Attachment A

ACA SUBMISSION: PRODUCTIVITY COMMISSION DRAFT REPORT ON COST RECOVERY

Introduction

The Australian Communications Authority welcomes the opportunity to provide a submission commenting on matters raised in the Productivity Commission's draft report on *Cost Recovery*.

The ACA broadly supports the Commission's conclusions and recommendations in the draft report. In particular we agree with the Commission that there would be benefits in improving cost recovery practices to increase the consistency and transparency with which they are applied.

There are, however, some issues relating to the implementation of cost recovery that the ACA would like to comment upon. We would also like to take this opportunity to clarify some of the matters raised by the Commission relating to the ACA's cost recovery practices.

What costs should be recovered?

We note and endorse the Commission's view that "cost recovery arrangements which are not justified on grounds of economic efficiency should not be undertaken merely to raise revenue for government activities" (*draft recommendation 6.1*). The Commission has concluded that "this has led to agencies inappropriately recovering costs for activities such as policy development, ministerial or parliamentary services and international obligations." However, the ACA disagrees with the Commission's argument (in *Appendix E, page E9*) that the ACA, through its Spectrum Maintenance Component (SMC) recovers costs "that seem to be compliance and policy-related, such as interference investigation and policy development. There is the question of whether it is desirable for industry to fund these activities of government."

The ACA believes that this latter comment stems in part from a misunderstanding of the nature of some of the costs recovered under the SMC. While to some extent this can be a matter of judgement, the ACA believes that these costs broadly relate to activities that benefit the users of spectrum.

Rather than being "compliance and policy-related" in the Commission's parlance, interference investigation is in fact an activity that improves the overall utility of the spectrum and thus is of direct benefit to users. There are significant externalities associated with minimising interference, and the ACA believes that it is desirable that the associated costs should be recovered from users rather than taxpayers generally. Often we cannot directly attribute the corresponding benefits to particular licensees (because the interference is of a generic nature affecting many users). As the SMC varies according to the amount and location of spectrum used, the ACA believes that it represents a reasonable 'proxy' for recovering these interference investigation costs.

Similarly we note the Commission's view (*page 220*) that firms or their customers should not be charged for activities that involve meeting parliamentary government requirements. However, many of the areas that we have called policy development under the SMC are also of direct benefit to users of the spectrum. These activities include making of spectrum plans and establishing rules and ACA policies for the orderly use of the spectrum. These activities do improve the overall utility of the spectrum, and are not really activities "meeting parliamentary or government requirements" or providing policy advice to government. Perhaps this misunderstanding could be clarified if the ACA adopted a different terminology to apply to activities related to maintaining the overall health of the radiofrequency spectrum, and distinguished such activities from policy development as defined by the Commission.

Beneficiary pays versus regulated industry pays

The ACA notes the Commission's discussion on the "beneficiary pays" and the "regulated pays" approaches for cost recovery of regulatory activities. However, we believe that the distinction between these approaches is likely to be somewhat blurred in practice. For many activities there will be a mix of beneficiaries — the activity may benefit both consumers of the final service and the providers of that service. To take an example: part of the ACA's radiocommunications licence fees goes to recover the cost of research into the health effects of electromagnetic radiation emitted from radiocommunications transmitters. This research could benefit:

- consumers of the final services (eg. users of mobile phones) in helping to ensure that the equipment they use is safe;
- the regulated industry (who may benefit both from increased consumer confidence about the safety of their product, and more directly from the research helping them to produce safer equipment); and
- the community, who could benefit from increasing safety of emissions from radiocommunications equipment in their general environment.

Apportioning the benefits between these groups would be almost impossible in practice, however. There is also a temporal dimension. In this example we lack information about how each of the beneficiaries would value the benefits. The benefits of long-term research are also unlikely to be realised for some time. Even where "results" are more readily achieved, such as for example with interference management, it is difficult to quantify the benefits accruing to end users (from effective communication systems) relative to those accruing to the industry.

In any event it is not clear that the distinction will be of much practical importance in many cases. Thus the Commission notes that in some cases it may be impractical to collect charges from consumers, so agencies should consider charging upstream firms. In these circumstances it may be that regardless of whether the benefits primarily accrue to end users or the industry, the charging mechanism will be the same.

