charge authorisation application and notification charges on an hourly rate based on actual costs could create incentives for it to drag out such considerations or devote more resources to the task than is efficient. But by not allowing the ACCC access to a s.31 agreement that would earmark such revenues to it, these incentives would be minimised. These arrangements should be subject to appropriate review mechanisms (chapter 8).

The impacts on competition and economic efficiency of adopting a more cost reflective approach to charging for regulatory activities need to be considered. As suggested earlier, the impacts of current charges appear to be negligible. But if charges for some regulatory activities, such as authorisations, were more cost reflective they could rise substantially. This increases the likelihood that they may discourage firms from applying for authorisations and notifications.

This could have two outcomes depending on the reactions of the firms involved. Using a merger authorisation as an example, increased charges may encourage the firms involved to go ahead with the merger without an authorisation. Alternatively the firms could be discouraged from proceeding with the merger at all.

Where firms go ahead with the merger, and risk any subsequent legal action, they would be taking a measured judgement of the likely outcomes of the two courses of action. Firms may avoid the initial charge, but if any subsequent court decision went against them they would be required not only to pay for their own legal costs but could also be fined and required to pay court costs. Given that these could be very substantial, and that there would be large private costs in unravelling the merger, it appears unlikely that a more cost reflective approach would unduly discourage firms from proceeding without first obtaining an authorisation.

If the firm is discouraged not only from making an application for the authorisation, but also from proceeding with the merger, there is a risk that public benefits may be forgone. This would be a problem only where (the present value of) the private benefits of the merger are less than the (one-off) costs of making the application, and there are public benefits that more than offset the shortfall. This is most likely to occur where markets are narrowly defined (and hence the firms involved are not necessarily very large), and the issues are complex. However, while this is a possibility, the likelihood of it occurring is probably small.

6.6 Summary and recommendations

TPA charges for access arbitrations, various applications and copying registers are set at the lowest expected cost of undertaking the particular activity. This policy is designed to minimise the possibility of these charges being interpreted as taxes. Charges under part X are broadly based on the cost of performing the function. Charges that the ACCC has discretion in setting — for conducting workshops and seminars and providing publications — are usually set at the cost of performing the function.

Where TPA charges are imposed, there are usually significant private benefits involved in the activity. Overall, TPA charges appear to have little effect on

competition. Charges that are set at the lowest expected cost of the function do not appear to limit access to functions performed under the TPA. In most cases, the charges are low when compared to the potential benefits that a firm can receive if, for example, an authorisation application or notification is successful. Discretionary charges charged by the ACCC, and charges under part X, also appear to have little, if any, effect on firm costs or competition.

FINDING

Current Trade Practices Act charges appear to have little if any impact on competition and economic efficiency and hence are not inconsistent with the competition tests under the Competition Principles Agreement. They do not appear to:

- *restrict access to the activities for which they are charged;*
- *impose a significant burden on firms (they appear to be relatively small compared to the transaction costs and potential private benefits); or*
- *substantially affect small to medium firms.*

Charges have a role in recovering some of the costs and in demand management. Where charges are prescribed by the TPA and are set at the lowest expected cost of the function, they ensure that consumers take account of some of the costs of providing the product in their consumption decisions. Hence, they may help deter frivolous or poorly prepared applications. Charges may also play a role in limiting authorisation applications and notifications that attempt to 'free ride' on ACCC legal advice.

The Commission has been unable to give close consideration to the application of cost recovery to other activities of the ACCC. However, it is apparent that there are many ACCC activities associated with general compliance and enforcement that should not be cost recovered and some areas, such as undertakings, where cost recovery might be contrary to policy objectives. It is also apparent that in no case is the ACCC currently charging for products where it should not.

However, the practice of setting charges at the lowest expected cost is inconsistent with the Guidelines recommended by this inquiry (see part 2). Where cost recovery is warranted, the Guidelines would suggest that as a general principle charges be matched more closely to the actual cost of products provided. This would ensure each user of the function or product takes the full cost of the product into account when making their consumption decisions. It would also ensure that the costs of more complex and costly applications are recovered from applicants. If charges reflect the cost of performing the particular function, then there should be no difficulties with the charges being interpreted as taxation.

TPA charges have not been changed for some years and, if left at their current levels, will also begin to lose their effectiveness as a demand management tool. The ACCC commented in relation to the review of charges that:

> … fees have not increased since their introduction and [we] would suggest that a mechanism for review may be appropriate. (sub. DR140, p. 1)

The ACCC's cost recovery arrangements should be one of the first reviewed as part of the recommended round of reviews of cost recovery arrangements (see chapter 9). The examination of cost recovery under the TPA in this chapter should be used as a basis for undertaking a Cost Recovery Impact Statement (CRIS) and associated stakeholder consultation.

RECOMMENDATION 6.1

Subject to the completion of a Cost Recovery Impact Statement, the Australian Competition and Consumer Commission should adopt a cost reflective approach to setting charges for those activities for which it is appropriate to charge. Any departure from this general principle should be justified in the Cost Recovery Impact Statement.

Moving to a cost reflective charging system would require that charges have appropriate legislative or regulatory underpinning. Charges could be imposed when an application is made or after the ACCC has considered the application but before it announces its decision. Charges can also be based on a number of units — for example, on the number of pages contained in an application, or on the number of person days spent considering the application. A future review would need to consider these issues after hearing the views of stakeholders.

The Commission recommends that agencies should not have automatic access to cost recovery revenue from compulsory regulatory activities because that could create adverse incentives (see chapter 8). Applying this rule to TPA charges would suggest that the current arrangement whereby the ACCC has access to revenue from discretionary products, but not to revenue from regulatory activities, is appropriate.

Information on charges under the TPA is readily available from the ACCC. But, apart from knowing that the charge is linked to the lowest expected cost, there is little information on the actual costs the charges are intended to recover. There should be a greater degree of transparency of these costs.

RECOMMENDATION 6.2

The Australian Competition and Consumer Commission should improve public information on the costs that Trade Practices Act charges are intended to recover.

There appears to be little concern with the current TPA charging arrangements. It can be presumed that this is not a major issue among inquiry participants and that the more significant costs are involved with compliance with the TPA. Only one inquiry participant, other than the ACCC, raised an issue related to charges under the TPA. The lack of comment has made it difficult for the Commission to consider some of the factors referred to in the terms of reference when assessing TPA charges. The terms of reference asked the Commission to take the compliance costs and paper burden on small firms into account, but no evidence on this issue was received.

7 Improving the application of cost recovery

This chapter draws on previous chapters to discuss how the application of cost recovery can be improved in practice. Some general principles, applicable to all Commonwealth Government cost recovery arrangements, are developed in section 7.1. These draw on chapter 2 and evidence put to the Commission. Cost recovery issues of special relevance to information and regulatory activities and products are examined in sections 7.2 and 7.3 respectively. Lastly, some practical considerations for the application of cost recovery are discussed in section 7.4.

7.1 General principles for applying cost recovery

The Commission has argued that the main rationale for cost recovery should be to improve economic efficiency (see chapter 2). Improving the equity of Government revenue raising is also important, as is ensuring that cost recovery arrangements are consistent with the objectives of the Government activities they support. Well designed cost recovery arrangements can promote economic efficiency and equity by ensuring those who use regulated products or request additional information bear the costs, and by instilling cost consciousness among agencies and users of Government products.

These principles are relevant to all Government agencies, but the manner of their application will vary. Most agencies have a range of objectives and activities with differing characteristics. Some information products, for example, are of a 'private good' nature or may warrant a price signal to help ration demand. For cost recovery of regulatory activities, identifying the effects of regulation — usually on consumers of the regulated products, but sometimes also on others through spillover effects — and ensuring consistency with the primary objectives of the regulations may be more relevant.

Cost recovery as a revenue raising mechanism

Raising revenue is an important (but not always stated) objective of cost recovery for many regulatory and information agencies. Where the Government has specified

cost recovery targets (of up to 100 per cent of agency costs), revenue raising would appear to be an important objective of the arrangements (see chapter 4). By pricing Government supplied products, cost recovery raises revenue that would otherwise have to be found elsewhere (for example, from increased taxation or from cuts to other Government activities and services).

However, if there is a poor link between the charges imposed and the products provided, then the economic efficiency improvements from cost recovery will be greatly diminished (or may even be negative). 'Over-recovery', where an agency is required to recover more than its own costs to fund other, unrelated Government activities, is an example of this. For example, the Australian Securities and Investments Commission raises revenue for a variety of purposes in addition to its own activities, including revenue for compensation payments to State and Northern Territory governments (see appendix E).

Such charges may (or may not) be efficient taxes, but it is inappropriate to characterise them as cost recovery if they are not directly linked to a particular set of Government activities or products. Taxation, like all Government revenue raising, is not without its distortions. These effects should be examined separately to cost recovery arrangements (see chapter 2). If cost recovery is used primarily as a revenue raising mechanism (for example, through a compulsory levy on certain products), without regard for the efficiency implications of the charge, then it ought to be assessed as if it were a tax.

Even where charges are specifically linked to an activity, if they are not also linked to costs, then they can quickly become revenue raising measures once the original costs have been recovered. The Tourism Taskforce claimed that the electronic travel authority charge introduced by the Department of Immigration and Multicultural Affairs in 2001 may be an example:

> [The Department] introduced a $20 charge for the electronic travel authority [ETA] issued over the Internet. ETAs before this have been free of charge. The reason for the $20 charge was to recover $200 000 in site development costs. In the first week more than 4000 visitors used the service. … at this rate they will over collect recovery costs by more than 2000 per cent. (sub DR167, p. 2)

Cost recovery arrangements that raise revenue for unrelated activities or that over-recover costs may have contributed to the perception, held by some users of Government services, that there is virtually no difference between general taxation and cost recovery charges. The Council of Small Business Organisations of Australia indicated that many small business people perceive virtually all cost recovery charges to be the same as taxes:

> … small business I think regards almost all imposts from the public sector as taxes in some form and it regards in many areas cost recovery mechanisms as effectively double taxation. (trans., p. 532)

Similar sentiments were expressed by the Australian Paint Manufacturers Federation, whose members pay charges relating to chemicals regulation:

> Such fees and charges cannot be seen other than as a tax on their operation. In this context the fees and charges are not only a tax on the industry, but they are a tax on the downstream consumers of the products. (sub. 74, p. 3)

These comments show that the rationale for cost recovery has not always been well explained by Government or accepted by users of its services. The confusion between general taxation and cost recovery charges might also have been exacerbated by using 'cost recovery' to describe charges that are imposed primarily to raise revenue. Clarifying the objectives of cost recovery — and differentiating them from those of general taxation — is therefore necessary.

RECOMMENDATION 7.1

Cost recovery arrangements that are not justified on grounds of economic efficiency should not be undertaken solely to raise revenue for Government activities.

Activity based cost recovery

Most agencies undertake a range of information, regulatory and other activities. These activities and products rarely have identical objectives and characteristics. A single agency may assess and register products, enforce standards, provide information to the public and provide services to Parliament or Ministers. The nature of these activities and products can be very different, as can the cost recovery issues arising from each.

Regulatory activities for which cost recovery is appropriate are generally those that have a direct link to a particular group of identifiable users or beneficiaries (industry, consumers or others), such as product assessments, licensing and monitoring. Often it is appropriate for the agency to recover the cost of these services directly from consumers or regulated firms (see section 7.3).

Information products may be categorised, for cost recovery purposes, according to the degree of private benefit or interest involved. Thus, basic information products may be disseminated freely, while more specialised products of limited application or interest may attract a charge (see section 7.2).

The wide differences in the nature of these activities and products means it is not possible to assess the appropriate level or type of cost recovery on an agency-wide basis. Rather, the case for cost recovery of agencies' activities and products should be assessed individually.

RECOMMENDATION 7.2

Cost recovery arrangements should apply to specific activities or products, and not to the agency as a whole.

Some activities are undertaken primarily as a service to Parliament or the whole community. Insight EFM stated:

> … advice, education/publicity campaigns, investigation, prosecution — these activities would not normally amount to services to individuals and thus should be cost recovered by way of broad-based levies or funded from Consolidated Revenue. (sub DR132, p. 3)

Services for Ministers and Parliament are aimed at assisting general Government policy formation, informing the community (via Parliament) and helping to maintain the democratic process. Government policy and advice functions are typically funded through general taxation revenue and are undertaken separately from more specific program development functions (such as developing regulatory standards or collating registration information, which may be cost recovered as part of a specific activity).

In principle, the cost of activities that are aimed at meeting the policy and advice needs of Government and Ministers should not be recovered directly from industry or other user groups. It is important that these 'higher level' Government policy activities maintain both the appearance and the reality of independence and accountability to Government (see chapter 5). Recovering the costs of such activities from industry may compromise that independence.

In some agencies, these different levels of policy development work are mixed together and may be cost recovered from users. Although it may be difficult, higher level Government policy work should be separated from policy work relating to specific agency functions or programs for cost recovery purposes (but not necessarily for staffing or administrative purposes).

Similarly, liaison with and information provision for foreign governments and organisations are often related to Government commitments (including treaties and agreements) or aid projects. While such international activities may benefit an industry or community group indirectly (for example, through export opportunities facilitated by trade agreements), these benefits are often of a longer term, general nature. These types of international activity should be funded through general taxation revenue. They are to be contrasted with international activities that are a

direct service to industry (such as organising trade fairs, as is done by Austrade), or part of a regulatory activity (such as assessing international production facilities for health and safety regulation purposes). These types of international activity have a direct effect on the firms involved, and cost recovery charges may be warranted.

RECOMMENDATION 7.3

Cost recovery of activities should exclude those undertaken for the Government (such as policy development, and Ministerial or Parliamentary services), or to comply with certain international obligations.

Cost recovery targets

A number of agencies in the Commonwealth public sector are subject to cost recovery targets of one form or another. The imposition of fixed cost recovery targets may be incompatible with achieving an agency's public policy objectives.

