COST RECOVERY

ACCI SUBMISSION
TO THE
PRODUCTIVITY COMMISSION

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The Australian Chamber of Commerce and Industry (ACCI) is the peak council of Australian business associations. ACCI's members are employer organisations in all States and Territories and all major sectors of Australian industry.

Through our membership, ACCI represents over 350,000 businesses nation-wide, including the top 100 companies, over 55,000 enterprises employing between 20-100 people, and over 280,000 enterprises employing less than 20 people. That makes ACCI the largest and most representative business organisation in Australia.

Membership of ACCI comprises State and Territory Chambers of Commerce and national employer and industry associations. Each ACCI member is a representative body for small employers or sole traders, as well as medium and large businesses.

1. Background

ACCI welcomes the review by the Productivity Commission (PC) on the cost recovery arrangements of Commonwealth Government regulatory, administrative and information agencies. We expect the inquiry will lead to a revision of cost recovery arrangements currently in place and the development of principles and guidelines for the future application of cost recovery by the Commonwealth Government.

ACCI strongly supports the review. We wrote to the Government in 1998 and again in 1999 asking for a reference to be made to the Productivity Commission on cost recovery in regulatory agencies. A call for an inquiry also featured in our 2000 New Year requests to Government.

The focus of our submission is cost recovery from a business perspective rather than a consumer perspective. Although, in general, the same principles are applicable to charging for government services, whether the customer/beneficiary is a business or a citizen.

The outline of our submission is as follows:

- Definition of and rationale for cost recovery
- Design, implementation and review of cost recovery in 4 regulatory agencies
- Determining 'Public good'
- Cost recovery in information agencies

- Cost recovery in administration agencies
- Content of guidelines

Cost recovery has grown in an ad hoc fashion across government agencies. The time is long overdue to address cost recovery from a systematic public policy perspective. It is unfortunate that the 1991 and 1996 guidelines on costing of government activities produced by the Department of Finance and Administration were limited in application and coverage, and were largely ignored. The development of sound principles to underpin guidelines for both future cost recovery approaches and existing cost recovery regimes will fill a vacuum in public policy on regulation and administration.

2. Definition of and Rationale for Cost Recovery

Cost recovery is the recovery by governments of some or all of the costs of particular government services.

While the notion of cost recovery is simple, the rationale for cost recovery is complex and not well understood by those who impose it and those who are affected by it. Therein lies the dilemma in the application of cost recovery to regulatory, administrative and information activities.

The economic rationale for levying user charges is to improve the efficiency with which departments and agencies make use of limited resources. To the extent that user charges finance activities previously funded through taxes, those limited tax dollars should be reallocated to activities that benefit the taxpayer or to reduce debt.

Cost recovery through fees and charges should only be initiated where there is a legitimate and necessary role for the Government, and one that cannot be provided adequately by the private sector.

When introducing a cost recovery regime, agencies must also address the question of whether there are better or cheaper ways to deliver the service without compromising objectives such as health and safety.

A 100 per cent cost recovery regime is only appropriate where individuals or a section of the community can be identified as the sole beneficiaries of the Government services. We cannot identify any regulatory function that solely benefits the business community. Cost recovery through fees and charges should not be used simply as a means of generating revenue to meet the funding requirements of a department or agency.

User charges differ from taxes in that they should be linked to specific benefits that are over and above those enjoyed by the general taxpayer and there should be a relationship between the fee charged and the cost of the good or service to the individual.

In summary, the objectives of any Cost Recovery approach should be to:

- promote more efficient use of government services;
- introduce more business-like and client oriented practices in the supply of government services;
- ensure that the costs of services which *primarily benefit the general public* are financed through budget allocations;
- ensure that the cost of services *which primarily benefit specific subsets of the population* are recovered from those who benefit from or cause such services; and
- ensure consultation between agencies and their clients before introducing or amending user charges, and on a continuing basis thereafter.

3. Regulatory Agencies and Public Good

One of the reasons that ACCI pursued the issue of cost recovery with the Government was concerns raised by our Members with regard to cost recovery by product assessment and registration authorities.

In Australia there are a number of Commonwealth Government regulatory agencies that carry the responsibility of protecting consumers and the environment from potentially dangerous products including:

1. The National Industrial Chemicals Notification and Assessment Scheme (NICNAS)
2. The National Registration Authority for Agricultural and Veterinary Chemicals (NRA)
3. Therapeutic Goods Administration (TGA)
4. Australian and New Zealand Food Authority (ANZFA)
5. Australian Quarantine Inspection Service (AQIS).

We will use these agencies to make our points about cost recovery and regulatory agencies.

Attachment 1 provides an outline of activities and authority of agencies 1-4.

***National Industrial Chemicals Notification and Assessment Scheme* (NICNAS)** was established in 1990 to aid in the protection of people at work, the public and the environment from harmful effects of industrial chemicals by assessing the risks associated with these chemicals. Before NICNAS was established there was no system for independent review of industrial chemicals in Australia. NICNAS was established by the *Industrial Chemicals (Notification and Assessment) Act 1989.*

Consistent with Commonwealth Government policy and with other Commonwealth assessment schemes, NICNAS moved to full cost recovery in 1997. With the move to full cost recovery, an Industry Government Consultative Committee was established to oversee the effective and efficient utilisation of resources by the Scheme, as well as providing advice on the development and implementation of a comprehensive compliance program.

The ***National Registration Scheme for Agricultural and Veterinary Chemicals*** is a single assessment and regulation system for agricultural and veterinary chemicals. The Scheme is administered by the National Registration Authority for Agricultural and Veterinary Chemicals (NRA). Under the National Registration Scheme, all agricultural and veterinary chemicals have to be registered by the NRA before they can be manufactured, supplied or sold in Australia. The registration process is a rigorous one that involves an evaluation of each chemical's safety to humans and the environment, its safety to non-target plants and animals, its efficacy and impact on trade.