In summary, we agree with the Commission that it would be useful for agencies to ask the question as to who benefits from the activity in question, as the answer *may* guide decisions about who and how to charge. If, however, as will often be the case, the practicalities suggest that in any case the regulated industry should be charged then it may be that agencies will not find it productive to devote too much time to precisely estimating the relative benefits between consumers and the regulated industry.

Extent and nature of cost recovery

The Commission notes (*page E3*) that the ACA recovers more than 100 per cent of its agency costs, but that this is less than 100 per cent of the sum of all the costs it is expected to recover. While this statement is true, the ACA believes that it may be misinterpreted (readers could form the impression that the ACA has engaged in *over-recovering* costs). Table E1 for example appears to indicate that cost-recovery in the ACA amounts to 110 per cent. However, as the Commission correctly points out, the ACA is also required to recover other costs such as those relating to ACCC regulation of telecommunications and Australia's contribution to the ITU.

In fact, as noted in the draft report, the ACA actually under-recovers costs. In addition to the reasons cited by the Commission, the extent of reported under-recovery is also affected by treatment of spectrum auctions. ACA reporting has shown only very limited cost recovery for spectrum auctions ($70,000 costs recovered out of total auction costs of $2.2 million in 1999/2000). Amounts reported for cost recovery for auctions refer only to non-refundable entry fees paid by auction bidders. A more accurate representation of cost recovery would probably be gained if the ACA notionally attributed part of auction *revenue* (ie. amounts bid at auction) to cost recovery.

Transparency of ACA cost recovery arrangements

The Commission notes that "the SMC bundles up a variety of costs, including interference investigation, domestic planning and policy development and this is likely to limit the transparency to external parties about individual activities" (*page E7*). The ACA agrees that cost recovery under the SMC is not likely to be as transparent to spectrum users as other cost recovery elements. The reason is simply that the SMC covers costs that are not easily attributable to individual licensees and that instead are of benefit to all licensees. (All licensees have an interest in the orderly and efficient use of the spectrum.)

The ACA considers that the SMC, based as it is on the amount and location of spectrum used by a licensee, is consistent with the principles set forward in the Commission's chapter on "*Guidelines for cost recovery*", and in particular the section on "*How should fees and levies be structured?*" In that section the Commission notes that "often it will be necessary to use a proxy for the costs that are attributable to a particular firm" (*page 226*). We believe the basis of the SMC represents a reasonable proxy for these costs.

Nevertheless, there is probably some marginal scope to improve the transparency of the SMC by separately identifying total costs for each of its components (for example in our Annual Report and in the Apparatus Licence Fee schedule booklet).

Economic effects

The Commission is incorrect in its assertion that the ACA preferentially charges the Department of Defence for its use of the spectrum (*pages E6* and *E11*). There is no fee exemption for the Department of Defence, which in fact pays the ACA radiocommunications licence fees of about $9 million per annum (including cost recovery components) and is one of our largest customers for radiocommunications apparatus licences. We believe that this fact considerably reduces the scope for distortions in resource allocation noted by the Commission. Although the Commission is correct that there are licence fee exemptions for volunteer organisations providing safety of life services (as a result of government policy), many of these groups are non-government organisations.

Exemptions for foreign diplomatic or consular missions arise from legal doubts about whether the ACA has the power to charge these missions for the use of spectrum. At any rate the amount of cost recovery forgone as a result would be very small and would be unlikely to represent a significant resource allocation distortion.

The Commission has noted (*page 139*) that "it is possible that ACA charges have had a different impact on regional spectrum users than metropolitan ones". Overall, it is likely that any such differential impacts would be positive for people living in regional areas, as the SMC is based on the amount and *location* of spectrum used by a licensee. Because spectrum is less congested outside metropolitan areas, the ACA charges lower access fees (including the SMC) in these less congested areas. The ACA, however, believes that this represents recognition of the overall lower costs of managing spectrum in low density areas rather than positive discrimination in favour of any particular class of users.

ACLC and the Carrier licence application fee

On pages E9 and E11 there is reference to a maximum amount for ACLC. There may be some confusion here between this charge and the carrier licence application fee.