Among existing cost recovery arrangements, targets for cost recovery have been particularly problematic where they are set at an agency level. For example, the Therapeutic Goods Administration and the National Registration Authority for Agricultural and Veterinary Chemicals are required to recover 100 per cent of all agency costs. This has obliged them to attempt to recover costs from industry (through regulatory charges) for activities (such as policy development and services to Ministers, Parliament and international organisations) which should be funded through general taxation revenue. This reinforces the need for cost recovery arrangements to be developed and implemented at an activity rather than an agency level.

Even where agency-wide cost recovery targets are set at less than 100 per cent and do not include inappropriate costs or activities, they can set up undesirable incentive effects. As discussed in chapter 5, agencies with specific cost recovery targets for the agency, or for whole activities, can be at risk of losing focus on their fundamental agency objectives.

At an activity level, where specific cost recovery targets are set for separate commercial-style activities or products (for example, aiming to attract a certain amount of commissioned, commercial style research work), agencies may be encouraged to pursue those value added activities that can be cost recovered, at the expense of other, taxpayer funded basic activities (or to distort taxpayer funded work toward areas in which there may be value adding opportunities). For example, the Australian Geological Survey Organisation said that revenue targets may have altered the way projects are prioritised:

> Any requirement to meet an arbitrary cost-recovery target … has the potential for a loss of focus from efficient delivery of agreed key outcomes to seeking alternative sources of funding. (sub. 55, p. 14)

Specific cost recovery targets for agencies or for particular activities may also discourage agencies from adopting lower cost methods of service delivery (such as cheaper data dissemination methods), given the potential impact on revenues (see chapter 5). The funding of agencies required to meet cost recovery targets should therefore be reviewed, and their cost recovery arrangements should be revised in line with the Guidelines proposed by this inquiry.

FINDING

Some agencies have been required to meet cost recovery targets. This has led to some agencies inappropriately recovering costs for activities (such as policy development, and Ministerial or Parliamentary services, and complying with certain international obligations), and may have distorted work priorities.

RECOMMENDATION 7.4

The practice of the Government setting targets that require agencies to recover a specific proportion of total agency costs should be discontinued.

Cost reflective charges

Cost recovery charges should closely reflect the costs of a particular activity (as distinct from competitive neutrality pricing or general taxation). This requires an in-principle choice of a costing approach to be adopted for each activity (for example, recovery of direct cost, fully distributed cost, marginal cost, incremental cost or the application of competitive neutrality principles, see box 7.1 and appendix H).

The costing approach chosen has implications for which costs are to be recovered and how they should be measured and allocated to different activities. In some cases, cost recovery charges may include a return on capital or a share of agency overheads — for example, where the activity represents a significant share of agency costs. In other cases, capital and overhead costs may need to be excluded — for example, where they would be incurred even if the particular activity were not undertaken.

Regardless of which costing approach is chosen, the collection of cost recovery charges will involve transaction costs, which must be taken into account. These include agency administration costs, the costs of third parties collecting revenue if relevant (for example, industry collection of the Passenger Movement Charge), and

consumer and firm compliance costs. Cost recovery arrangements should aim to minimise these transaction costs while also promoting economic efficiency, transparency and accountability (see chapter 8).

Box 7.1 **Costing approaches**

Direct costs: This approach includes only those costs that can be directly and unequivocally attributed to an activity. The indirect costs of producing the output, such as a share of overheads, are not taken into account. Agencies may choose to charge direct costs where cost recovered activities make up only a small proportion of their total activities and make only a small call on agency overheads. In such cases, the impact of excluding indirect costs may not be significant.

Fully distributed costs: This approach allocates the total costs of an agency across all outputs. It includes direct, indirect and capital costs. Direct costs are allocated to their respective output, while indirect costs are spread across all outputs. Agencies that recover costs for a large proportion of their activities typically use a Fully Distributed Costs approach.

Marginal costs: Marginal cost is the increase in cost involved with producing an additional unit of output. It excludes costs that are fixed in the short run, such as capital costs. Marginal cost is often much lower than average cost — for example, where large fixed costs are incurred regardless of how much is produced. This is important for information agencies, where gathering information may be costly, but disseminating it to many users has a very low cost per user. Other costing approaches would discourage users who would have paid the marginal cost of dissemination.

Incremental and avoidable costs: Incremental cost refers to the increase in costs attributable to the production of a particular type of product (rather than the marginal cost of producing an additional unit of that product). Avoidable cost refers to the costs that would be avoided if that particular type of product were no longer produced. There is generally little difference between incremental cost and avoidable cost. These approaches are most suitable for agencies seeking to recover the additional costs of undertaking 'add-on' work outside their basic activities. Agencies should seek to recover all of the costs they would have avoided if they had not undertaken the activity.

Competitive neutrality: When Government agencies supply products that have actual or potential competition, cost recovery charges should be consistent with the competitive neutrality guidelines of the Commonwealth Competitive Neutrality Complaints Office. Competitive neutrality does not always mean that agencies must charge 'market prices'. In some instances it may be appropriate for agencies to charge incremental or avoidable cost, to allow for efficient use of idle agency capacity.

Cost recovery as a demand management mechanism

Cost recovery charges also affect the demand for Government services. As identified by the Department of Transport and Regional Services:

> … where the charge is levied to deter misuse or excessive use of a service … the objective for charging … [is] not so much to raise revenue but to reduce the cost of an unreasonable amount of service demand. (sub. 48, p. 4)

Several information agencies cited demand management as a key objective of cost recovery (see chapter 4). Most information agencies provide a certain amount of free access to their basic information products (for example, through libraries), but sell copies of their products to individuals rather than distributing them freely. Such sales both cover the cost of printing and distribution, and limit demand to individuals who value the product enough to pay the purchase price.

Cost recovery charges can also have demand management advantages for regulatory activities, where charges can help to discourage frivolous, inadequate or incomplete applications. However, where cost recovery charges are not otherwise warranted, some inquiry participants were concerned that they may also discourage other desirable (but financially marginal) applications. For example, the National Standards Commission has not increased fees since 1996, due to concerns about the potential adverse effect on demand:

> Past experience has shown that customers are very sensitive to increases in pattern approval charges, and current prices already restrict trade. Over the past 10 years, prices have been adjusted to meet budget imperatives, without any consultation with industry. Each price rise has been followed by a drop in demand, as suppliers decided not to launch new models in Australia. In response to this situation, the Commission has not increased prices since 1996 (except for the inclusion of GST). (sub. 31, p. 3)

Similarly, for therapeutic goods and other products subject to regulatory registration charges, several inquiry participants said that the regulatory costs per product meant some firms have chosen not to register as many products as they otherwise might have done (see chapter 5). These effects indicate that regulatory charges — like information service charges — can be used to encourage or discourage certain demands and behaviours among users, as well as to help manage resources within agencies. For example, the National Regulatory Authority for Agricultural and Veterinary Chemicals charges a minimum annual fee of $200 to maintain products on its register (even if sales have been nil) to discourage firms from continuing to register superseded products (see appendix D).

In all cases, agencies need to ensure charges imposed for demand management or other reasons do not impede key agency objectives, such as informing the public or ensuring public safety. For example, excessive information product prices may discourage public research and debate, while direct regulatory charges may discourage firms from registering a product or participating in regulatory activities. This is why no agencies charge directly for product recalls — to do so could seriously impede the basic objectives of providing recall services. The potential

conflicts with agency objectives need to be considered in relation to each activity and each type of charge (such as fees and levies) which may have different demand effects (see section 7.4).

FINDING

Cost recovery can be a useful tool for conveying price signals.

7.2 Applying cost recovery to information products

Cost recovery objectives appear to be more straightforward for information agencies than for regulatory agencies. They generally relate to the objectives of the agency, by identifying 'public good' and private benefit elements in various information products or by managing demand.

Identification of information products

The objectives of most information agencies tend to distinguish between basic and additional information products. Each agency's mission statement, program objectives or charter of obligations are used to identify the 'basic' products that are appropriate for government funding. Additional products may also be relevant to agency objectives, but may be appropriately cost recovered at various levels.

Agencies sometimes further classify additional information products along a spectrum, from those that are incremental to their basic product set, to more commercial or specialist products. Some information agencies have made greater effort than others to identify each product they offer as being basic, incremental or commercial (see appendix C). Agencies have also been inconsistent in applying cost recovery to each type of product.

Many agencies whose primary functions are regulatory or administrative may also supply information and related products. Safety regulatory agencies often disseminate public health and safety information to complement their regulatory activities. For example, public information publications, telephone lines and education activities are often required to help potential consumers understand regulatory labelling, ratings or registration systems (particularly at their introduction or during regulatory changes). These products should be evaluated as information products for cost recovery purposes, even though they are not produced by an information agency. In many cases, the 'public good' nature of these products and the significant positive spillovers they can produce may mean that they should be regarded as basic information products and should be taxpayer funded.

Definition and funding of basic information products

Identification of basic information products, which are generally taxpayer funded rather than cost recovered, usually involves an iterative process between the information agency and the Government. Information products that are taxpayer funded generally reflect, among other things, the Government's own information and data requirements, established with expert advice from the relevant agency.

However, as explained in chapter 2, some economics principles can help to guide this identification process. In principle, basic information products should be characterised by a high degree of non-rivalness and non-excludability for potential users (that is, they should have some of the characteristics of a 'public good') and/or they should have significant positive spillover effects for the community.

Where basic information products can be widely disseminated at little or no marginal cost to the agency (for example, through the media or education institutions), they are often provided free of charge. The Bureau of Meteorology does not charge media outlets for basic forecasting information, and the ABS provides free sets of its basic publications to public libraries, education institutions and some media, which in turn provide free access to students and the public.

On the other hand, many basic information products are not disseminated free of charge to everyone who may want them. For example, those wanting personal copies of basic ABS publications must pay for them, while the Australian Surveying and Land Information Group charges for all packaged products such as maps and satellite images. Prices for the additional distribution of basic products typically include the cost of publication, but not the cost of collecting, compiling and analysing the data. The rationale for attaching a price to these basic products is primarily to meet demand management objectives (see section 7.1).

Research

Information agencies that also undertake research, such as the Australian Bureau of Agricultural and Resource Economics, the Commonwealth Scientific and Industrial Research Organisation (CSIRO), the Bureau of Transport Research and the Bureau of Rural Sciences, normally distinguish between basic and additional research products on a case by case basis.

Some research projects generate a greater degree of private or commercial interest (for example, commissioned and joint research projects) and are cost recovered, while more basic 'public interest' research does not. Individual research projects are charged at anywhere from zero to 100 per cent of costs, depending on their potential

commercial demand, or to meet overall agency targets (see appendix C). As discussed in section 7.1, the Commission has recommended the assessment of cost recovery on an activity or product basis and the removal of cost recovery targets.

Archives

Agencies with archive and library activities, such as the National Library of Australia and ScreenSound Australia, have defined and documented their basic products for cost recovery purposes. These products include collecting, preserving and providing public access to their collections and archives. These agencies tend to define their basic products according to their key objectives, which are then wholly taxpayer funded. Additional products, such as preparing bibliographies or making and distributing copies of archival materials for the public, attract fees in line with their incremental cost.

ScreenSound Australia also considers access and equity factors when setting fees for products provided to individuals and groups (for example, fees for video copies of archival material). A higher fee may be charged for products requested for commercial purposes than for the same product requested for private or community use (ScreenSound Australia, sub. DR144).

Dynamic definition of basic information products

For all agencies, the content of their basic information products — and appropriate pricing policies for their dissemination — will change over time, in response to changing Government policy objectives and new technologies.

The emergence of the Internet illustrates the need for a dynamic approach to identifying and defining basic information products. Currently, some agencies appear to be failing to take advantage of the Internet's potential for increasing dissemination at a reduced cost to the agency per item or per product.

Several inquiry participants argued that basic data products from the ABS, the Australian Bureau of Agricultural and Resource Economics and other information agencies should be free or provided at a price that reflects the marginal cost to the agency of placing it on a website. They argued that the information has non-rivalrous 'public good' characteristics (that is, it can be provided to a virtually unlimited number of users at zero or very low marginal cost per user) and can produce positive spillovers for the wider community. For example, Commodore Station argued that all basic data produced by the Australian Bureau of Agricultural and Resource Economics should be free:

> ABARE should make all the data free on the Web — as is done by many government agencies. That would be the most economically responsible policy. Economic data is a non-rival public good with strong positive externalities; by depriving access to potential users there is waste. (Commodore Station, sub. 84, p. 3)

The Australian Bureau of Agricultural and Resource Economics has made some — but by no means all — of its basic data products (such as the *Digital Atlas of Australian Soils*) available for free downloading from the Internet. It cited cost, complexity and data confidentiality requirements as reasons for not making its basic data fully available through this medium (AFFA, sub. DR151, p. 5).

Similarly, the ABS places samples and summaries of its basic data products on the Internet for free access, but not whole publications, even though the marginal cost of doing so would appear to be relatively low and would contribute considerably to the agency's objective of informing the community.

Instead, the ABS charges the same prices for downloaded products as for hard copy equivalents (with lower prices for subsequent downloads of the same product by the same user). In addition, some inquiry participants said that ABS online products are often provided in Portable Document Format (PDF) only, which means the data cannot be readily manipulated by users and full advantage of available technologies cannot be made (see chapter 5 and appendix C).

Some information agencies (including the ABS) indicated that they are reviewing their pricing policies for Internet based dissemination of basic data and information products, with a view to improving public access (see appendix C). The ABS said that, at least in the short run, the cost of Internet based dissemination of basic data products is not necessarily lower than that for hard copies. Indeed, the cost of expanding and maintaining its information technology services to accommodate additional data products and demand could be up to $4 million per year, or about 1.5 per cent of the ABS's current annual budget of around $250 million. (sub. DR134, p. 3, see appendix C). However, in the longer term, offsetting cost savings could be expected, including a reduction in the cost of disseminating hard copies to education institutions, media and other free recipients.