The ***Therapeutic Goods Administration*** (TGA) is a division of the Federal Department of Health and Aged Care and is responsible for administering the provisions of the *Therapeutic Goods Act 1989*. The TGA carries out a range of assessment and monitoring activities to ensure therapeutic goods available in Australia are of an acceptable standard. At the same time, the TGA aims to ensure that the Australian community has access, within a reasonable time, to advances in therapeutics.

Essentially, any product for which therapeutic claims are made must be entered in the Australian Register of Therapeutic Goods (ARTG) before the product can be supplied in Australia. The ARTG is a computer database of information about therapeutic goods for human use approved for supply in, or exported from, Australia.

The ***Australian New Zealand Food Authority*** (ANZFA) is a Commonwealth statutory authority established under the *Australian*

New Zealand Food Authority Act 1991 (ANZFA Act). In cooperation with the Commonwealth, State and Territory Governments and the New Zealand Government, ANZFA develops uniform food standards and other food regulatory measures for Australia and New Zealand.

The ***Australian Quarantine and Inspection Service*** (AQIS) is an operating group within the Department of Agriculture, Fisheries and Forestry charged with protecting Australia from exotic pests and diseases while helping the international movement of people and providing export certification for agricultural produce and other commodities.

AQIS is responsible for the administration of several Acts in concert with their related legislation including the *Quarantine Act 1908 (Cwlth); Export Control Act 1982;* and *Imported Food Control Act 1982*.

AQIS's goal is to work with its stakeholders to improve market access and to protect Australia's animal and plant health systems.

AQIS provides inspection and certification services to clients from a broad commercial and private base, through programs delivered through locations across Australia and overseas. AQIS's services impact on many industry groups and members of the community, through a number of service delivery points and a variety of systems.

AQIS provides quarantine inspection service for the arrival on international passengers, cargo, mail, animals and plants into Australia and inspection certification for a range of animal and plant products exported from Australia

Although all four bodies provide different services to the industries they regulate, there are two significant similarities. Primarily, the four bodies provide a net public benefit to the Australian community and secondly they have 100 per cent cost recovery regimes for all or part of the services they provide to industry.

Their primary purpose is to protect consumers and the environment from potentially dangerous products. This protection is provided by assessing, monitoring and/or registering new products or substances into the Australian market

An indirect benefit of these agencies is that, in providing protection to consumers, they promote consumer confidence that in turn acts to stimulate commerce.

In addition to these generic benefits of Government regulatory activities, the NRA, NICNAS and TGA also provide a benefit to the businesses that register products under these schemes.

A business that is successful in registering a product under these schemes is provided an exclusive licence for the sale of that product in Australia for a finite period. This exclusive licence provides the registering business with a monopoly on the sale of that particular product. However, this does not constitute a true monopoly position, as the licence does not prevent the sale of close substitutes provided they do not infringe upon the intellectual property of the registered product.

Examples at **Attachment 2** show how NICNAS's approach affects business, particularly small business. The approach has inhibited the take up of new technology, especially more environmentally friendly technologies; reduced Australian manufacturing capability; increased costs because of a lack of acceptance of EU and US assessments; and impacted Australian firms' competitiveness both domestically and internationally.

The major concern about AQIS is that the charges imposed are excessive for the actual services provided.

AQIS imposes three basic types of fees, all of which have to be considered by exporters: an establishment service charge, for the registration of an export establishment; a fee for service charge, for specific services and audits; and, quantity charges, for some products based on the amount of product exported.

The Chamber movement hears regularly from traders, both exporters and importers, of anomalies and inconsistencies, and the high level of fees imposed for some services on industry sectors and products.

One notable inconsistency is the cross-subsidisation of establishments. A case in point involves the travelling time of inspectors visiting regional/rural establishments, where 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.

A related issue is the pass-on of costs relating to the varying levels of experience of inspectors, with a more junior less experienced inspector, understandably, taking longer to do an inspection than his/her more senior counterpart.

The Chamber has been informed such differences in efficiency are reflected in higher charges (with differentials of up to $200 per inspection), which diminishes the commercial viability of the trade concerned.

Similarly, we have been advised of substantial differences in the charging and service levels between major capital cities for what are ostensibly similar inspections. One member reported a specified type of inspection for the export of fresh produce can cost $100 in Melbourne, but $350 in Adelaide.

ACCI is represented on the AQIS Industry Cargo Consultative Committee and will continue to raise these issues in that forum.

4. The Economics of Public Good

A public good is a good or service which is available to be consumed by everyone and from which no one can be excluded. The four agencies outlined above satisfy these two criteria. All Australians benefit from the existence of these agencies and it is impossible to exclude any individual from benefiting from their activities.

As with most public goods, it is difficult to place a value on the services provided by these organisations. For example, it is basically impossible to place a value on the protection of the environment from potentially dangerous chemicals, or individuals from toxic food additives.

Despite this, the economic theory of public goods must underpin any cost recovery approach. This point is recognised by the Office of Regulation Review in their publication *A Guide to Regulation* which states that to determine "… whether regulation meets the dual goals of 'effectiveness' and 'efficiency' requires a structured cost-benefit analysis approach to policy development."

The following is a cost/benefit analysis of the funding arrangements and activities of these four regulatory agencies.

The Total Cost and Benefit of Public Goods

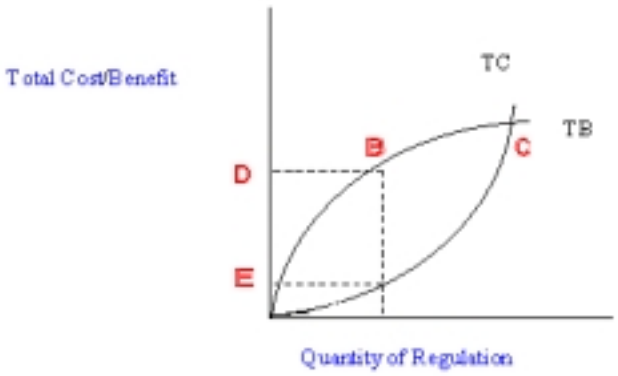
Total benefit is the total dollar value a person or community places on a given level of provision of a public good. Similarly, total cost is the total dollar cost a person or community places on a given level of provision of a public good.