There are two different charges that a carrier may have to pay as part of the process of being granted and subsequently holding a carrier licence under the *Telecommunications Act 1997* (the Act). These are as follows:

- Carrier licence application fee
- Annual carrier licence charge

The method for calculating both charges is set out in the *Telecommunications (Carrier Licence Charges) Act 1997* (the Charges Act). The Carrier licence application fee is a one off fee that is calculated in accordance with section 9 of the Charges Act. Section 10 of the Charges Act sets a maximum amount of $100 000. There is no minimum amount set by the Charges Act. The initial amount of $10 000 was set by the ACA in 1997 after consultation with the Minister for the Department of Communications, Information Technology and the Arts (DoCITA). The Minister requested the amount be set at $10 000 in order to provide a small disincentive to less financially sound and frivolous applicants. The current application fee is $9800.40 after a reduction following the introduction of the GST.

As noted above, the carrier licence application fee needs to be distinguished from the annual carrier licence charge (ACLC). The ACLC is calculated in accordance with a determination made under section 14 of the Charges Act. Section 15 of the Charges Act sets the limit on total charges. ACLC includes a fixed component and a variable component. The fixed component is set at $10 000 while the variable component is calculated using carriers total eligible revenue. It is important to note that there is no capped amount for the ACLC. However, the limit on charges is the total amount to be recovered from the carriers and is calculated under section 15 of the Charges Act. It includes the costs attributable to the ACA and ACCC for the administration of their telecommunications functions and powers, an amount which is the proportion of the Commonwealth's contribution to the International Telecommunication Union, as well as the costs of several other non-ACA activities.

There also appears to be a misunderstanding as to the nature of nominated carriers. A network operator can arrange to have a carrier apply to be declared the nominated carrier in relation to network units owned by the operator and specified in a nominated carrier declaration. Where a nominated carrier declaration is made, the obligations of a carrier under the *Telecommunications Act 1997* apply to the nominated carrier as if the nominated carrier owned and operated the network units irrespective of whether or not the carrier owns or operates the network units. As noted above, the owner of the network units, covered by the nominated carrier declaration, does not pay any ACLCs or annual levies because it is not a carrier. Unless the nominated carrier receives revenue from the network units covered by the nominated carrier declaration, none of the revenue related to the relevant network units is attributed to the nominated carrier and the revenue has no impact on the ACLCs and annual levies paid by the carrier. The only amount which would affect a carrier's revenue and therefore its ACLC and annual levy would be any management or administration fees paid by the operator to the nominated carrier.

Other comments

The ACA would like to make some minor comments about other aspects of the draft report:

- In Box E.1, the seventh dot point should read ' reporting on telecommunications carrier and carriage service provider performance' (words to be added).
- In Box E.1, the Ninth dot point should read 'overseeing ... to ensure that standard telephone services are available...' (not 'core telecommunications services')

- On page E3 (and in Box E.2) "Industry Development Plans" are given as a service for which the ACA recovers costs. This should be amended to read "administration of Industry Development Plans."
- On page E10, the report refers to an increase in the ACLC between 1995 and 2001 from 29.9 to 39.8 per cent of SAT. The reference should be to SMC not the ACLC.
- On page E10, the Commission refers to the 'board' of the ACA. While the term board may be familiar to some readers, the ACA would prefer that the report use the correct terminology (ie Authority members not board directors).
- On page E10, is it pointed out that no consultation was undertaken with respect to telecommunications charges. The two sentences beginning "However, ... " should be replaced with:
  "However no such consultation was undertaken at the time the ACLC process was established. The justification for this is that the fixed components are set as a matter of Government policy."
- On page E11, it is not made clear why "the ATO is likely to have more expertise in scrutinising businesses' accounts". While it is true that the ATO would have access to 'other relevant sources of information', our staff bring both telecommunications expertise and financial analysis skills to bear on the current assessments.
- On page E12, the last two sentences of the paragraph *Technology and innovation effects* should read, "Telecommunications equipment needs to comply with ACA-determined standards in order to be connected to telecommunications infrastructure. The costs of demonstrating compliance may be a barrier to the manufacturers of niche equipment (ACA sub, 108, p.9)."
- On page E12, the question of how much of the ACLC charge is passed on to consumers is a function of the elasticities of supply and demand. Carriers in non-dominant positions or in markets where demand is elastic are unlikely to be able to pass the full amount on.
- The case study makes no mention of charges for numbers, which arguably should be discussed, even if in passing. For example, the three numbered points at the bottom of page E3 refer to three mechanisms by which we raise revenue. For completeness mention could be made of the annual numbering charges, which raises $60m.