Agencies could address some perceived problems of managing web based data dissemination by segmenting the products into different types, or by considering flexible pricing options for Internet access to basic data products. Pricing options could include subscription pricing (for example, a flat fee for access to all databases over a prescribed time period) or peak load pricing, whereby a fee is charged for access to a database during a certain period, but made free thereafter (for example, a charge for access within 24 hours of the data first being released). Peak load pricing is already used by some commercial websites, including some 'trading post' style

sites, which charge a fee for early access to new product listings. A similar model of peak load pricing for some basic information products would allow agencies to manage user demand at the critical peak times (thus reducing the risk of network congestion), while enabling free access for users at other times.

These product and pricing options demonstrate the importance of information agencies defining their basic products in a responsive and dynamic manner. This should involve an iterative process between the agency and Government, so as to ensure that primary Government information requirements are adequately addressed and funded, and that basic information products are disseminated to the public in the most cost effective and user friendly way.

FINDING

Information agencies generally have attempted to link their cost recovery arrangements with the objectives of the agency itself, by distinguishing between basic and additional information products. However, it is often difficult to define clearly the boundary between the two.

RECOMMENDATION 7.5

Agencies and the Government together should define a basic information product set. This should be a dynamic process, with basic information products determined by reference to:

- ***'public good' characteristics;***
- ***significant positive spillovers; and***
- ***other Government policy reasons.***

Funding basic information products

In principle, the simplest and clearest pricing policy for information agencies would be for all basic information activities and products (including a certain level of dissemination) to be taxpayer funded, with cost recovery imposed only for additional dissemination, analysis or other incremental activities or products.

To some extent, many information agencies already have this arrangement. The ABS, the Bureau of Meteorology and other key information agencies have fee structures based on the level of specialisation of the request, relative to their basic product set (see appendix C). Similarly, although it is not strictly an information agency, Austrade provides general trade information free to all users, with 'demand for the more expensive-to-produce services being moderated by the charging of

appropriate fees', on a scale that rises according to the degree of 'tailoring' required and the private benefit derived (sub. 58, p. 6).

Some dissemination will always be part of information agencies' basic activities. Without it, the public benefits of the information would clearly not be achieved. However, not all dissemination of basic information products can, or should be, regarded as essential to meeting agency objectives and therefore be taxpayer funded. In order to ensure free public access to basic information products, it may be sufficient to give free hard copies to public libraries, education institutions, and the media, but not necessarily to all individual users who request them.

Indeed, most information agencies currently disseminate their basic information products in this way. Some regulatory agencies also follow this model for their information products. For example, the Australian Securities and Investments Commission provides company searches to the media at no charge, but charges members of the public a fee for the same product (see appendix F).

Additional dissemination of basic data products to private users can be defined as a non-basic or incremental activity, because it is not essential to ensuring public access. Charges based on marginal costs (box 7.1) for this additional dissemination can help agencies to measure and respond to demand, and help to manage demand for personal copies of publications.

RECOMMENDATION 7.6

The basic information product set of agencies should be funded from general taxation revenue.

Cost recovery for additional information products

Different pricing principles apply to information products that are incremental to basic products or of a more commercial nature. Where there is a capturable private benefit to the user and charging is cost effective, charges will encourage efficient levels of demand and supply. Charges can give users important price signals and assist agencies to use their resources efficiently (see chapter 2).

In practice, pricing arrangements for these products largely depend on whether the incremental product is so closely linked to the basic product set that the agency is the only organisation that can conceivably supply it, or whether it is of a more commercial, contestable nature.

Incremental information products

Information products that are incremental extensions of basic products are unlikely to have any competitors, so competitive neutrality pricing considerations will not apply. However, provided the necessary confidentiality can be maintained for the raw data, basic datasets could be available for manipulation and analysis on a neutral basis to all who demand them, thus providing potential competition in the supply of these incremental data products.

Often, providing additional data analysis and manipulation can be expensive. The ABS said:

> We certainly recognise our prices are high and, for example, our charges for clerical services are much higher than people like, but when you bring into account all the costs of providing those clerical services — I think it's $120, $130 an hour — it's more expensive than getting a plumber, so they are quite high. But when you factor in all the costs involved, that's what we charge. (ABS, trans., p. 529)

Some participants said that high prices for incremental data requests not only deter potential users, but may also give a misleading demand signal to the agency about individual products. Cumpston Sarjeant stated that:

> Users often cannot judge the relevance of ABS data to their real needs without making explorations. … High prices will deter many potential users with genuine needs for data, so that sales reflect only a small part of the demand. (sub. 77, p. 2)

The Australian Geological Survey Organisation argued that prices for incremental information products should be set to help maximise demand (and to cover costs) rather than to maximise revenue:

> Logically, prices need to be set at levels which maximise the uptake of the information rather than maximising the level of cost recovery. (sub. 55, pp. 15–16)

It is important that incremental information products are priced to recover the incremental cost incurred by the agency. Charging below incremental cost would divert resources from the agency's basic activities (which should always take precedence over any additional work). Pricing above incremental cost would discourage any potential users who are prepared to pay no more than the incremental cost. Like all government activities, incremental information products need to be provided efficiently; the price should include only the incremental costs of direct relevance to the additional activity (box 7.1).

In addition to direct user charges, several information agencies (including the ABS, the Australian Surveying and Land Information Group and ScreenSound Australia) use copyright licence fees and royalties in their cost recovery arrangements (ScreenSound Australia, trans., p. 344; MariTrade sub. DR171). For private firms

wishing to on-sell research products based on ABS data, the ABS charges royalties of up to 25 per cent of firm revenue, in addition to a flat fee for the data (ABS 2001, see appendix C). For other information agencies, royalty mechanisms are 'the exception rather than the rule' (Australian Surveying and Land Information Group, trans., p 435) and raise only a relatively small proportion of revenue, but they can have significant demand and efficiency effects (see chapter 5).

Once information has been generated, the marginal cost of its dissemination is often very low. The use of royalties and licence fees — which are linked to the value of subsequent use rather than the cost of providing the product — may discourage some users who would have paid the marginal cost of dissemination, so a potential use of the information has been prevented. Where copyright is owned by the Commonwealth,[1] the case for using royalty mechanisms for cost recovery seems weak. Rather than using royalties to recover some of the costs of collecting and compiling information, the focus of cost recovery should be on charging only the additional (marginal or incremental) cost of providing the information product.

Competitive neutrality issues

Some Government information products may compete with similar products offered by private firms. This may be the case, for example, with tailored analysis provided by the ABS, the Bureau of Meteorology or the Australian Bureau of Agricultural and Resource Economics (see appendix C) or with the more specialised market research reports prepared by Austrade for individual firms (which may be similar to those prepared by private research consultancy firms). Where information products are contestable, the Government's competitive neutrality principles should apply, such that prices are set commercially (see chapter 2).

Differential pricing issues

Differential pricing refers to charging different types of customer different prices for the same or similar products, in line with their different willingness to pay. It is usually associated with profit maximising behaviour by private firms. Typical examples include cinema tickets, airfares and commercial premiums on utilities. Differential pricing is normally implemented to maximise revenue from a range of different demand levels. This is not an appropriate objective for Government agencies which should, at most, seek to recover their costs, not maximise their revenue collection.

[1] Copyright for some archival material is owned privately and may result in agencies paying royalties for products they use or sell.

Another potential reason for adopting differential pricing is to pursue access or social objectives. Some Government information agencies charge different prices for public and private sector clients, or for education/research and commercial clients. For example, the ABS has special arrangements for data access and pricing for Australian universities (which the ABS describes as a group or bulk purchase discount).

The research output of academics and other non-commercial researchers who use information products often has potential for positive spillovers (that is, public benefits that cannot be captured by the producers of the research). Such research is supported by Government, but it is more effective to provide this support though direct policy measures (such as subsidies or grants to researchers), than through subsidised prices for information products. However, this may require individual information agencies to create rationing devices based on factors other than price, and to make potentially difficult social and equity judgements about the value or 'worthiness' of downstream applications of their data products. For example, it is more effective to subsidise landcare and conservation programs directly, than to subsidise the maps or data they require (which would benefit all map and data users, including commercial users, and not just landcare groups).

Price subsidies become even more problematic if they are (or are perceived to be) funded through cross-subsidies from other users of Government products (see chapter 5). As identified by the Council of Small Business Organisations of Australia, any subsidies should be funded by taxpayers and not by other users:

> … any good or service in the market place should be purchased at the same rate, and if society believes that some disadvantaged group needs support that should be through some sort of tax relief or some benefit. … if society determines that these people need support it is the State's responsibility to deliver the support and not the private sector. (trans., p. 535)

If all users are charged only the incremental costs of the information products, then little opportunity for differential pricing should arise.

RECOMMENDATION 7.7

As a general principle, the costs of providing information products that are additional to the basic product set should be recovered. However, cost recovery should not be implemented where:

- ***it is not cost effective;***
- ***it would be inconsistent with policy objectives; or***
- ***it would unduly stifle competition and industry innovation.***

RECOMMENDATION 7.8

Additional information products should be classified into three broad categories and priced accordingly:

- ***dissemination of existing products at marginal cost;***
- ***incremental products (which may involve additional data collection or compilation) at incremental (avoidable) cost; and***
- ***commercial (contestable) products according to competitive neutrality principles.***

7.3 Applying cost recovery to regulatory activities

The number and level of cost recovery charges have been increasing across regulatory activities over the past decade. Regulatory agencies have a wide variety of cost recovery arrangements in place, recovering from zero to over 100 per cent of agency costs (see chapter 4). Identifying appropriate, consistent cost recovery objectives has been more complex for regulatory agencies than information agencies. This complexity is due to the difficult economic and social issues involved, and has led to the largely *ad hoc* application of cost recovery to many regulatory agencies.

Principles for applying cost recovery to regulatory activities

In the inquiry draft report, the Commission sought to differentiate cost recovery arrangements for regulatory activities according to whether their objective was to recover regulatory costs from the beneficiaries of regulation, or to impose the costs of regulation on those who create or contribute to the potential negative spillovers that necessitate the regulation. In practice, these objectives are two examples (or applications) of the same broad principle — that the price of a regulated product should incorporate the administrative costs of its regulation.

In practice, the application of this principle to regulatory activities is subject to the same caveats as for information products: cost effectiveness; consistency with Government policy objectives; and reduced potential to stifle industry competition and innovation. For example, the Australia New Zealand Food Authority has not charged food producers fees to vary food standards to date, because generic food producers may be able to 'free ride' on any first application for a variation. A direct charge may therefore discourage firms from applying for a variation and introducing a new product (see chapter 5).

The main objective of recognising regulatory costs in the price of regulated products is economic efficiency — excluding regulatory costs from product prices may distort resource allocation across the economy. If the administrative cost of regulation is not incorporated in the price of the regulated product, then there would be incentives to produce and consume more of the heavily regulated products and less of lightly regulated and unregulated products, than would otherwise occur. This principle should apply regardless of whether the main objective of the regulatory activity is to protect consumers or to prevent harmful spillovers (see chapter 2).

In addition to efficiency, there is also an important equity benefit to be gained from incorporating regulatory costs in the price of regulated products. In this context, equity refers to the fairness in the way that people with similar characteristics are treated (that is, horizontal equity). Recovering the cost of regulatory activities means that less of the cost of regulation is paid by general taxpayers, who do not directly benefit from the regulations or use the regulated products. Recovering these costs may also help to avoid some of the economic distortions inherent in general taxation (see chapter 2), and help to make the costs of regulation more transparent to the whole community.

Ensuring the price of a regulated product incorporates the administrative costs of regulation may imply that the consumers of regulated products should be charged the cost of regulation directly, because they are the main beneficiaries of regulation (or the main beneficiaries of products which are regulated for spillover reasons). However, it is often difficult to identify and charge all consumers of a regulated product in a manner that accurately reflects the actual costs of its regulation.

This is true of regulated products that can be used as intermediate inputs into the manufacture of other products or as final consumer products in their own right. Some products are used as both. For example, Roundup and other herbicides are typically purchased both by farmers for use in commercial crop production and by individual consumers for use in their home gardens.

A further complication is that different products of the same type or within the same industry often incur different regulatory costs (for example, pharmaceutical products of the same class and risk which require different testing procedures). Developing an administratively simple and cost effective charging system that can accurately reflect the costs of regulating such products, and that can be paid by these different user groups directly, would be extremely difficult.

In most cases it is simpler and more cost effective to charge the producer of the regulated product through either a direct fee-for-service, or an industry levy. Firms can then pass on some or all of this charge to purchasers, down the production chain to final consumers. The extent to which the cost of the regulation is passed on from

the producer to purchasers will be decided by the market for the particular product. The producer may bear the regulatory cost through lower profits or the final consumer may bear it through higher product prices and/or a reduced range of products (see chapter 5). In most cases, the two will share the incidence of the charge (see chapter 2).

As a final consideration, unique market issues may arise for some regulatory activities, which can affect the appropriateness of cost recovery. For example, the Office of the Gene Technology Regulator and the Space Licensing and Safety Office have been set up recently to oversee the development of new industries in Australia. Depending on their design, cost recovery arrangements could conflict with, or unreasonably discourage, that development and thus undermine the agencies' objectives (see chapter 5).

These market characteristics reinforce the importance of examining the case for (and appropriate design of) cost recovery separately for each activity, rather than looking at cost recovery arrangements at an agency level only. In some instances, practical considerations may justify a levy instead of fees-for-service (see section 7.4) or no cost recovery charges at all.

Appropriate regulatory activities for cost recovery

As discussed in section 7.1, where cost recovery applies, only the costs of the relevant activity or product should be recovered from users. Regulatory agencies should recover the cost of administering regulation, but not the cost of general policy development or related Government activities.

This issue will not arise for regulatory agencies that do not undertake these other activities. For example, the National Occupational Health and Safety Commission provides part of the public safety and handling advice for the National Industrial Chemicals Notification and Assessment Scheme, while the Department of Employment, Workplace Relations and Small Business undertakes policy development. Neither the commission nor the department recover the cost of these activities from chemicals users (see appendix D).

In other cases, regulatory agencies that undertake activities that should not be cost recovered have included them in their cost recovery arrangements. As discussed in section 7.1, this has typically occurred as a result of inappropriate agency-wide cost recovery arrangements.