Total cost, as used in this context, not only refers to the monetary cost of funding these organisations but also the additional costs these organisations may place on the community through restricting competition and innovation. That is, the total cost includes welfare losses or dead weight losses associated with and caused by the activities and funding arrangements of these bodies.

The value to a community of these regulatory bodies accrues when the total benefit of the provision of their activities exceeds the total cost of their services.

The graph below shows a hypothetical total cost and total benefit curve for the provision of Government regulatory services. Total benefit and cost is measured on the Y-axis and the quantity of regulatory activity is measured on the X-axis.

Graph #1
Total Cost and Benefit Curve for Government Regulatory Agencies



No empirical studies have been conducted to determine the exact gradient of a total cost or benefit curve for Commonwealth Government regulatory enterprises. Intuitively however, it is reasonable to expect that the slope of a typical total cost and benefit curve would appear similar to the total cost and benefits curves in Graph #1 above.

At the origin, there is zero expenditure on these Government regulatory agencies and zero public benefit. From this point, as the provision of the services increase, so too does the total benefit to the community from the agencies activities. Moreover, as regulatory structures are put in place, the community begins to benefit from the protection of health, safety and the environment.

The marginal benefit to the community from the provision of the first unit of regulation is relatively large. This is because the community places a greater value on the first unit of regulation than they do on later units.

At some point however, the law of diminishing returns sets in and the marginal benefit from an increase in the level of regulation decreases. That is, at some point consumers feel relatively satisfied in the level of protection they are receiving from these regulatory bodies and an increase in the provision of regulation will not increase public benefit by as much as the previous increase in regulation.

Similarly the gradient of the total cost curve can be estimated intuitively. The total cost curve initiates from the origin and as the level of regulatory service is increased, the cost of providing these services also increases and at an increasing rate. That is, the cost to provide the first unit of protection to consumers is less than latter units of protection. This is because the higher the level of consumer protection these agencies provide, the higher the marginal cost of each additional increase in protection.

Given these intuitive estimations of the total cost and benefits curves, it is therefore reasonable to expect that at some point, the total cost of providing a higher level of protection will be equal to the total benefit to the community of that protection. The point on the Graph # 1 where total benefit to the community equals total cost of these agencies at is point C.

This outcome does however make one assumption, that is, at some point the total benefit of these agencies exceeds the total cost. There is perhaps merit in the argument that the costs of these organisations always exceed the benefits however we assume that there is a benefit in the existence of these agencies.

As already stated the community benefits from these regulatory services at any point where total benefit exceeds total cost. However, there is a point at which community benefit is maximised.

The optimal provision of regulatory services occurs where the net benefit to the community is maximised. Net benefit is calculated as the difference between total cost and total benefit curves. Net benefit to the community is therefore maximised where there is the greatest difference (vertical distance) between the total cost and benefits curve point C. From this point, if regulatory services are either increased or decreased the net benefit to the community is decreased.

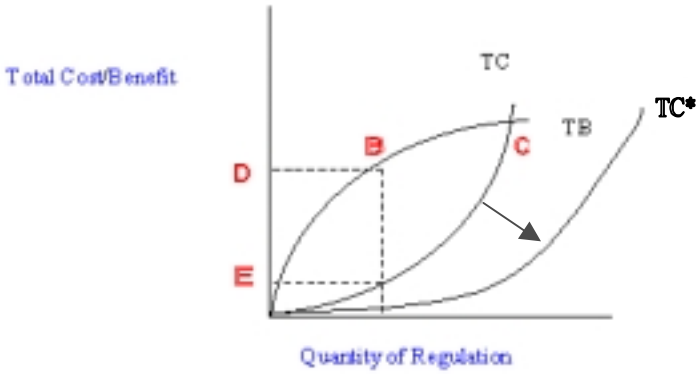
Although it is possible to provide a higher level of benefit to the community by increasing the provision of regulatory services, this will also result in a larger increase in total cost. Therefore, the net benefit to the community will decrease.

As the quantity of regulation increases the net benefit to the community decreases until total benefit equals total cost at point C. At this point the net public benefit to the community from the regulatory agency is equal to the net public benefit at the origin. That is, the public is indifferent between being at the origin with no consumer protection and at point C with a very high and expensive level of protection.

What is important to note from this graph is that irrespective of where Australia is positioned on the Total Cost and Total Benefit graph, there would be an increase in net benefit to the community from these regulatory agencies if the total cost curve could be shifted outwards. That is, by improving the efficiency of a regulatory agency it is possible to provide the same total benefit to the community but at a lower total cost. In effect this shifts the total cost curve down (or out), increasing the net benefit to the community of the regulatory body, irrespective of where net benefits are maximised.

Graph #2

Total Cost and Benefits Curves for Government Regulatory Agencies including an improvement in Efficiency



Graph #2 above shows diagrammatically this improvement in the efficiency of these regulatory agencies, which can be achieved via either improvements to cost effectiveness or a more efficient method of funding than full cost recovery. The Total Cost curve has shifted outwards and as a result, if the level of regulatory services was to remain unchanged for example, at point B, then the net public benefit (the difference between total cost and total benefit) will increase. That is the community receives the same level of public benefit but at a lower cost.

The method of funding of these agencies is critical to the level of public benefit provided by these organisations. A less distortionary method of funding other than full cost recovery would increase the total benefit to the community from these agencies without diminishing their effectiveness at providing consumer and environmental protection.