It is the cost of these non-regulatory activities that regulated firms most often resent paying. For example, the Investment and Financial Services Association objected to paying for all activities of the Australian Prudential Regulation Authority:

> While IFSA (along with many other bodies) has strongly supported [financial regulation agencies'] public policy objectives, we are of the view that the whole community should fund them. Examples include policing activity; regulation to prevent or limit tax deferral; retirement incomes policy objectives, … and retirement savings (superannuation) and incomes public education. (sub. 9, p. 2)

In addition, many regulatory agencies produce public information and education products as part of their regulatory functions. As discussed in section 7.2, these information products should be examined in relation to cost recovery principles that are appropriate to their 'information product' characteristics.

RECOMMENDATION 7.9

As a general principle, the administrative costs of regulation should be recovered, so that the price of each regulated product incorporates the cost of efficient regulation. Cost recovery should not be implemented where:

- ***it is not cost effective;***
- ***it would be inconsistent with policy objectives; or***
- ***it would unduly stifle competition and industry innovation.***

7.4 Practical considerations in applying cost recovery

The Commission has identified some general principles to guide the application of cost recovery to different types of government activity. However, once these principles have been applied, some 'second order' questions arise regarding how a given cost recovery arrangement should operate. These questions involve choosing between types of fees or levies; examining options for partial cost recovery; accommodating inter-agency and inter-government funding arrangements; and improving the cost effectiveness and administrative efficiency of cost recovery arrangements. These are discussed briefly in this section and are addressed further in the Commission's recommended Guidelines.

Selecting the type of cost recovery charge — fees or levies?

As a general principle, the link between an activity and a cost recovery charge should be as close as possible. The more directly a charge relates to the activity or product supplied, the stronger the link is between the costs incurred and the pricing

signal, and the more efficient the outcome will be (see chapters 2 and 5). This means that a direct fee-for-service will, in principle, be preferable to a levy.

However, a direct fee-for-service may be inappropriate or not cost effective for all Government cost recovery arrangements. Trade-offs between economic efficiency and cost effectiveness may be inevitable in the design of cost recovery mechanisms. On the one hand, levies may be administratively simple and cheap, but they can dilute the impact on efficiency. On the other hand, fees-for-service provide a more effective and transparent price signal, but they may be more expensive than a levy to administer.

Levies are rarely used by information agencies, which usually charge a direct fee for their products, but are relatively common among regulatory agencies. Levies tend to be used by regulatory agencies to recover the cost of activities where:

- the activity is of a general industry nature (such as post-market compliance and monitoring) rather than of immediate application to one identifiable firm. These levies often take the form of an annual charge that funds industry compliance, monitoring and other post-market regulatory activities (for example, activities by the National Registration Authority for Agricultural and Veterinary Chemicals and the Therapeutic Goods Administration);
- it is difficult or impossible to identify the users of a particular service or the extent of their use. For example, it may be difficult to track exactly who has used a particular lighthouse and charge them accordingly. But, it may be possible to identify the industry that uses or benefits from the service (for example, ship owners), and to charge them a general levy to cover the cost;
- an agency can identify the immediate users of their activities, but does not wish to charge them a direct fee because it may impede the objectives of the activity (as in product recall programs or post-market monitoring); and
- administrative complexity means that it is simpler and cheaper to recover regulatory costs for a defined industry through a single industry levy, rather than by collecting a larger number of small fees. For example, the Australian Maritime Safety Authority funds its regulatory and maritime safety activities from a shipping industry levy, given the administrative complexity of recovering separate fees for each of its activities.

For these reasons, a levy on relevant firms can be an appropriate alternative to direct fees. Insight EFM stated:

> Cost recovery should be applied in such a way that it is not a disincentive to safe operations .... This can sometimes be achieved by applying recovery on a broader basis such as incorporating those costs in a more broadly defined fee-for-service or by the use of some form of broad-based levy. (sub DR132, p. 3)

As for all cost recovery arrangements, the design of levy mechanisms should account for administration costs, transaction costs and compliance costs (see chapter 8). In some cases, these costs may mean that even an industry levy is impractical or expensive. For example, although cost recovery for the Australia New Zealand Food Authority was ruled out due to 'free rider' concerns (see chapter 5), it would also have been relatively impractical and administratively expensive to recover the rather small amount needed to fund the authority from a very large number of firms through a levy. In such cases, taxpayer funding may be preferable.

Taxpayer funding may also be preferable if it is not possible to link the levy closely enough to the activity for cost recovery to generate the desired efficiency and equity effects (and the levy becomes, in effect, general taxation, see section 7.1).

RECOMMENDATION 7.10

Cost recovery charges should be linked as closely as possible to the costs of activities or products. Fees-for-service reflecting efficient costs should be used wherever possible. Where this is not possible, specific taxation measures (such as levies) may be appropriate but only where the basis of collection is closely linked to the costs involved.

Partial cost recovery

The Commission uses the term 'partial cost recovery' to refer to circumstances in which agencies may depart from the general principles outlined above and recover some, but not all, of the cost of an activity from those who use it. This is not the same as 'partial' recovery of agency costs (that is, when the costs of some of an agency's activities are recovered but not the costs of others), and it is not necessarily the same as recovering only the marginal or incremental cost of an activity (for example, where the marginal costs of an activity are less than its average costs, then marginal cost pricing would leave a funding deficit, see appendix H).

For regulatory activities, partial cost recovery arrangements would be inconsistent with the general principle that the price of regulated products should, in the interests of maximising economic efficiency, incorporate the cost of their regulation.

For information products, there might appear to be a case for partial cost recovery where the product has private benefits, but also significant positive spillovers. If the private benefit is less than the fee (which should be based on the marginal or incremental cost), then the consumer will not demand the product. However, in practice it would be difficult to determine the degree of partial funding according to the relative sizes of the public and private benefits involved. A more effective

approach would be to opt for no cost recovery (and general taxation funding) where the positive spillover is significant, or to recover the incremental cost where it is not (as recommended for additional information products in section 7.2).

Inter-agency and inter-government cost recovery

Commonwealth Government agencies may engage in a variety of transactions with other Commonwealth Government agencies, including purchasing discrete products, as well as forming contractual arrangements such as purchaser/provider relationships, outsourcing and resource sharing arrangements.

To the extent that transactions between Commonwealth agencies reflect transfers of general taxation revenue, inter-agency charges can be more about budget allocations than cost recovery. Nonetheless, the proper location of costs may bring efficiency and accountability benefits, and the principles underlying appropriate cost recovery could be usefully applied to inter-agency transactions.

Where one or both of the agencies involved in inter-agency transactions also provide products to purchasers outside the Commonwealth Government sector, the inter-agency arrangements need to be transparent to avoid the introduction of cost shifting and cross-subsidies between government and non-government parties. If an activity that recovers costs from industry and consumers receives some inputs from another Government agency, then the value of those inputs should be incorporated in its cost recovery charges (for example, assessments provided by Therapeutic Goods Administration to the National Registration Authority for Agricultural and Veterinary Chemicals). In these cases, the transactions between the agencies should be transparent and charged on the same basis as that of cost recovery between the government and private sectors.

In many cases, it may be appropriate to fund the purchasing agency and establish a charging arrangement (for example, the purchase of ABS statistics). Such charging arrangements may act as a demand rationing device and improve the efficiency of service provision. Where these arrangements involve the provision of significant levels of activity, incremental cost charging arrangements may include the costs of capital or overheads (for example, research by the Australian Bureau of Agricultural and Resource Economics).

Similar arguments apply to transactions between different levels of Government. Some arrangements reflect inter-government agreements on collectively provided services. Using pricing mechanisms can help to drive efficiency and accountability. The cost recovery Guidelines may provide some useful assistance in achieving this.

7.5 Conclusions

In chapter 2 and elsewhere in this report, the Commission has argued that the main objective for cost recovery should be to improve economic efficiency. This should be a central objective for all Government regulatory activities and information products, not just for those whose customers have freedom to choose whether to consume the product. Even where firms are obliged by regulation to use particular government activities, appropriately implemented cost recovery can encourage efficient resource allocation.

Cost recovery arrangements can also have equity implications. To the extent that some types of regulatory activities are not cost recovered, general taxpayers may have to fund activities that mainly benefit a particular group of consumers in society. When cost recovery arrangements are appropriately implemented and carefully designed, they can directly improve the equity of Government financial arrangements and the efficiency with which Government activities and products are provided and consumed.

8 Improving agency efficiency

Cost recovery can have significant incentive effects on agency efficiency (see chapter 5). This chapter examines four ways in which to improve the efficiency of agencies that cost recover:

- ensuring better accountability to government;
- increasing consultation with users;
- applying existing mechanisms to promote efficiency; and
- introducing new cost recovery review mechanisms.

8.1 Accountability to government

Accountability and transparency are very important for government agencies, particularly where cost recovery may be creating incentives for undesirable practices such as regulatory creep, gold plating and cost padding or, in the case of information agencies, to pursue cost recovery activities at the expense of basic activities (see chapter 5). However, in the absence of a standard institutional framework for cost recovery, accountability and transparency have suffered. This lack of transparency is particularly significant where the ability to raise cost recovery revenue reduces the level of budgetary and Parliamentary scrutiny of an agency.

Cost recovery can allow agencies' budgets and resources to be more responsive to demand. Where demand is unpredictable and charges are closely linked to the costs of providing a service for example, access to cost recovery revenues can allow an agency to meet unexpected demand without seeking additional general taxation revenue.[1] However, there are potential disadvantages from allowing agencies too much independence from the budget process and Parliamentary scrutiny. The ability to raise revenue that is somewhat sheltered from external scrutiny can reduce incentives for the agency to become more efficient (see chapter 5). The Australian Chamber of Commerce and Industry stated:

[1] Cost recovery agencies can be given 'automatic' access to cost recovery revenues through mechanisms such as special appropriations or net appropriation agreements (see chapter 3).

> The level of scrutiny in the normal budgetary process means agencies have to bid for and justify the allocation of funds. Where an agency is self-funding, there is not the same rigour or review. (sub. 70, p. 15)

The Complementary Healthcare Council of Australia had similar views about the Therapeutic Goods Administration (TGA):

> Without some Government [financial] involvement there is no interest on the part of central Government oversighting agencies in the management and efficiency of an agency. … As there are no Parliamentary appropriations there is little or no Parliamentary oversight of the agency or its operations. (sub. 17, p. 8)

For both regulatory and information agencies, retaining cost recovery revenues may encourage agencies to concentrate on activities for which they can cost recover, at the expense of other activities. The Australian Geological Survey Organisation argued that:

> Undue focus on the pursuit of cost recovery … as an objective in its own right has the potential to subvert and distort longer-term strategic Government objectives in favour of short-term imperatives likely to attract funding from industry. (sub. 55, p. 14)

Budgetary and Parliamentary scrutiny can help to reduce incentives for regulatory creep, gold plating and cost padding, and can encourage the pursuit of cost effective regulatory strategies such as harmonisation and mutual recognition. However, some participants questioned the benefits of Parliamentary scrutiny. Insight EFM argued that the Senate Estimates Committee was not well enough informed to scrutinise cost recovery (trans., p. 1244). On the other hand, the Australian Chamber of Commerce and Industry argued that this was a 'catch 22' because the Senate Estimates Committee took little interest in the efficiency of agencies whose funding was not from the Consolidated Revenue Fund (sub. 136, p. 5).

The Commission recognises that there are limits on the extent to which budgetary and Parliamentary scrutiny can drive agency efficiency. Cost recovery has the potential to influence the budgetary process even where agencies do not have direct access to the funds they raise. It may be easier for example, to have new proposals approved if they make no net call on the budget. However, Parliament is accountable to the public for the activities of all Commonwealth agencies and should have the opportunity to review all cost recovery revenues and expenditures as part of the budget process. Agencies that cost recover should be subject to the same budgetary oversight and stringency that apply to other agencies. Many inquiry participants, such as the Association of Superannuation Funds of Australia (sub. DR135, p. 1), the National Farmers' Federation (sub. DR162, p. 5), the Complementary Healthcare Council of Australia (sub. DR117, p. 5) and the Australian Chamber of Commerce and Industry (sub. DR136, p. 5) agreed with this principle.

Most information agencies have section 31 agreements in place that enable them to retain revenue raised from discretionary activities such as sale of publications (questionnaire responses). However, information agencies are subject to budget and Parliamentary scrutiny to the extent they receive taxpayer funding for basic activities — a large proportion of their total revenue in most cases (see chapter 4). The additional revenue raised through cost recovery of discretionary activities is then subject to a degree of market discipline, which can help drive agency efficiency.

Most regulatory agencies also have automatic access to cost recovery revenues through section 31 agreements or section 20 special appropriations (questionnaire responses). Many regulatory agencies raise a large proportion (and, in some cases, all) of their revenue through cost recovery of compulsory regulatory activities. This could encourage regulatory agencies to extend the scope of their regulatory activities to earn more revenue. This revenue is not subject to the same market disciplines faced by information agencies and should be subject to the same level of budgetary discipline and Parliamentary oversight that apply to non-cost recovery revenue.

Two approaches may achieve this result. The first is more transparent reporting of cost recovery arrangements as part of the budget process. The Commission recommends improved reporting arrangements in chapter 3. However, it is doubtful whether this increased transparency would be sufficient to focus official scrutiny on cost recovered activities.

The second approach would be to limit the use of section 31 agreements and section 20 special appropriations to activities that face a degree of market discipline (such as the provision of discretionary information). Cost recovery revenues from other activities (such as the provision of compulsory regulatory services) would be paid into the Consolidated Revenue Fund, with the agencies being funded through general appropriations. The Australian Competition and Consumer Commission already has this sort of arrangement, with a section 31 agreement providing access to funds derived from discretionary activities, but not to those derived from regulatory activities (see chapter 6).