5. Cost Recovery in Regulatory Agencies - Impacts

The method of funding Government regulatory agencies is crucial to their effectiveness and efficiency. Methods of funding can vary from full cost recovery through user fees and charges to funding from the community through taxes.

From 1997 to the present, in line with a change in Commonwealth Government policy, the four case study agencies moved to full cost

recovery. This meant that they were required to recover 100 per cent of their operating costs from the businesses they regulate.

The effect of this policy has been to increase the total cost to the community of operating these agencies. Additional costs due to reduced innovation, competition and international competitiveness have increased the cost of these agencies to the community as well as to business. Drawing from the economic analysis of public good, this policy of full cost recovery has had the effect of shifting the total cost curve upwards and therefore reduced the net public benefit of these agencies.

Impact on Innovation

Innovation is critical to business around the world and is the basis for competition. It is the major determinant of enhanced productivity and competitive advantage at both the firm and nation level.

The innovation process involves significant sunk costs which can only be recovered once the product reaches the market. There are many factors that contribute to how much research, development and commercialisation a business undertakes. In the four areas discussed, the policy of full cost recovery further adds to the cost of developing a new product without providing any value-add to the product. This reduces the incentive for business to conduct R&D.

Impact on Competition

The costs of registration, both in time and assessment processes, can be a barrier to new overseas products being registered for use in Australia. The move to full cost recovery has increased the costs to business of introducing a new product into the Australian market.

Agencies considering the introduction of user charges need to ensure that they are not structured in such a way as to advantage or disadvantage particular groups. There are many situations where a particular fee structure could advantage a large user to the disadvantage of a smaller competitor.

The relatively small size of the Australian market means that there is not a significant return for businesses to market their product in Australia. The cost of registrations reduces the potential returns to investors in Australia.

Impact on the Environment

The four examples of regulatory agencies (with the exception of the TGA) aim to protect the environment. The move to full cost recovery has seen an ironic situation develop where new, more environmentally friendly products are being restricted from entering Australia because of the cost recovery arrangements of these agencies.

The worldwide demand for more environmentally friendly products has seen the development of environmental technologies to improve and replace existing products. Although these new products are more environmentally friendly than those they seek to replace, they are still required to undergo assessment through schemes such as NICNAS.

In some circumstances, the additional costs from full cost recovery has seen business decide not to apply to register more environmentally friendly chemicals for use in Australia. The costs of assessment prohibit the import of these products given the relatively small Australian market. As a consequence of full cost recovery, these regulatory agencies which were in part established to protect the environment, are in fact delaying the introduction of products which will potentially lessen the impact on the environment.

Impact on the Economy

The negative impacts of full cost recovery are not isolated to businesses that register products under these schemes. The combination of the reduced incentive to be innovative, reduced competition and restricted access to new technologies impacts upon the economy as a whole.

For example, chemicals used in plastics are required to be registered under NICNAS. The additional costs of assessment under full cost recovery not only restrict the competitiveness of Australia's chemicals industries but also add to the costs of production of businesses that use plastics in either manufacturing or packaging. This reduces the competitiveness of Australian businesses internationally, which in turn effects employment and economic growth.

The registration process with full cost recovery can result in components to domestic manufacture not being available but finished goods including those components entering the market without the same constraints.

Capture

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. The involvement of industry in the activities of these regulatory agencies benefits the community through improved economic efficiency.

However, 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. Since the introduction of full cost recovery in Australia there has been no evidence of 'capture' of regulatory activities, although consumer organisations have claimed that, for example, ANZFA has been captured by industry interests. Ironically, elements of the food industry, claim that ANZFA has too much of an emphasis on consumer interests to the detriment of the food manufacturing industry.

Utilisation of Expenditure

Another issue that business has repeatedly raised in respect of many regulatory agencies is the question of how the revenue raised is spent.

There is a tendency within the regulatory agencies, that once the money is collected from business, is does not matter how or on what the money is spent. The NRA has addressed this problem in part by having two industry board members on the monitoring audit committee. This means that there is greater rigour in ensuring that the fees collected are actually being spent on the provision of the service for which they were intended.

As a general principle there should be more business involvement in the management of the expenditure of the regulatory authorities.

The relationship between the fees collected and the operating costs of the agency should be closely examined. Industry fees should not fund total operating costs not generate a surplus. For instance, fee and levy revenue in the financial sector and for corporations far exceeds 100% of the cost of regulation. This is most pronounced in the case of the Australian Securities and Investments Commission (ASIC), while the Australian Prudential Regulation Authority (APRA) also raises more revenue than its own costs.

Much, if not all, financial services and corporations regulation is a pure public good, and does not create direct benefits for financial services industry or for individual corporations. Industry supports the public policy objectives of this regulation, but as a public good, it should be funded by the whole community.

In the 1998-99 financial year:

- ASIC took in fee and charge revenues of $339m while operating costs were $145.5m; and
- APRA took in fee and levy revenues of $62.8m while operating costs were $42.7m.

APRA does pass on some revenue to the Australian Taxation Office (ATO), and to ASIC, in respect of activities transferred to those agencies.

The corporations law scheme under which ASIC fees are collected involves the payment of fees from the Commonwealth to the States in respect of foregone state revenues. The scheme accumulated a deficit of some $217 million during 1991-96. Revenues went into an annual surplus in 1996-97 and Treasury forecasts that the accumulated deficit will be eliminated in 2000-01.

Consequently, there does not appear to be any convincing revenue argument to continue ASIC fees at the current levels, even on a basis of 100% cost recovery. A surplus is difficult to justify on the basis of cost recovery or public policy principles.

There are also concerns about the scrutiny of expenditure in the budget process for an agency that raises all its operating costs from business. The level of scrutiny in the normal budgetary process, means agencies have to bid and justify for allocation of funds. Where an agency is self-funding, there is not the same rigour or review.

A related issue is the setting of fees. For authorisation under the *Trade Practices Act*, a fee of $15,000 applies whether the time taken by the Australian Competition and Consumer Commission 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.

Potential Benefits of Full Cost Recovery

Given the costs associated with cost recovery, it is important to also consider the potential benefits of full cost recovery.

The greatest benefit from full cost recovery is efficiency improvements. Increased involvement from industry in the activities of these organisations can result in greater efficiency.

With the issue of 'capture' aside, these potential efficiency gains should not be dependent upon the introduction of full cost recovery. The involvement of industry in the activities of regulatory agencies should occur irrespective of the level of cost recovery as a component of regulatory best practice.

The only *bona fide* benefit from increasing or introducing cost recovery arrangements occurs when a Government department or agency introduces user charges for providing a good or service which benefits only an individual or a section of the community, rather than the community as a whole. The introduction of user charges in this situation frees up resources for other services, which can benefit the entire community.

But this has not been the rationale for the introduction of cost recovery in Government regulatory agencies as outlined above.

The four agencies aim to provide a public benefit to the community as a whole and not to specific individuals or sections of the community.

It is clear that the beneficiary of the activities of these regulatory bodies is the community as a whole. For instance, it is the community that receives the benefit of a safe food supply and chemicals. Given the public good nature of these Government regulatory agencies, if the "User Pays" principle of economic pricing is applied the community as a whole would be charged for the services of these regulatory bodies.

There is some merit in the argument that irrespective of who pays for the cost of these regulatory bodies that the cost, in the end, is borne by consumers. However, this view fails to take into consideration the additional costs that the community bears such as reduced innovation and competition.

International Comparisons for Regulatory Agencies

Cost recovery arrangements are not exclusive to Australia. But, the application of fees and charges for the assessment and registration of new products is not standard in other OECD countries. In fact 100% cost recovery for the provision of product or substance assessment and/or registration appears unique to Australia and New Zealand. Some examples include:

The New Zealand Ministry for Agriculture and Forestry assesses new animal products under the *Animal Product Act 1999* on a full cost recovery basis. The Act regulates the production and processing of animal material and products with the purpose of protecting human and animal health and facilitating overseas market access.

The Animal Health Risk Assessment Unit of the Canadian Food Inspection Agency conducts risk assessment of new agricultural and veterinary products. Currently, there are no fees or charges applied to Canadian companies seeking assessments of new products as these costs are borne directly by the Government. Foreign firms, however face full cost recovery. These funding arrangements appear unique and raise concerns about compliance with World Trade Organisation rules.

In Europe, the majority of product assessments and registrations occur at a national level and do not involve user fees or charges. Efforts are being made to establish a mutual recognition program within the European Union as a method of streamlining regulation.

The operating costs for the United States Food and Drug Administration, which has responsibility for ensuring the safety and effectiveness of cosmetics, food, medicines and animal health products, is approximately $US1.3b per year. There is no cost recovery.

Cost Effectiveness of Government Regulatory Agencies

There are three underlying principles to which Commonwealth regulatory agencies should adhere. These are transparency, accountability and efficiency.

For public agencies, the need for transparency is not only to ensure efficiency of operations but also to ensure that interested or affected parties are not able to compromise or 'capture' the interests of the agency. Accountability, means that these agencies act in the interests of all stakeholders, including business and the community.

The third criteria of efficiency relates to both the efficient funding of these agencies and to the cost effectiveness of their expenditure.

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.

One factor which stands out in the comparison of these four regulatory agencies is their principal aim or mission statement. Mission statements are recognised by some as being beneficial to enhancing and guiding performance as well as assisting in communicating corporate image. Commonwealth Government regulatory agencies do not adequately use their mission statement to reflect the interest of all stakeholders in their operations.

None of the four agencies outlined issue a mission statement *per se*, however the following excerpts contained in publications from these agencies frequently appear as *pseudo* mission statements:

> ***NICNAS:*** *To ensure the protection of the environment and human health and safety from industrial chemicals.*
>
> ***ANZFA:*** *To ensure a safe and nutritious food supply.*
>
> ***NRA:*** *To protect the health and safety of people, animals and the environment.*
>
> ***TGA:*** *To ensure the quality, safety and efficacy of therapeutic goods in Australia and at the same time ensure that the Australian community has access, within a reasonable time to therapeutic advances.*
>
> ***AQIS****: To work with our stakeholders to improve market access and to protect our animal and plant health systems.*

It is worth noting that these five statements, with the exception of AQIS and the TGA, only take into consideration the outcome these agencies wish to achieve without incorporating any aim about the process and its impact.

Conversely, the US FDA states its purpose as:

> *…ensuring the highest level of safety for marketed products* (postmarket), *and ensuring timely availability of safe and effective new products that benefit the public* (premarket) – *which will allow our nation to continue as the world leader in new product innovation and development.*

Not only does the US FDA have a clear mission statement but it also recognises that the organisation has a responsibility beyond the consumer or environmental protection to ensure a competitive economy.

Recognising the potential impacts of regulation in the mission statement of an organisation could be a significant step toward improving the cost effectiveness of these agencies. This in turn would benefit the Australian economy and community particularly with a cost recovery approach.

Regulation Reform and Self-regulation

Any consideration of cost recovery in regulatory agencies must also look at the key principles of regulation reform and self regulation.

ACCI has been a strong proponent of regulatory reform to reduce the compliance burden on business, particularly small business. One element of the regulatory reform process adopted by the Government in 1997 was the introduction of the Regulatory Impact Statements (RISs).

RISs have been introduced at the Commonwealth level, consistent with OECD Guidelines, to ensure that options to address a perceived policy problem are canvassed in a systematic, objective and transparent manner with options ranked according to their net social benefits. A RIS should set out:

- The problem or issues which give rise to the need for action;
- The desired objective(s)
- The options (regulatory and/or non-regulatory) that may constitute viable means for achieving the desired objective(s)
- An assessment of the impact (costs and benefits) on consumers, business, government and the community of each option
- A consultation statement
- A recommended option; and
- A strategy to implement and review the preferred option.