This approach would mean that regulatory agencies would not have automatic access to cost recovery revenues, potentially placing them at a disadvantage in addressing any unexpected demand for regulatory activities. However, these agencies would thus be in the same situation as that of other government bodies that do not cost recover. Existing budgetary mechanisms for ‘topping up’ appropriations in cases of unexpected calls on agency budgets should be adequate to meet unexpected demand. An exception could be made for revenue from non-compulsory

regulatory fees, such as the 'fast tracking' arrangements of the Australia New Zealand Food Authority and the Office of Film and Literature Classification. Under these arrangements, applicants have the option of paying additional fees to allow agencies to purchase additional resources to expedite their application. (It is important that additional resources are employed, rather than 'leap-frogging' a queue of applicants).

FINDING

Many information agencies have automatic access (for example, through net appropriation agreements) to cost recovery revenue from the sale of additional information products. This revenue is not subject to close budgetary and Parliamentary scrutiny. It is, however, subject to a degree of market discipline, which can help drive agency efficiency.

FINDING

Many regulatory agencies have automatic access (for example, through net appropriation agreements) to cost recovery revenues from compulsory regulatory activities. This revenue is not subject to close budgetary and Parliamentary scrutiny, or to market discipline.

RECOMMENDATION 8.1

Agencies should not have automatic access to cost recovery revenue from compulsory regulatory activities. Funding for these activities should be subject to the same budgetary and Parliamentary scrutiny as activities funded from general taxation revenue.

8.2 Consultation arrangements

Consultation with affected parties is an important component of agency accountability and transparency. It can also improve the efficiency of government activities and cost recovery arrangements. Those who pay for an activity have an interest in the design and delivery of that activity. Many inquiry participants raised the positive impact that consultation could have on agency efficiency. Insight EFM stated:

> I've found that … [industry associations] … can be extremely thorough in their grilling of bodies to identify costs and efficiencies and make managers accountable. I see that as a major benefit. (trans., p. 1243)

The Department of Agriculture, Fisheries and Forestry — Australia stressed that:

> The value of consultative arrangements between industry and cost recovery agencies should be further emphasised. (sub. DR151, p. 6)

However, other inquiry participants criticised current consultation arrangements. The Council of Small Business Organisations of Australia argued that the lack of transparency in many cost recovery arrangements could hide inefficiency:

> One of our central concerns with cost recovery is, because it is so widespread and so difficult to measure and assess, it is difficult to … measure the efficiency of the delivery of the service or good for which costs are being recovered. (trans., p. 533)

Agencies contemplating cost recovery should undertake meaningful and effective consultation with those who will be subject to the charges. But despite the undeniable benefits, consultation with user groups also present the risk of real or perceived conflicts of interest or undue influence where a private interest group has an inappropriate level of influence or control over a public agency. This is not unique to cost recovery. It can occur in any situation where a powerful interest group faces a regulator. The Australian Chamber of Commerce and Industry referred to the risk of agencies being 'captured' by industry:

> … the move to full cost recovery and industry involvement may create the perception that industry has 'captured' the activities of the regulatory agency to the extent that the agency may not fulfil its primary role of protecting the community. (sub. 70, p. 14)

There is a particular risk of capture where firms have been encouraged to believe they are the beneficiaries of regulation — they feel that if they are paying for a benefit, they should be able to dictate the nature of the benefit they receive. This has led some industries to view an ability to influence regulatory agencies as a right. The Plastics and Chemicals Industries Association stated:

> Industry, if required to fund a scheme to 100 per cent should have a strong ability to influence the allocation and priority of the activities. (sub. 24, p. 7)

Despite the risks of agency capture, stakeholder consultation is necessary to help drive agency efficiency. Those expected (or required) to pay have a clear interest in the costs, efficiency and quality standards of agency activities and should be consulted on these arrangements. However, competing policy objectives may impose practical limits on this process. The Civil Aviation Safety Authority recognised a tension between 'economic' and safety objectives:

> We've had numerous discussions in our board, for example, and one of the major concerns is that we don't want the economic imperatives to over-ride what otherwise might be the regulatory objectives, safety objectives, of what we're doing. (trans., p. 1134)

Agencies should consult with other affected parties to ensure competing policy objectives are not compromised. Further, consultation needs to be supported by open and accountable processes that reduce the risk of conflicts of interest or undue influence. The issue is determining the most appropriate structure to encourage meaningful consultation, with the least risk of agency capture. Some existing consultative mechanisms are discussed in the following sections.

Boards

Agencies that are regulated by the *Commonwealth Authorities and Companies Act 1997* (the CAC Act) typically have a board structure.[2] The chief executive officer of the agency reports to the board, which in turn is accountable to the responsible Minister. In contrast, other agencies may not have a board, and their chief executive officers are accountable to the Minister responsible for the operation of the agency.

Inquiry participants, such as Avcare, suggested that a board structure with industry representation 'may be one way to achieve transparency, and scrutiny of cost recovery' (Avcare, trans., p. 385). However, many agencies have multiple stakeholders, not just industry. The Australian National Audit Office (ANAO) identified a range of potential stakeholders, including Parliament, Ministers, central agencies, the general community, customers and employees (ANAO 1999, p. 14). The Australian Chamber of Commerce and Industry argued that agencies that cost recover should be governed by independent boards made up of representatives of all stakeholders:

> The governance of these agencies should play a crucial role in improving the cost effectiveness or achieving value for money in these agencies. An independent board of directors comprising representatives of all stakeholders, including the broader community, with the power to make decisions regarding the actions and financial activities of the agency can make these agencies provide cost efficiency protection of consumers and the environment. (sub. 70, pp. 17–8)

Many agencies that cost recover have boards that include members drawn from a variety of stakeholders. The board of the National Registration Authority for Agricultural and Veterinary Chemicals for example, includes:

> … members having experience in regulatory affairs, consumer interests, [occupational health and safety], farming, government and the chemicals industry under an independent Chairperson. (sub. 39, p. 8)

[2] The CAC Act imposes duties on directors, rather than on the board. The term 'board' is a commonly accepted term for the forum in which directors meet to carry out these duties (see chapter 3).

It is important to note that under the CAC Act directors have a legal responsibility for the performance of the agency as a public body, rather than representing a particular group of stakeholders (ANAO 1999, pp. 8–9). The ANAO (1999, p. 4) has noted the relative breadth of responsibilities held by boards of Government agencies:

> … the very nature of public services, with often broad objectives, variable and complex benefits and society wide impact, distinguish management of public services from management of most private services where the over-riding objective is to maximise the organisation's value, including dividends to shareholders.

These wider responsibilities and duties can present potential conflicts of interest for directors who are expected to represent certain stakeholder interests. It is an important principle of good governance that the majority of a board be independent (of both management and stakeholders). The ANAO (1999, p. 22) stated: 'The majority of the CAC Board should be independent of both the management team and any commercial dealings with the [authority or company]'. This independence would help avoid perceptions of conflict of interest and reduce the potential for particular groups wielding undue influence.

There are clear limits to the extent to which boards can act as vehicles for pursuing stakeholder and consumer consultation. Alternative mechanisms, such as consultative committees, may be better able to fill this role.

Audit committees

Audit committees are mandated under both the CAC and *Financial Management and Accountability 1997* (FMA) Acts. They are responsible for oversight of the audit function, including liaison with internal and external auditors, and report to the board or chief executive officer.

Although audit committees perform an important function in the governance of public sector agencies, they have major drawbacks in terms of the efficiency of cost recovery activities. Although they may include external members, they are typically internal expert committees with a specific focus on financial accountability and compliance with legal requirements, rather than on broader concepts of agency efficiency.

Consultative committees

Many agencies have consultative committees, which may be statutory (established by legislation) or administrative, and which perform many different roles. The

TGA, for example, has established many advisory and consultative committees (box 8.1).

Box 8.1 **TGA consultative committees**

In addition to a number of expert committees that advise on therapeutic products and complementary healthcare products, the TGA has established the following committees to facilitate consultation.

The TGA–Industry Consultative Committee (TICC) facilitates consultation between the TGA and the industry regarding input to its budget and accounting against the corporate plan. It also provides direct feedback from industry to the TGA on broad policy, resource allocation and performance issues.

The Complementary Healthcare Consultative Forum promotes and fosters constructive relations between the Government and the complementary healthcare sector, and examines policy and other issues relating to regulation, research, education, and industry, consumer and practitioner concerns.

The National Coordinating Committee for Therapeutic Goods will be a Commonwealth–State and Territory committee which enables a national approach to the regulation of therapeutic goods (this committee is yet to be established).

These committees, both statutory and non-statutory, provide the TGA with expert advice. They act as a check on the regulator through the quality of their advice, the need for consensus in some situations, and the links and networks that the committee system provides to the TGA in its day-to-day operations.

Source: TGA (sub. 89, p. 17).

Some inquiry participants were satisfied with existing consultative arrangements, particularly those of the Australian Quarantine and Inspection Service, the Australia New Zealand Food Authority and the Australian Fisheries Management Authority. However, a number of participants from different industries regarded current consultative arrangements as being inadequate. Avcare argued that consultation arrangements would need to be implemented for the Office of the Gene Technology Regulator (sub. 28, p. 8). The Association of Superannuation Funds of Australia was concerned about the limited accountability of finance sector regulatory agencies (sub. 135, p. 1). Ansett was concerned about the lack of information that the Bureau of Meteorology provided at industry consultation days (sub. 68, p. 11).

The following section summarises comments about the TGA–Industry Consultative Committee (TICC) which were fairly typical of many (but not all) industry views of existing arrangements. The agency and industry had different views of the value of the existing arrangements. As reflected in box 8.1, the TGA stated that the TICC:

> … facilitates consultation between TGA and the industry regarding input to the TGA budget and accounting against the TGA Corporate Plan; [it] also provides direct feedback from industry to TGA on broad policy, resource allocation and performance issues. (sub. 89, p. 17)

Many industry participants disagreed with this view. They raised three main criticisms of the TICC: (1) the scope of its functions is limited to non-economic matters; (2) industry members are not given sufficient information on which to base their contributions; and (3) the TGA can too easily ignore industry advice.

The Complementary Healthcare Council of Australia suggested the TICC is not sufficiently accountable and transparent, particularly regarding issues of financial management:

> The TICC which has been referred to in so much of the hearings is managed by the TGA with little opportunity to question expenditure or budget. The transcripts show many conflicting attitudes to the usefulness of this forum. (sub. 98, p. 5)

The Australian Self-Medication Industry recommended that TICC members be given better information:

> TGA financial and management information provided to industry through the TICC [should] be improved to provide better accountability and measurable results, including accountability criteria and measures, understandable and relevant reporting formats and productivity initiatives. (sub. 23, p. 18)

The Australian Pharmaceutical Manufacturers Association criticised the lack of powers of industry members of the TICC:

> … the industry members may 'examine and comment' upon the TGA's performance and budget, but it has no directional powers, for example to require the TGA to achieve certain performance standards or to expend its revenue in ways that the industry members might consider most cost effective. (sub. 14, p. 4)

Some critics of the TICC appeared to want to blur the line between consultation and control; they wanted a more direct voice in operational decision making. The Medical Industry Association of Australia stated:

> The TICC forum offers an opportunity to exchange ideas and provide current information on industry issues and trends, but it fails to deliver a forum in which industry can expect to be given an opportunity to shape TGA business practices. (sub. DR122, p. 4)

The Australian Self-Medication Industry made similar comments:

> The TICC is not a management committee, but a consultative forum. Its ability to influence the direction of TGA policy is therefore marginal, and the limitations on the

> information that is discussed by the TICC severely restrict industry's ability to participate in a meaningful dialogue with TGA officials. (sub. 23, p. 12)

As discussed above, there is the risk of real or perceived conflicts of interest or undue influence where a private interest group has an inappropriate level of influence or control over a public agency. The governance and accountability arrangements of these agencies are meant to balance the interests of multiple stakeholders. However, this does not mean that existing consultative mechanisms cannot be improved.

In its draft report the Commission requested further views on the establishment of efficiency audit committees, which would be consultative committees with explicit powers to examine agency efficiency and report to the relevant Minister (box 8.2).

Commission's preferred approach

Improved agency transparency and adequate consultation mechanisms are important tools in promoting efficiency. However, the Commission is reluctant to suggest a new layer of bureaucracy where it is not necessary or desired, or where it duplicates the activities of existing committees. Many inquiry participants supported this approach. The National Industrial Chemcials Notification and Assessment Scheme stated:

> It may be preferable to define and provide guidance on the EAC [efficiency audit committee] functions, rather than requiring the establishment of stand alone EACs. This would provide the flexibility for agencies to supplement existing processes, if appropriate, rather than creating new committees. This would minimise the cost impact. (sub. DR130, p. 2)

The Australian Fisheries Management Authority stated that it:

> … supports the use of stakeholder consultation as the most effective means of addressing the efficiency of agencies. However, we do not see any additional value in introducing an Efficiency Audit Committee. We believe this would add additional costs to the established process. (sub. DR160, p. 2)

Similarly the National Farmers' Federation stated that while it:

> … agrees that the Government should address the effectiveness of the existing performance review process, it questions the necessity for the development and funding of an Efficiency Audit Committee … (sub. DR162, p. 6)

Box 8.2 **Efficiency audit committees**

In its draft report on cost recovery, the Commission recommended that government address the effectiveness of the existing consultative arrangements and raised the need for an efficiency audit approach based on stakeholder consultation. It requested further views on the establishment of efficiency audit committees to address agency efficiency. The suggested characteristics of these committees included:

- representation by industry, consumers and the agency;
- appointments to the committee by the relevant Minister;
- the right to be provided with relevant information on agency budgets and performance;
- an independent chair (not an agency representative); and
- reporting directly to the Minister.

Inquiry participants generally were in favour of measures to improve agency efficiency and better consultation. Some participants (the Australian Pharmaceutical Manufacturers Association, Blackmores, the Red Meat Advisory Council and the Complementary Healthcare Council of Australia) favoured the efficiency audit committee model as outlined in the draft report. Some issues raised were:

- stakeholder input — existing consultation mechanisms may provide the opportunity to exchange ideas but fail to incorporate industry input in business practices and performance standards (the Medical Industry Association of Australia and the Australian Self Medication Industry); and
- independence — in many cases, existing committee chairs are agency representatives, allowing them to influence the agenda.

However, other inquiry participants questioned the need for an entirely new process. A few particular issues raised were:

- the duplication of existing processes — the efficiency audit committee would duplicate existing processes such as consultative committees, boards, ANAO performance audits and Department of Finance and Administration pricing reviews (ABS and Austrade);
- the adequacy of existing arrangements — both industry and agencies argued that some existing consultation arrangements were working well (the Industry Working Group on Quarantine and the Australian Seafood Industry Council);
- more direct means of improving efficiency — efficiency could be more directly targeted by emphasising mechanisms such as benchmarking, third party competition and mutual recognition (the Plastics and Chemicals Industry Association and the Complementary Healthcare Council of Australia); and
- the possible inappropriateness of direct access to the Minister — there was some concern that direct access from the committee to the Minister may amount to 'unwarranted escalation' and could politicise what should be administrative decisions (AQIS, trans., p. 672; CHF, trans., p. 808).

The Commission also recognises that a single model may not be applicable to all agencies. The Department of Immigration and Multicultural Affairs supported:

> … the principle of consultation, however, such a regularised structure of consultation may not be appropriate in all cases. For example, industry and stakeholders interests may be in conflict with the intent of the Government policy that lead to the cost recovery regime and may lead to unintended complications. Application of this policy should be assessed on a case by case basis. (sub. DR165, p. 2)

However, successful consultative arrangements seem to share some common features. The Commission has suggested criteria for consultation arrangements (based on the efficiency audit committee model) that all cost recovering agencies should meet (box 8.3).

Box 8.3 Suggested criteria for consultative arrangements

Agencies with significant cost recovery arrangements should have consultative arrangements with the following features:

- responsibility to address a broad range of efficiency related matters, with a particular focus on cost recovery;
- both industry and consumer representatives (who may be appointed by the relevant Minister);
- a minority of agency representatives;
- a committee chair who is independent of the regulatory agency;
- the power to require such information as is reasonably necessary for the committee to undertake its role; and
- transparent processes (subject to confidentiality requirements).

An important first step would be to recognise that cost recovery arrangements are an appropriate subject for consultation. Those subject to cost recovery charges may have valuable insights into ways in which to promote appropriate regulation and efficient agency operations. Agencies should be open to advice from industry on cost recovery issues.

The Commission has noted the lack of satisfactory information on cost recovery objectives, costing and revenue, and recommends improved reporting by agencies that cost recover (see chapter 3). Further, consultative committees need sufficient information to allow meaningful consultation.

Agencies have also been criticised for ignoring the advice of consultative committees. Although agencies should not be bound to follow committee advice, it is appropriate that they give a considered response to this advice, providing reasons

for not accepting recommendations of the committee. Both the committee's advice and the agency response should be publicly available.

Inquiry participants did not agree on the appropriate lines of authority for consultative committees. One option is for committees to report to the relevant Minister directly. Several participants favoured this approach. The Medical Industry Association of Australia argued 'for independent chairing of the TICC, with reporting from the Chair back to the Minister' (sub. DR122, p. 5).

Other participants questioned whether this was desirable. The Australian Quarantine and Inspection Service was wary of introducing 'political games':

> The regulator could be caught in a very difficult situation, with being required to recover their costs by government policy, but with a vehicle being established where political games could be played. (trans., p. 672)

Creating a reporting structure that bypasses agency heads would also be contrary to the system of devolved responsibility and accountability structures put in place in the Commonwealth public sector. The Department of Finance and Administration stated:

> The Financial Management and Accountability Act and the Commonwealth Authorities and Companies Act devolved a degree of responsibility to the chief executives of Commonwealth agencies for managing their own affairs, including the application of cost recovery. (sub. DR148, p. 1)

The Commission considers that the best approach is to give greater weight to consultative arrangements through improved transparency. This could be achieved by requiring the publication of consultative committees' recommendations on agency websites and in annual reports, together with a formal agency response signed off by the chief executive. This would be consistent with the Department's general approach of devolving responsibility to agency heads, coupled with appropriate accountability and reporting safeguards.

Some participants questioned who should bear the cost of consultative arrangements (ACCI, trans., p. 799). The Commission considers that this is an area where 'one size does not fit all', but that costs in most cases would be shared between the agency and members of the committee. Typically, the agency would provide secretariat services and members would cover their own costs. However, there may be good reason for departing from this general rule — for example, the desire to subsidise poorly resourced community groups to participate in the committee.

Applying the criteria

Those arrangements that are already working well would need little or no change. For example, the Industry Cargo Consultative Committee of the Australian Quarantine and Inspection Service has many of the features listed above, and appears to enjoy widespread support (box 8.4). Similarly, Australian Fisheries Management Authority stated that it has a separate Management Advisory Committee for each fishery. These committees included industry members and are able to examine the budget for their fishery in detail and recommend either increases or decreases in expenditure (sub. DR160, p. 3).

Box 8.4 **Industry Cargo Consultative Committee of the Australian Quarantine and Inspection Service**

Formed in 1993 in response to the introduction of full cost recovery, this committee has the following features:

- its terms of reference address cost recovery mechanisms and charging levels;
- it is chaired by an industry representative;
- representatives come from both the Australian Quarantine and Inspection Service and industry. Industry interests are represented through the Industry Working Group on Quarantine (for which membership is open to all stakeholders);
- it meets four times a year (once each in Canberra, Melbourne, Sydney and another capital city);
- a member of the committee is also a member of the Quarantine Expert Advisory Council, which reports to the Minister; and
- the committee is indirectly funded by industry, with its secretariat funded through the import clearance program and travel expenses financed through over-recovered funds.

Source: IWGQ (trans., p. 12).

Existing arrangements that are not working well could be amended according to the criteria in box 8.3. The Australian Pharmaceutical Manufacturers Association supported this approach in relation to the TGA's existing committee structure:

> … if the principles you have outlined in your [draft] report are applied and there is more information and greater transparent information provided, I don't see much purpose in setting up another layer. (trans., p. 981)

Where existing consultation arrangements cannot be amended to provide the desired features (or where there are no existing arrangements), it may be appropriate to introduce new arrangements to promote efficiency, transparency and accountability.

RECOMMENDATION 8.2

Agencies with significant cost recovery arrangements should have adequate mechanisms in place to promote meaningful consultation with stakeholders. Consultative committees should include the following characteristics:

- ***stakeholder representation;***
- ***a chairperson independent of the agency;***
- ***the ability to monitor agency efficiency;***
- ***access to adequate information on agency processes and costs; and***
- ***transparent processes.***

A process is required to ensure that agencies have appropriate consultative mechanisms in place. In section 8.4 the Commission recommends improved review processes for cost recovery arrangements, including the review of all existing arrangements. An important function of these reviews, which would involve stakeholder consultation, would be to examine agency consultative arrangements and make recommendations for their improvement in line with the above criteria.

8.3 Existing mechanisms to promote efficiency

Current administrative and institutional arrangements include a number of mechanisms for promoting agency efficiency. This section examines their application to agencies that recover costs.

Efficiency dividend

Most Commonwealth agencies are subject to an annual reduction in their budget funding, known as an efficiency dividend. Agencies that are subject to the efficiency dividend are expected to offset these budget cuts through efficiency improvements in their running costs.

Some inquiry participants such as the Australian Fisheries Management Authority (sub. DR160, p. 3) criticised the efficiency dividend as being a 'blunt' instrument for pursuing efficiency gains, because it is not targeted at particular outputs or activities.

An efficiency dividend currently does not apply to cost recovery revenue deemed to be appropriated to agencies under a s.31 agreement (see chapter 3). This blanket

exclusion not only relieves cost recovered activities from efficiency pressures, but also can create incentives for agencies to increase cost recovery charges to offset reduced budget appropriations in other areas, or to impose cost recovery for more activities, to avoid the efficiency dividend. Some participants argued that cost recovered activities should also be subject to the efficiency dividend. The Complementary Healthcare Council of Australia stated:

> An efficiency dividend would be a good start. Why should a cost-recovering agency be exempted from a discipline applied routinely to other Government agencies? (sub. 17, p. 12)

The Australian Chamber of Commerce and Industry argued that efficiency dividends would need to be applied with care:

> Regulatory agencies … may find this an effective policy to reduce costs. However, reducing the funding of an agency whose objective is to protect public health and safety would need to be done in a balanced and appropriate way. (sub. 136, p. 6)

Other inquiry participants had concerns about applying an efficiency dividend to cost recovery activities. ScreenSound Australia argued that:

> This is a blunt enough instrument when applied across the board (punishing the most efficient agencies as they have the least room for easy wins in improved efficiency). It is particularly problematic to apply it in a context where most efficiency gains should properly be reflected in price reductions ... (sub. DR144, p. 5)

It should not be necessary to impose an efficiency dividend if only the efficient costs of an activity are recovered. However, it may be difficult in practice to establish efficient costs. It is also important to create incentives to pursue efficiency improvements over time. In the absence of competition to drive efficiency, a moderate efficiency dividend may be a desirable means of promoting productivity improvement. However, the efficiency dividend should not be relied on in isolation. It should be supported by regular, comprehensive reviews of agency efficiency and tailored to individual agency situations. The National Industrial Chemicals Notification and Assessment Scheme, for example, cautioned that the application of efficiency dividends should account for the size of agencies:

> In general, it may be more difficult for small schemes to continually achieve the same percentage efficiency improvement as larger ones. (sub. DR130, p. 5)

The Department of Finance and Administration examines the application of efficiency dividends to non-cost recovery revenue on an agency basis as part of its output pricing reviews (discussed below). These reviews could also consider extending agency-specific efficiency dividends to cost recovered activities, for example, by requiring that total agency resources (regardless of the source of the funding) be subject to an appropriate efficiency dividend.

Benchmarking

Benchmarking of performance (also known as yardstick competition) is an important tool for measuring the relative efficiency of government agencies. Benchmarking can be used for policy evaluation as well as price setting. It can promote debate about comparative performance by allowing agencies to compare their performance over time or with agencies undertaking similar activities. 'Like with like' benchmarking can be undertaken at the agency level, for example, comparing the performance of the Australian TGA with the US Food and Drug Administration. But, it is also possible to undertake 'like with unlike' benchmarking at the activity level, comparing the cost of similar processes, such as the provision of corporate services, in two otherwise dissimilar agencies.

The Department of Industry, Science and Resources stated that benchmarking was particularly relevant for monopolies and regulators:

> Two areas where [transparent costing processes and international benchmarking] would be particularly relevant are government monopolies and regulators where consumers are not provided with a competitive market situation and are forced to accept the government set charges. (sub. 62, p. 5)

A principal source of benchmarking information may be overseas agencies. But, as noted by the Australian Chamber of Commerce and Industry, benchmarking should account for different approaches adopted in different jurisdictions:

> International benchmarking of regulatory agencies may have limited use given different legislative underpinning across different countries. However, in particular circumstances it may be useful to benchmark the costs of regulation, and the cost of registering products in countries with similar regulatory frameworks. (sub. DR136, p. 6)

Even where different jurisdictions adopt different regulatory approaches, international benchmarking can provide useful information about the costs and benefits of those different approaches.

Benchmarking is also an important element of output based budgeting, and is being used in output pricing reviews (discussed below). The Department of Finance and Administration is creating a repository of benchmarking information to assist agencies to compare their performance with other Australian agencies, similar agencies overseas and private organisations.

The Commission considers that benchmarking can play an important role for agencies undertaking cost recovery, particularly in improving the transparency of charging and encouraging informed consultation with users.

Introduction of competitive pressures

The negative incentives created by cost recovery are often related to the lack of the market forces that normally drive efficiency. Many information agencies have natural or statutory monopolies on the products and services they sell. Regulatory requirements, including charges, are compulsory for entry to certain markets. However, even in these circumstances, some market forces can be used to encourage agency efficiency.

Market testing and third party competition

Market testing and third party competition allow suppliers other than a specified agency to deliver services. Market testing involves putting the provision of an agency activity out to public tender (for example, running a tender to choose a private consultancy to undertake research). Third party competition allows the users of a service to choose from among multiple providers. Alternative providers of mandatory assessment services for example, could be licensed or certified.

Mechanisms such as market testing and third party competition that introduce competitive pressures to agency activities can improve the accountability, quality and cost effectiveness of these activities. The Australian Chamber of Commerce and Industry claimed there were potential efficiency gains from introducing competition for the provision of both regulatory and information services:

> For example the outsourcing of non-core activities such as personnel, purchasing, library services etcetera, in order to achieve economies of scale. Further still, providers of risk assessment services could be licensed or certified to provide a service in order to introduce competition. In relation to some information services, the Government is already competing directly with business and there is a need for urgent market testing of these services. (sub. DR136, p. 6)

Market testing and third party competition are widely used in Australia and overseas, and regulatory agencies overseas have begun to adopt them; for example, private commercial organisations called 'notified bodies' undertake conformity assessment of medical devices on behalf of governments in the European Union (TGA, sub. 89, p. 23). The TGA is recognised as the non-European equivalent of a notified body and can charge users to conduct assessments on behalf of EU regulatory agencies (Awin Services, sub. 20, p. 2).[3]

[3] Under the Australian/EC Memorandum of Understanding, the TGA can act as a conformity assessment body, which is the term used for non-European based bodies undertaking the responsibilities of a notified body (Awin Services, sub. 20, p. 2).

In the United States, the Food and Drug Administration has expanded a pilot program under which it accredits third party experts to conduct the initial review of all class one and low-to-intermediate risk class two medical devices. The Food and Drug Administration will also allow EU notified bodies to perform inspections to US requirements (FDA 2000b).