Cost recovery is an important element of this cost/benefit analysis. The optimal use of Regulation Impact Statements can contribute immensely to an effective and efficient regulatory system framework. However, it is clear that the use of RISs has not been as widespread or thorough as intended.

A RIS must clearly indicate the costs to business of not only complying with the regulation (which is often higher than necessary due to the inflexibility of administration), but the costs to business in terms of industry funding the regulation, lost opportunities, reduced incentives and loss of competitiveness. The RIS should clearly justify why the proposed regulation is necessary and why the outcome cannot be achieved by other methods.

The RIS process must precede, rather than follow, the consultation process so that the analysis used in balancing costs and benefits can be adequately assessed by stakeholders. In addition, it appears as if on many occasions, a RIS is not undertaken until after the decision has been made by government to introduce a new law. Reporting on an agency by agency basis of compliance with meeting RIS requirements is essential to ensure that the regulation making culture is improved.

The effective use of RISs must be incorporated into a broader commitment to regulation that encompasses transparency, adequate consultation and responsiveness to the needs of the private sector as well as the community.

An example of where the RIS process on cost recovery has been inadequate is the Regulatory Impact Statement tabled with the *Gene Technology Bill* in June 2000. It stated that

> *…it is not possible to fully cost the regulatory system until the Bill is passed and the regulations developed; and that in the meantime, the Interim Office of the Gene Technology Regulator, would commission an analysis of the costs, which will be delivered in September 2000.'*

The report on cost recovery by KPMG Consulting was released in late October.

The report proposes four options for a sustainable cost recovery approach to meet the $7.8M per year operating costs of the Office of the Gene Technology Regulator. Sensibly, KPMG have adopted key points made by ACCI in our initial submission on the Bill, namely:

- an inappropriate cost recovery regime could lead to R&D in gene technology being undertaken overseas;
- small businesses dealing in gene technology are unlikely to have commercial production, for some time, so significant fees would be unsustainable; and
- most existing R&D work in gene technology is undertaken by public institutions.

KPMG concludes that there is limited industry income to fund any fees and charges with any degree of equity. Nevertheless, they propose four options:

- Option 1: Full: Direct fees for applications cost 63%)
  Direct fees for monitoring (37%)

- Option 2: 75%: Direct fees for applications (36%)
  Direct fees for monitoring (21%)
  Levy (18%)
  Government assistance (25%)

- Option 3: 50%: Direct fees for applications (21%)
  Direct fees for monitoring (11%)
  Levy (18%)
  Government assistance (50%)

- Option 4: 25%: Direct fees for applications (4%)
  Direct fees for monitoring (3%)
  Levy (18%)
  Government assistance (75%)

There are significant issues to resolve with any of these options. In particular, the nature of the levy and how "public good" is factored into the approach.

The proposed levy has three rates:

Research and Universities - $4,000
Small companies - $20,000
Large Companies - $200,000.

This would be unacceptable to business. Such a levy, as well as business paying for application and monitoring costs, would be a disincentive to gene technology research being undertaken in Australia. This is also completely at odds with the Government's $18M biotechnology strategy.

Such an approach also fails to make a judgement about who determines the 'appropriate cost' of administering the regulatory regime, and who should bear the start up costs.

The Commission should note that the Senate Community Affairs Reference Committee report into the Gene Technology Bill 2000 of 1 November 2000, has recommended that further discussion, and proposals (including the KPMG Report) relating to cost recovery and the operation of the Office of the Gene Technology Regulator (OGTR), be deferred until after the Productivity Commission report and its recommendations are available. The Committee has also recommended that until such time, the Government fully fund the operation of the OGTR.

6. Administration Agencies

In the category of administration agencies, Members expressed concern about the Australian Customs Service (ACS) and cost recovery for refunds. Changes to the existing cost recovery arrangements will occur when the Cargo Management Re-engineering Structure comes into place in 2001.

The decision to introduce cost recovery was made by the Government as part of a government-wide push to reduce the budget deficit. The legislation to enable cost recovery came into effect on 1 April 1997. Specifically, the Government decided that all import processing activity by Customs should be the subject of cost recovery charges.

It is useful to outline the process that ACS has undertaken in the Cargo Management Re-Engineering project and how it has derived new fees. This section relies heavily on material provided by ACS. There was consultation with industry on the pricing structure change under Cargo Management Re-Engineering.

In September 1999, ACS commenced an industry consultation process on determining the most acceptable pricing structure for import processing services under the forthcoming Cargo Management Re-Engineering framework.

Based on industry comment, two pricing structure options were presented by ACS for further consideration. The ACS has adopted the pricing structure option that gained the most support from industry.

In September 1999, an initial Cost Recovery Discussion Paper was circulated to industry which identified a number of pricing issues that were linked to proposed costing principles and strategies. Industry comment was incorporated in a second paper that was distributed to industry in December 1999.

A number of charges will be eliminated with the introduction of the new pricing structure. The charges to be eliminated include:

- Import Entry via Sea
- Import Entry via Air or Post
- Manual Import Entry via Sea
- Manual Import Entry via Air or Post
- Import Entry ex-warehouse
- Manual Import Entry Ex-Warehouse
- Refund Application Fee

- Manual Reporting Charge for Sea Cargo
- Manual Reporting Charge for Air Cargo

A number of charges will be maintained. These include:

- Charge for Air Cargo not requiring an Import Entry
- Licence Fee for Customs Depot
- S.28 Location, Overtime and Travel Fees

There will be a number of new charges introduced. These include:

- Simplified Declaration Charge (for goods entered below a certain threshold)
- Full Declaration Charge (for goods entered above a certain threshold)
- Periodic Declaration charge: linked to
    - RCR Charge (for Accredited Clients)
    - Manual Reporting Charge

The charging structure to apply following the introduction of Cargo Management Re-Engineering has been developed. ACS says that the prices are current best estimates only and based on anticipated import entry volumes and costs. Should these volumes significantly change, there will be an impact on prices.