Participants were critical of the lack of market testing of TGA activities. The Australian Pharmaceutical Manufacturers Association saw scope for market testing of at least some TGA activities:

> … if you took at least part of it and see that it was market tested you would feel confident that you were getting value for your money. I think there is a capacity — not all of it, but some of it — to go out there into the private sector and test procedures. (trans., p. 982)

Similarly, the Complementary Healthcare Council of Australia stated:

> Many TGA activities could be contested by the private sector. For example, the Australian Register of Therapeutic Goods is a database of information, much of which appears on product labels and could be managed by a range of licensed service providers. Laboratory analysis of substances could be carried out by NATA accredited laboratories. Manufacturing facilities in Australia and overseas could be audited out by local auditors. (sub. 17, p. 2)

Blackmores argued that private bodies capable of undertaking TGA assessment activities already existed:

> … in the commercial world there are very large and very well set up commercial laboratories already who actually perform those tests already for industry. (trans., p. 1077)

Blackmores also argued for contracting out TGA audits of overseas manufacturers:

> Audit fees charged by the TGA to certify [Good Manufacturing Practice] in Australia are reasonable but charges for overseas manufacturers' audits seem excessive and industry has no avenue to scrutinise these costs. … The private sector could equally perform audits on a contract basis for the TGA at reduced cost. (sub. 25, p. 2)

The Department of Finance and Administration stated that its current priorities include the application of market testing, competitive tendering and contracting principles to drive efficient and effective operations (sub. 38, p. 2). But many Australian agencies that cost recover do not appear to be enthusiastic about market testing their services. Agencies may have a number of reasons for not pursuing market testing and third party competition: they may be required to downsize if work is performed outside the agency; regulatory agencies, in particular, appear to be concerned about a (real or perceived) lack of expertise in the private sector; and

agencies may also have concerns that private providers are more vulnerable to commercial pressures to make decisions favourable to applicants.

Such concerns need not rule out the introduction of competitive pressures to regulatory agencies, but they highlight the need to select carefully those activities to be market tested and to have rigorous accreditation criteria for private sector suppliers. The government agency must retain responsibility for managing outcomes, even if it does not undertake the actual activity. The Australian Pharmaceutical Manufacturers Association argued that:

> I'm quite confident [the TGA] could write specifications for a contract for those tasks to be undertaken which meets the public interest requirements of having the regulatory control. (trans., p. 982)

The Plastics and Chemicals Industries Association suggested agencies:

> … outsource the technical review aspects and undertake a more managerial approach to the assessment process. Government would still need to be assured of the quality of the process and retain its role as final arbiter of results to ensure that the level of technical support remains independent and sound. (sub. 24, p. 3)

The Commission considers that departments and agencies should assess the scope for market testing and third party competition on a case by case basis, as part of the ongoing process of ensuring agency activities are both necessary and as efficient as possible. This process can be assisted by a comparison of both processes and performance with those of other agencies (see earlier discussion on benchmarking).

Harmonisation and mutual recognition

Competitive pressures can also be brought to bear on the efficiency of regulatory agencies by encouraging mutual recognition of regulatory decisions by overseas agencies with comparable standards and levels of rigour. This would make assessment and approval processes more contestable by increasing the number of agencies worldwide that could provide those services. An important preliminary step towards mutual recognition is international harmonisation of standards.

Harmonisation and mutual recognition can also reduce industries' compliance costs by saving the costs of preparing multiple submissions to meet different requirements and by reducing unnecessary repetition of tests in Australia and overseas. The Australian Chemical Specialties Manufacturers Association noted:

> One area with the potential for regulators to decrease their costs significantly, and therefore the amount recovered from industry, is the improved recognition of chemical approvals by foreign regulatory authorities. This would also significantly reduce the costs of companies providing information to regulators. (sub. 60, p. 6)

And:

> … the refusal by Australian regulatory agencies to recognise the approval of products or chemicals overseas has led to high costs, substantial delays or products being prevented from reaching the market. (sub. DR164, p. 5)

Mutual recognition would affect all aspects of agencies' efficiency, including timeliness as well as the level of cost recovery charges. Mutual recognition could also lead to agencies ceasing some functions if they cannot provide them at competitive cost. The National Standards Commission stated:

> … as a member of the International Organisation of Legal Metrology, the [National Standards] Commission is actively working towards an agreement under which major international laboratories would accept each other's test reports. Such mutual recognition agreements would place the Commission in price competition with overseas laboratories, and would significantly reduce the amount of testing conducted in Australia. (sub. 31, p. 4)

The Commission considers that harmonisation of standards and mutual recognition with jurisdictions with comparable standards can improve the contestability of assessment and approval processes and encourage regulatory agency efficiency. These improvements would reduce the cost recovery burden on those subject to regulation.

There may be circumstances in which Government wishes to retain a regulatory presence (for 'national sovereignty' or other reasons), when it would be more cost effective to pursue mutual recognition. Such circumstances may justify government subsidisation of the regulator. This would avoid penalising industry (via higher cost recovery charges) for a social choice that imposes more expensive regulation than is required to achieve a given level of safety.

Australian National Audit Office

The ANAO is a specialist Commonwealth agency that provides audit services (performance audits, financial statements audits and better practice guides) to Parliament, Commonwealth agencies and statutory bodies. *The Auditor-General Act 1997* regulates the powers and responsibilities of the Auditor-General and the ANAO.

ANAO performance audits can include cost recovery arrangements. The Australian Quarantine and Inspection Service's cost recovery systems for example, were the subject of an audit in 2000. However, performance audits are performed on an *ad hoc* basis and do not form a systematic review mechanism for cost recovery arrangements.

Output pricing reviews

The Department of Finance and Administration has initiated a program of output pricing reviews across Commonwealth departments and agencies (see chapter 3). These reviews are designed to assess 'prices' of outputs used in the outcomes/outputs accrual budgeting framework. Pricing reviews provide Ministers and the Expenditure Review Committee (a subcommittee of Cabinet) with information on which to base resourcing decisions. The outcome of the Expenditure Review Committee's consideration of a pricing review is a three year finance agreement with the reviewed agency.

Output pricing reviews promise to be valuable tools for assessing government funding decisions. Their scope could be broadened to incorporate the price of cost recovered outputs. Agencies such as the Australian Federal Police supported the idea of a 'pricing review' to be carried out to test the prices attached to cost recovered activities. (sub. DR146, p. 1).

The Department of Finance and Administration also supported this approach:

> Finance would be quite comfortable with pricing review methodology and approach also incorporating cost recovery, to see whether external parties who are paying prices on the basis of cost recovery are also getting value for money. (trans., p. 1177)

However, output pricing reviews have several limitations that constrain their application to cost recovery arrangements, including:

- many agencies with significant cost recovery activities have not yet been reviewed;
- reviews are expected to be conducted on a three year cycle, while users may have ongoing concerns with cost recovery arrangements;
- pricing reviews are conducted between the Department and the agency, with only limited opportunity for stakeholder involvement;
- pricing reviews are confidential Cabinet documents and lack transparency;
- under current guidelines it is unclear whether activities that are cost recovered will be subject to the same degree of scrutiny as applied to outputs purchased by Government; and
- reviews appear to have been conducted at a fairly broad level, while users often have specific concerns with individual cost recovery charges.

The Commission recognises that pricing reviews are a relatively recent innovation and still evolving. Some problems identified above can be addressed as the pricing review process is consolidated for example, by:

- publishing a review schedule identifying all agencies to be reviewed and their anticipated review date;
- making a clear statement (and consequential amendments to guidance notes) to ensure that pricing reviews also cover the pricing of cost recovered outputs;
- ensuring cost recovery outputs are defined sufficiently narrowly to allow meaningful review of agency efficiency; and
- establishing mechanisms to allow meaningful consultation with interested parties in the review of cost recovery outputs.

However, one major shortcoming is not easily addressed — that is, the confidential nature of the results of a price review makes them unsatisfactory vehicles for monitoring the efficiency of agencies that impose charges on members of the public.

Summary

Improving agency efficiency can reduce the burden on those paying cost recovery charges as well as on general taxpayers. The mechanisms discussed above can help offset the potential negative incentives for agency efficiency created by cost recovery. Many participants, including the Australian Chamber of Commerce and Industry (sub. 136, p. 2) and the Complementary Healthcare Council of Australia (sub. DR117, p. 5) supported these different approaches. The Plastics and Chemicals Industries Association stated that it:

> … is also pleased to see the Commission discussing the practical application of concepts such as benchmarking, third party competition and mutual recognition of overseas regulatory schemes as a means to improve efficiency in cost recovery practices. (sub. DR143, p. 2)

The Commission considers that existing mechanisms such as efficiency dividends, benchmarking, market testing and third party competition, harmonisation of standards and mutual recognition should be actively pursued to the extent that they are compatible with broader government and agency objectives. The Commission also considers that output pricing reviews could play a useful role in assessing the efficiency of agencies that recover costs. This role would be encouraged by clarifying that output pricing reviews include the pricing of cost recovered outputs, ensuring these outputs are defined sufficiently narrowly to allow a focused review, and establishing mechanisms to allow meaningful stakeholder consultation.

FINDING

Improving agency efficiency can reduce the cost burden on those subject to cost recovery and taxpayers alike. Mechanisms such as efficiency dividends, benchmarking, market testing and third party competition can help drive agency efficiency. Harmonisation of standards and mutual recognition can also encourage regulatory agency efficiency by improving the contestability of assessment and approval processes.

FINDING

The confidential nature of output pricing reviews limits the ability of stakeholders to promote agency efficiency.

However, these mechanisms alone are insufficient to ensure adequate attention to the efficiency of these agencies. The following section examines ways in which to improve the review of cost recovery arrangements.

8.4 Improving the review of cost recovery

As discussed in chapters 3 and 4, there is a lack of transparency and accountability in current cost recovery arrangements. It is difficult to establish the objectives, costing and revenue raising of many cost recovery arrangements. The absence of current cost recovery guidelines has led agencies to rely on outdated publications, *ad hoc* reviews and consultants' advice. This has contributed to inconsistency in many aspects of cost recovery within and across agencies and portfolios.

In chapter 7, the Commission makes a series of recommendations about when and how cost recovery should be applied. The Commission has also drafted Guidelines to assist policy makers and agencies to apply these recommendations (see chapter 9 and part 2). The next step is to develop a process for applying the Guidelines.

The Guidelines need to be applied in three circumstances:

- in the assessment of new cost recovery proposals;
- in the assessment of existing cost recovery arrangements; and
- in the periodic review of cost recovery arrangements.

The proposed reviews are not simple exercises and would involve significant effort and resources. Given the large number of cost recovery arrangements, it may be appropriate to restrict detailed reviews to significant arrangements, where the benefits of the review are likely to outweigh the associated costs. The amount of revenue raised may be a guide to the significance of a cost recovery arrangement,

but should not be the sole criterion. Some arrangements may raise small amounts of revenue but have significant effects. Similarly, a large number of small charges may collectively have a substantial impact. Stakeholder consultation should be an important guide to whether a cost recovery arrangement is substantial enough to warrant review. If a cost recovery arrangement is of lesser significance, both in terms of the amount recovered and impact on users, a less comprehensive approach might be warranted.

RECOMMENDATION 8.3

All existing, new and amended cost recovery arrangements of a significant nature should be assessed against the Guidelines recommended by this inquiry. All significant cost recovery arrangements should then be subject to periodic review, at least every ten years.

The Commission does not want to duplicate existing review processes. Two existing processes potentially could be applied to assess cost recovery arrangements: output pricing reviews and Regulation Impact Statements (RIS). As discussed in section 8.3, the Commission considers that the lack of transparency of output pricing reviews significantly limits their usefulness for reviewing cost recovery. The following section examines the potential application of a RIS to cost recovery.

Regulation Impact Statements

A RIS is a valuable tool for assessing new regulatory proposals that affect business. With minor enhancements, a RIS can perform much of the review role for cost recovery arrangements associated with regulations that fall within the RIS ambit.

These enhancements would clarify that cost recovery arrangements of regulatory agencies that affect business, or cost recovery arrangements that are established in regulation and affect business, are properly subject to a RIS. It should also be made clear that a RIS (1) requires policy makers to address the rationale for establishing cost recovery and (2) requires those responsible for implementation to address the impact of cost recovery on business, the agency and the broader community.

These enhancements could be achieved through a direction from the Treasurer to the Office of Regulation Review and incorporated in the next edition of its publication, *A Guide to Regulation*.

RECOMMENDATION 8.4

The Regulation Impact Statement process should be clarified to make it explicit that, where a regulation under review includes a significant cost recovery element, the Regulation Impact Statement should apply the Guidelines recommended by this inquiry.

Cost Recovery Impact Statements

Although an enhanced RIS process could adequately provide scrutiny of many cost recovery arrangements, a separate process is required for those arrangements that are still not covered. These include:

- reviews of existing cost recovery arrangements;
- cost recovery for regulations that affect individuals, not businesses;
- cost recovery introduced administratively by information agencies; and
- ongoing reviews of cost recovery arrangements without an associated review of regulation.

A separate Cost Recovery Impact Statement (CRIS) process is necessary to ensure these cost recovery arrangements are subject to scrutiny equivalent to that in a RIS process.

A fundamental difference between a RIS and a CRIS is that the scope of the RIS process goes beyond cost recovery to examine the need for regulation and all available options for achieving the objectives of the regulation. The focus of the CRIS process is on the rationale for, and suitability of, cost recovery arrangements, not on the rationale for the underlying activity. Government has instituted other governance arrangements to determine appropriate activities for these agencies (such as boards and consultative committees). It would be inappropriate for the CRIS process to 'second guess' the outcomes of these processes. However, the CRIS could examine whether decision making followed due processes (for example, whether board approval or Ministerial endorsement was received where required).

CRIS process issues

The Commission envisages a relatively formal process, similar to that of a RIS, whereby policy makers and relevant agencies produce a written report (the CRIS)

describing how the guidelines apply to their particular situation. The CRIS process is summarised in box 8.5.

Box 8.5 **Cost Recovery Impact Statements (CRIS) — the process**

A CRIS will normally consist of two stages.

Stage 1 Initial policy review

- Which of the agency's objectives are relevant to the activities being considered for cost recovery?
- Should cost recovery be introduced?
- What mechanisms, including consultation, should be used for ongoing monitoring of the efficiency and effectiveness of cost recovery arrangements?
- How long (not more than 10 years) before the cost recovery arrangements should be reviewed again?