The charges cover the processing costs that include both information technology and commercial aspects of sea, air and post import transactions. The full cost of providing these services is required to be recovered from the direct users of the service.

Excluded from the cost calculations are the community protection aspects of the import processing, all aspects of export processing, and other commercial related functions including goods classification and valuation, and preference and rules of origin.

The new charges will come into effect with the commencement of Cargo Management Re-Engineering.

ACS will maintain a detailed activity based costing of its services to ensure that the costs recovered are closely aligned to the costs calculated to process import transactions. The charges struck are limited to the estimated cost of delivering the functions.

Price review reports are provided to all industry representatives on the Customs National Consultative Committee.

While cost recovery was introduced in an adhoc way in 1997, it appears as if ACS has undertaken the current review in an appropriate manner – engaging industry, determining public and private good, and having a process in place to monitor the appropriateness of charges.

7. Information Agencies

There are many Commonwealth Government agencies that provide information services on a cost recovery basis. Some, such as the National Library, appear to charge for individual services in an appropriate manner. The National Library it seems, without the benefit of Commonwealth Guidelines, have struck a balance between charging for the private good, but not the public good.

On the other hand, the Australian Bureau of Statistics has been repeatedly cited by business as having an odd approach to cost recovery. Businesses are obligated to fill in ABS surveys, and some businesses find this onerous particularly if they are a small business, yet they have to pay to get the results of the surveys they participated in.

8. Principles of Cost Recovery

Given the trend toward increased cost recovery in Australia, it is essential that principles be established that resolve the question of who receives benefit from Government activities and whether it is appropriate for individuals to pay the full cost of regulation when benefits accrue to the community as a whole. These principles should be developed to guide Government departments and agencies in determining the appropriate level of cost recovery and should incorporate incentives to improve the cost effectiveness of agencies.

Before making the decision to move to a cost recovery regime the Government must deem the activity in question to be a legitimate and necessary role for Government, and one that cannot be provided adequately by the private or voluntary sector. The Government must also determine if there are better and/or cheaper ways to deliver the service without compromising program objectives such as health and safety.

The decision to move toward a cost recovery regime or to increase the level of cost recovery needs to take into consideration:

- The nature and extent of the public good role of regulatory agencies;
- Any anti-competitive effects or negative impacts upon innovation;
- The impact on businesses, particularly; small and medium enterprises;
- The impact upon the competitiveness of Australian business;
- Any impacts upon consumers and the community; and,
- Whether the costs to the community of full cost recovery outweigh the benefits.

User charges are not appropriate for all Government activities, especially where charging for goods and services is technically not feasible. Many programs are provided for the general benefit of the entire community and such programs should be funded through general revenue measures. User charges are often viewed as alternative forms of taxation, however they should differ from taxation arrangements in that they should only be used where they provide specific benefits over and above those enjoyed by the general tax payer.

In addition to those specific cost recovery principles, accepted good public policy design and administration principles should be adopted. As outlined in the PC's *Issues Paper*: appropriateness, effectiveness, efficiency, accountability, transparency, impartiality, certainty/predictability, accessibility and equity must be addressed.

9. Draft Guidelines for Cost Recovery

The above principles provide a framework to guide Government and agencies decisions when considering cost recovery arrangements. Underpinning the principles for cost recovery for business goods and services, is that any cost recovery arrangements should be developed in consultation with both industry representatives and with individual businesses and clients.

ACCI supports the development of cost recovery guidelines that include the following:

Policy Statement

A policy statement along the following lines should be a preamble:

It is Government policy to implement cost recovery for services that provide identifiable recipients with direct benefits beyond those received by the general public. The aim is to:

- promote the efficient allocation of public resources;
- eliminate the excess demand that can exist with 'free goods' by subjecting programs to market tests of supply and demand;
- to promote an equitable approach to financing government programs, mandatory or otherwise, by fairly charging clients or beneficiaries who benefit from services beyond those enjoyed by the general public.

This should allow a greater share of general tax dollars to be devoted to activities that benefit the general taxpayer or to reduce debt. It may also facilitate improvements in the delivery of specific cost-recovered services.

Application

The guidelines should apply to and be followed by all Commonwealth regulatory, administrative and information agencies, regardless of the authority used to establish fees.

Adoption of these guidelines should be implemented in conjunction with the important Regulatory Impact Assessment process by all agencies.

Agencies should report to Government (either through Ministers to the Parliament in their Annual Reports or to the Minister for Finance and Administration who would report to Parliament in a consolidated way) how they have adhered to the guidelines.

Implementation Requirements

Where it is appropriate to implement new or amend existing user charges, agencies must adhere to the following:

- Representative clients, both large and small, be consulted;
- Effected parties are given the opportunity to provide input;
- Conduct impact assessments to identify all significant effects, positive and negative, and factor those results into cost recovery decisions;
- Any cost recovery in regulatory processes, should be subject to a Regulatory Impact Statement and be assessed by the Office of Regulation Review;
- Government should work with industry to assess the cumulative impact of multiple fees from all agencies, and assess proposed fees in that context;

- Agencies identify and explain clearly to clients why services are being developed in the manner they are, how charges are determined, and how costs are being controlled;
- Agencies provide feedback to clients on concerns expressed and suggestions made in a timeframe that is relevant to the process; and,
- Agencies establish a dispute resolution process for complaints that are not able to be resolved otherwise.

Where it can be shown that it is appropriate to implement new, or amend existing cost recovery arrangements, agencies must adhere to, and be open in, the application of the following underlying principles.