The Stage 2 Implementation review (if cost recovery is appropriate)

- Who should pay cost recovery charges?
- Should cost recovery charges be imposed via fees or levies?
- What legal authority is necessary to impose the charges?
- Which issues should be addressed by any legislation?
- Which costs should be included in the charges?
- How should charges be structured?
- How should costs be calculated and allocated?

Together, the responses to the questions in stages 1 and 2 form a CRIS. The CRIS should be released for public scrutiny and should include:

- a signed declaration by the agency's chair, chief executive officer or chief financial officer that the CRIS meets the Guidelines;
- a copy of the independent review assessment;
- a description and justification of the level of consultation undertaken; and
- a summary of the views expressed by those consulted.

The Commission considers that transparency and independence are important elements of a CRIS and prefers some degree of independent scrutiny of a CRIS, similar to that applied by the Office of Regulation Review to a RIS. There are several options for providing this scrutiny. One option would be for the Department of Finance and Administration to assess all CRISs. However, this could introduce a conflict of interest between the Department's budgetary imperatives and the pursuit

of appropriate cost recovery policies. An alternative approach would be to direct an independent agency to assess CRISs, in the same way the Office of Regulation Review assesses RISs.

As with a RIS, a CRIS and the assessment report of the independent agency would be forwarded to the relevant decision maker to determine any action. The relevant decision maker will vary, depending on the nature of the decision; it may be Cabinet, the Expenditure Review Committee, the board of a statutory authority or the Minister of a portfolio.

If a cost recovery arrangement is of lesser significance, both in terms of the amount recovered and impact on users, a less comprehensive approach might be warranted, with a simplified CRIS. This may also apply to arrangements where policy issues have been previously settled, and only design and implementation questions remain.

RECOMMENDATION 8.5

A Cost Recovery Impact Statement process should be applied to all significant cost recovery arrangements not covered by a Regulation Impact Statement. These include:

- ***existing cost recovery arrangements;***
- ***new cost recovery proposals for regulations that affect individuals, not businesses;***
- ***new cost recovery proposals of information agencies; and***
- ***periodic reviews.***

RECOMMENDATION 8.6

An independent review body should be appointed to assess whether Cost Recovery Impact Statements adequately address the cost recovery Guidelines.

Once the decision has been made on a cost recovery arrangement, a CRIS and independent report should be made publicly available (subject to confidentiality requirements). They should be published on agency websites and summarised in agency annual reports. RISs are typically tabled in Parliament. CRISs should also be presented to Parliament through tabling or publication in Portfolio Budget Statements.

RECOMMENDATION 8.7

Agencies that cost recover should publish Cost Recovery Impact Statements and the assessment of the independent review body on their websites and include a summary in their Annual Reports. Cost Recovery Impact Statements should also be made available to Parliament through tabling or publication in Portfolio Budget Statements.

Implementation of the RIS and CRIS process is discussed further in chapter 9.

9 Implementation

This chapter provides a brief discussion of how the Commission views the implementation of its cost recovery Guidelines and their incorporation into existing processes. It suggests changes to the machinery of Government to allow for the implementation of the initial and periodic cost recovery review processes.

9.1 Introduction

Currently, no Government endorsed guidelines are available to Commonwealth agencies that have introduced — or are considering introducing — cost recovery. The terms of reference to this inquiry recognise this deficiency, asking the Commission to report on:

> … appropriate guidelines for:
>
> (i) where cost recovery arrangements should be applied;
>
> (ii) whether cost recovery should be full, partial or nil;
>
> (iii) ensuring that cost-recovered activities are necessary and are provided in the most cost-effective manner;
>
> (iv) the design and operation of cost recovery arrangements, including the treatment of small business;
>
> (v) the review of cost recovery arrangements; and
>
> (vi) where necessary, implementation strategies to improve current arrangements.

The evidence and analysis presented in this report confirm the need for guidelines. Little guidance is available to agencies faced with difficult and complex decisions on how, or even whether, to implement cost recovery. The Commission considers this absence of advice to be a major shortcoming, particularly given recent increases in the level of cost recovery and stakeholder concerns. The absence of guidelines has meant that approaches to cost recovery are often *ad hoc* and inconsistent among agencies. In many cases, cost recovery arrangements do not appear to be based on sound economic principles and administrative practices.

The Guidelines provided in part 2 of this report are a guide to assist policy departments and cost recovery agencies in identifying those activities for which cost recovery is appropriate. They address: the initial consideration of whether cost

recovery is consistent with the agency's policy objectives; the design of the charging arrangements and associated implementation issues; and mechanisms for the ongoing monitoring and periodic review of cost recovery arrangements.

To avoid duplication, the Commission has integrated the processes outlined in these cost recovery Guidelines with existing related processes. Where relevant, the cost recovery Guidelines refer to Commonwealth guidelines governing Regulation Impact Statements (RISs) and the application of competitive neutrality.

9.2 Implementing the guidelines

The Commission considers that the following steps are necessary for the smooth and timely implementation of the Guidelines. They require the active cooperation of Government, departments and agencies that cost recover (or propose to do so).

As an important first step, the Commission recommends that the Government adopt a formal cost recovery policy for regulatory and information agencies (see chapter 4). The policy should endorse the cost recovery Guidelines recommended by this inquiry. This step would prove valuable for agencies already confronting cost recovery issues.

As a second step, the Commission suggests that Government widely disseminate the Guidelines — to departments and agencies, and to industry and consumer representative organisations — together with appropriate advice on their implementation by agencies.

Third, the Commission recommends that Government resolve that all substantial existing cost recovery arrangements and substantial new proposals be reviewed using the Guidelines (see chapter 8).

The Commission also suggests that Government look to the ongoing development and refinement of the Guidelines, as experience in their application is gathered. The development of supporting technical and legal material — such as detailed costing, pricing and legislative advice to agencies that cost recover — would ensure cost recovery arrangements are robust and consistent across agencies. The Commission considers that the Department of Finance and Administration, subject to wide consultation with other agencies and interested parties, is best placed to undertake these tasks.

9.3 Assessment of cost recovery arrangements

An integral part of the Commission's Guidelines is the requirement that agencies and departments assess all substantial existing cost recovery arrangements against the Guidelines through a Cost Recovery Impact Statement (CRIS) process. The CRIS process would be similar to the RIS process applied to assess new regulatory proposals that affect business. Policy makers and relevant agencies would produce a written report (the CRIS) on how the Guidelines apply to their particular situation.

All proposals for substantial new cost recovery arrangements would also be assessed against the Guidelines through either an enhanced RIS or a CRIS (see chapter 8).

The Commission considers that transparency, accountability and independence are important elements of the assessment process, and recommends that an independent review body be appointed to assess whether CRISs adequately address the Guidelines, similar to the role undertaken by the Office of Regulation Review for RISs.

Independent assessment of the CRIS could be achieved in a number of ways. One approach would be assessment by the Department of Finance and Administration, which may allow for some broad administrative synergies. However, this approach would concentrate within the same department the responsibilities for conveying cost recovery 'best practice' to agencies and for evaluating its implementation. Further, there may be perceptions of a potential conflict with the department's pre-eminent role in the budgetary process.

Another approach is to appoint an independent reviewer. Experience with the RIS process has demonstrated the advantages of oversight by an independent agency or persons. An independent reviewer could be appointed on a case by case basis, or a specific agency could be appointed to review CRISs on a whole-of-government basis.

The Office of Regulation Review, currently in charge of assessing RISs, could be instructed by the Government to assume responsibility for the CRIS process. It would monitor the rigour with which agencies and departments follow the RIS and CRIS processes, and make a separate report to Parliament. This would present opportunities for economies of scale and scope in the review process. Further, experience gained from the RIS process would benefit the introduction of CRISs.

As with the RISs, following independent assessment, the CRIS and the assessment report of the independent agency would be forwarded to the relevant decision maker to determine the appropriate course of action. The relevant decision maker will

vary, depending on the nature of the decision; it may be Cabinet, the Expenditure Review Committee, the Minister of a portfolio or the board of a statutory authority.

9.4 Accountability and transparency

The Guidelines emphasise the need for cost recovery arrangements to be as transparent and accountable as possible. The Commission has made a number of recommendations to improve current reporting arrangements and to encourage Parliamentary and public overview of cost recovery.

Cost recovery revenues should be subject to the same Parliamentary and budgetary scrutiny as imposed on other revenues (see chapter 8). Cost recovery information should be made available in agencies' annual reports and, possibly, in Portfolio Budget Statements (see chapter 3). The Minister for Finance could ensure this scrutiny by issuing instructions to chief executive officers under the *Financial Management and Accountability Act 1997*.

Once a cost recovery arrangement has been decided, the CRIS (or RIS) and the assessment of the independent review body should be published on agency websites and summarised in agency annual reports (see chapter 8). RISs are typically tabled in Parliament. CRISs should also be made available to Parliament (through tabling or publication in Portfolio Budget Statements).

The desirable coverage and level of detail of this information may need to be developed over time. Input from the Joint Committee of Public Accounts and Audit and/or Senate estimates committees would be valuable in determining the appropriate level of reporting. The joint committee may also wish to invite the Australian National Audit Office to consider cost recovery arrangements closely as part of its annual financial audits and periodic performance reviews.

9.5 Review and monitoring

The Commission recommends the initial review of all existing and proposed cost recovery arrangements against the Guidelines, as well as ongoing monitoring and periodic reviews of cost recovery arrangements (see chapter 8).

The Commission considers that a systematic review of all substantial arrangements should be completed within five years. Given the numerous cost recovery arrangements in existence, the reviews will need to be scheduled over time. Criteria that could be used to schedule reviews include: agency size; the degree of compulsion attached to cost recovery charges; amounts that are cost recovered;

specific user requests for review; and the time since a major review of cost recovery issues was last undertaken.

Participants criticised the cost recovery arrangements of a number of agencies, and these agencies should be subject to early review (for example, the Australian Securities and Investments Commission, the ABS, and the Australian Geological Survey Organisation). Some participants specifically suggested the Therapeutic Goods Administration be subject to early review. The Complementary Healthcare Council of Australia, for example, stated:

> … any schedule of review developed by Government should place [Therapeutic Goods Administration] cost recovery arrangements as the first to be reviewed. (sub. DR155, p. 1)

Early review of the Therapeutic Goods Administration was also supported by the Australian Pharmaceutical Manufacturers Association:

> … our principal area of course is the Therapeutic Goods Administration and we would be pressing them to make sure they do [their review] sooner rather than later. (trans., p. 970)

The Commission also specifically recommends that the Australian Competition and Consumer Commission be a high priority for review (see chapter 6).

The scheduling of initial reviews should be the responsibility of the Department of Finance and Administration. The Joint Committee of Public Accounts and Audit and Senate estimates committees may also like to nominate cost recovery arrangements that warrant priority consideration.

RECOMMENDATION 9.1

All existing significant cost recovery arrangements should be reviewed against the Guidelines within five years. The Department of Finance and Administration should prepare a review schedule.

The review process should build on related reviews, such as Department of Finance and Administration output pricing reviews or Australian National Audit Office performance audits, as far as possible. As discussed in chapters 3 and 8, output pricing reviews do not appear to be an appropriate stand-alone vehicle for the initial review of cost recovery arrangements. However, it may be desirable to schedule cost recovery reviews in parallel with output pricing reviews, to take advantage of any synergies in the processes.

The Commission also recommends ongoing monitoring of cost recovery arrangements. At present, agencies' output pricing arrangements are subject to some Parliamentary oversight and to output pricing reviews. The Commission

recommends improving the capacity of consultative committees to become the main vehicle for the ongoing monitoring of cost recovery arrangements (see chapter 8). In addition, it suggests that existing processes could complement monitoring by consultative committees, although they would require some modification to allow adequate scrutiny of cost recovery between formal reviews.

The Commission considers that responsibility for assessing the suitability of existing monitoring and consultation mechanisms should form part of the initial reviews of existing cost recovery arrangements. Based on this assessment and the independent assessment of the CRIS, the appropriate decision maker should develop proposals for new or improved forms of monitoring and consultation.

The Commission also recommends that all cost recovery arrangements should be subject to a follow-up review at least every 10 years. The Department of Finance and Administration should be responsible for ensuring these periodic reviews are undertaken as appropriate.

The process for implementing the Guidelines is summarised in table 9.1.

Table 9.1 **Summary of the process for implementing the Guidelines**

Step no.	*Measure to be implemented*[a]	*Recommendation no.*
1	Commonwealth Government to adopt a formal cost recovery policy for regulatory and information agencies, endorsing Commission Guidelines	4.1
2	Commonwealth Government to disseminate the Guidelines widely — to departments and agencies, industry and consumer representative organisations — and to provide appropriate guidance on their implementation	
3	Commonwealth Government to announce that all existing significant arrangements be reviewed within five years using the Guidelines	9.1
4	Commonwealth Government to announce that all proposals for new significant cost recovery arrangements be reviewed using the Guidelines	8.3
5	Department of Finance and Administration to publish a schedule of initial reviews for existing cost recovery arrangements, based on criteria for priority reviews	9.1
6	Department of Finance and Administration or similar agency to develop supporting technical and legal material for the Guidelines	
7	Department of Finance and Administration to identify cost recovery revenue separately in budget and Consolidated Financial Statements	3.2
8	Agencies to identify cost recovery revenue separately in annual reports and Portfolio Budget Statements	3.2
9	Commonwealth Government to appoint an independent review body to assess Cost Recovery Impact Statements (CRISs).	8.6
10	Commonwealth Government to instruct the Office of Regulation Review to extend the current Regulation Impact Statement (RIS) process, using the Guidelines, to address the cost recovery element of any regulatory proposal	8.4
11	Following initial reviews, Commonwealth Government to consider new or improved consultation mechanisms for cost recovery agencies according to recommended criteria	8.2
12	Agencies to publish CRISs or RISs, accompanied by independent review assessments.	8.7

a Column presents a summary of relevant recommendations and suggestions. Refer to previous chapters for the full text of recommendations and associated discussion.