- Agencies should engage in meaningful and effective consultations with interested parties through out the fee setting process.
- Agencies must follow appropriate costing and pricing practices to determine the full cost of providing services. However wherever there is a mix of public and private benefits, fees should be lower than full cost recovery.
- Prices should be:
    - Cost based for goods, regulatory and optional services, information products, use of public facilities;
    - Based on market value for the sale, lease or license of public property (where market value is the amount that would be paid if it were offered in the open market with enough time and in a way to attract potential investors);
    - Based on market value for rights and privileges which are de facto commercial inputs for users.
- Fees should be set on the basis of clear, and preferably agreed, service standards and performance measures.
- Where agencies are competing with industry there must be competitive neutrality, that is, agencies must compete fairly and not set fees that undercut the private sector by ignoring sunk capital costs and cross subsidies.

Roles and Responsibilities

The Department of Finance and Administration should develop and interpret the general policy on cost recovery.

Ministers or individual agencies should be responsible for implementing or amending user charges within their areas of

responsibility in accordance with their legal authority and the above policy principles.

Monitoring

Agencies should conduct periodic reviews to ensure the principles are being met. Such reviews should also address whether fees should be increased or decreased where cost structures have changed, where the mix of public and private benefits have changed or where service levels have altered.

10. Conclusion

The key to appropriate cost recovery arrangements is determining the allocation of public and private benefits. There is a continuum between purely public and private benefits with many Government activities generating both. The extent to which individuals can be excluded from a good or service appears to be a key criterion for determining whether it is a public or private benefit.

For cost recovery in regulatory agencies, industry should not be required to pay for regulation that delivers benefits that are solely a public good. In many cases, cost recovery activity has led to increased costs to business without providing a better, faster and less complex process. While the difficulty of defining and identifying, in a practical cost sense, the extent of public good of regulation, it should be acknowledged that 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.

Cost recovery relating to administration and information agencies should be based on the same principles as for regulatory agencies ensuring the charges do not exceed the cost of providing the service, and they do not seek to recoup unrelated agencies 'infrastructure' costs.

Attachment 1

Commonwealth Government Regulatory Agencies

	Industrial Chemicals	**Agricultural & Veterinary Affairs**	**Medicine & Medicinal Products**	**Food, Food Additives, Food Standards**
Agency	National Industrial Chemicals Notification & Assessment Scheme (NICNAS)	National Registration Authority (NRA) for Agricultural and Veterinary Chemicals	Therapeutic Goods Administration (TGA)	Australia New Zealand Food Authority (ANZFA)
Ministry	Employment, Workplace Relations and Small Business	Agriculture, Fisheries and Forestry	Health and Aged Care	Health and Aged Care
Scope	Assessment only, not registration based	Assessment and Product Registration	Assessment and Product Registration	Assessment and Product Registration
Relevant Legislation	*Industrial Chemicals (Notification & Assessment) Act 1989*	*Agricultural & Veterinary Chemicals Act 1994* *Agricultural & Veterinary Chemicals Administration Act 1994*	*Therapeutic Goods Act 1989*	*Australia New Zealand Food Authority Act 1994* *Food Standard Code*
About the Chemicals	Industrial Chemicals are varied and cover, for example, Dyes, Solvents, Adhesives, Plastics, Laboratory Chemicals used in cleaning products and cosmetics and toiletries.	Agricultural products include chemicals which generally destroy/repel pests and plants. Veterinary products are used to prevent, diagnose, or treat diseases in animals.	Therapeutic goods include prescription and non-prescription (OTC) medicines. OTCs include complementary medicines, some sterilents and disinfectants.	Chemicals are added to food for a number of reasons, for instance as a processing agent, preservative or as a flavouring or colouring. These are known as food additives.

Source: NICNAS, *Assessment and Registration of Chemicals in Australia*

Attachment 2

Example: Polymers of Low Concern

NICNAS has a number of categories of chemicals which seek to rank chemicals by their risk. The polymers of low concern category has the lowest risk level of all categories yet represents about 30% of NICNAS's workload (excluding temporary permits). This means there is less time and ability for NICNAS to assess those high risk chemicals that are in use or industry would like introduced into Australia.

Example: Phototronics Industry Inputs

The phototronics industry involves the production of computer chips, silicon wafers and solar cells and depends on new chemistry to underpin development. NICNAS hinders the ability of Australian firms supplying this industry to keep up with developments:

- With the short shelf life of chemicals as a result of the pace of development in the industry, existing chemicals are superseded possibly even before an assessment has been completed.
- The market for photoresist chemicals is small but necessary for larger value added industries. The size makes it even difficult to justify applying for a low volume chemical permit as products may be consumed at 1 litre per month making it not cost effective.
- As a result of the above many of the small market niche products rely on old chemistry leading to internationally uncompetitive products.

Example: Windscreen films for Automotive Industry

With a transition to lead free chemicals, overseas companies are using safer chemicals for automotive windscreen tints. However, an Australian company is not able to import the chemicals as they are not listed. While data sets exist to satisfy their current usage in both the European Union and the United States, the company does not have the complete dossier for a NICNAS notification. The cost for the company to perform all the testing required is too high given the size of market for the product. As a result the chemicals are now imported as a finished article on windscreens without the need to notify NICNAS. The Australian company is unable to satisfy customer demand and revenue from sales flows to a foreign based firm.

Example: Australian Refinish Industry

Low solvent paints are currently mandated in both the United States and European Union but are not used in Australia due to the large cost barriers imposed by NICNAS. The Australian refinish industry uses approximately 15 million litres of paint annually, of which more than 50% is low solids acrylic lacquer that has a solvent content of 70 – 80% (based on the old technology). Adoption of these low solvent alternatives available internationally would reduce solvent emissions by approximately 2 million litres per year. It would also lead to world class finishes improving the competitiveness of final finished products.